International Monetary Fund

Islamic Republic of Mauritania and the IMF

Press Release:
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December 18, 2006

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Islamic Republic of Mauritania: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 29, 2006

Nouakchott, November 29, 2006

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

Dear Mr. de Rato:

The transitional government, which in August 2005 took control of Mauritania's destiny, set itself the goal of restoring Mauritania to democracy in less than two years. In parallel with the setting up of democratic institutions, the government intends to continue focusing on poverty alleviation with the support of the international community. In consultation with civil society, the administration, labor unions, and political parties, it has prepared a new Poverty Reduction Strategy Paper (PRSP2) covering the period 2006–10. The PRSP2 seeks to achieve the challenging objective of lowering the incidence of poverty to below 35 percent in 2010, against 47 percent in 2004. Further, by restoring fiscal discipline and implementing prudent monetary policy, the government restored macroeconomic stability in the last quarter of 2005, maintaining sustained economic growth while keeping inflation under control. Against that backdrop, the international community showed its concrete support for the policies adopted by the Mauritanian authorities, in particular with the debt relief from the International Monetary Fund in June 2006 and the subsequent cancellation of debt to the World Bank and the African Development Fund under the Multilateral Debt Relief Initiative.

The attached Memorandum on Economic and Financial Policies (MEFP), guided by the PRSP2, describes the main features of the government's economic program for the next three years. It also sets out the macroeconomic objectives, structural measures, and indicators for the first year of the program.

The government is seeking IMF support for the program through a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF), in the amount of SDR 16.1 million or 25 percent of quota. The government will provide the IMF with all the information required to monitor its progress in implementing the program. The first and second review of Mauritania's performance under the arrangement will be conducted by March 31, 2007 and September 30, 2007, respectively.

The government believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. The government will consult with the IMF on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation.

Sincerely yours,

/s/
Ousmane Kane
Governor of the Central Bank of Mauritania

/s/
For Mohamed Ould Abed, absent
Minister of Economic Affairs and Development
Abdallah Ould Souleymane Ould Cheikkh-Sidia (acting)

/s/
Abdallah Ould Souleymane Ould Cheikkh-Sidia
Minister of Finance

Memorandum of Economic and Financial Policies, 2006–09

November 29, 2006

I. Introduction

1. Since the summer of 2005, the transitional government has been preparing for a return to democracy, which will culminate in the holding of legislative and municipal elections in November 2006 and presidential elections in March 2007. At the same time, we have undertaken to establish economic transparency and good governance and restored the accuracy of economic and financial statistics. This contributed to restoring confidence in our relations with the international financial community. The International Monetary Fund (IMF) staff-monitored program (SMP) covering the first six months of 2006 ended successfully with the implementation of all the measures envisaged and the achievement of the macroeconomic targets. This strong performance enabled Mauritania to qualify for debt relief under the Multilateral Debt Relief Initiative (MDRI).

2. Simultaneously, we have prepared a new Poverty Reduction Strategy Paper (PRSP2) for the period 2006–10, using a participatory approach, which involved not only the government but also the private sector, trade unions, political parties, and civil society. Meeting our ambitious poverty reduction goals will require the continuation of sound macroeconomic management and structural reforms to promote the development of a market economy, the improvement of governance, and capacity building.

3. To build on the results obtained under the SMP, ensure implementation of the macroeconomic and financial components of the PRSP2, and facilitate the mobilization of the external resources needed to achieve its goals, we have developed a three-year program, covering the period October 2006–September 2009, for which we are requesting the IMF's financial support under the Poverty Reduction and Growth Facility (PRGF). The present memorandum describes the broad outlines of this program and the actions that we will undertake during its first year. The government that will be appointed after the presidential elections is expected to pursue the efforts begun during this first year.

II. Recent Economic Developments and Reforms

4. The economic situation has improved markedly during the past 12 months. Our prudent macroeconomic policies have contributed to bringing back inflation to single-digit levels (8.7 percent year-on-year in September 2006) and to a sustained economic growth (5.4 percent in 2005 and 6.1 percent, excluding oil, projected for 2006). On the other hand, oil production has been lower than initially projected and fishing sector came up against temporary difficulties. The significant improvement in fiscal management that started in the

second quarter of 2005 continued under the SMP, making it possible to contain the budget deficit and reduce government arrears. Owing to a further increase in the iron ore price in 2006 and the start of oil production in February 2006, the balance of payments has improved and the parallel foreign exchange market premium has virtually disappeared since the beginning of the year. The Central Bank of Mauritania (BCM)'s foreign exchange reserves increased from 1.0 month of imports of goods and services (excluding imports by extractive industries and externally financed imports) at end-2005 to 1.4 months at end-September 2006.

5. Reflecting a strong revenue performance and the maintenance of expenditure within the SMP limits, the budget deficit, excluding oil revenue and grants, was limited to 4.6 percent of annual non-oil GDP during the first half of 2006.[1] Tax collection overperformed by about 10 percent, owing to concerted efforts by the government. Along with the containment of public spending, this strong performance made possible a reduction of the treasury float to UM 6.2 billion at end-June, equivalent to about two weeks of domestically financed expenditure (excluding wages and interest).

6. Mauritania recently benefited from substantial receipts that had not been anticipated when the 2006 budget was adopted, namely: a one-off $100 million bonus payment in June 2006 in the context of the settlement of the dispute between the authorities and Woodside regarding some clauses of the initial production-sharing contract; and the proceeds of the sale, last July, of the third cellular telephone license for $103 million. Mauritania also benefited from the cancellation of its multilateral debt under the MDRI and from the signing in July of a fishing agreement with the European Union (EU) covering the period 2006–12 and providing for an annual financial compensation of EUR 86 million (in addition to the charges paid by the EU vessels).

7. In this context, we adopted in July 2006 a supplementary budget, which provides for additional domestically financed spending in an amount equivalent to the additional fishing revenue. We decided to allocate the remainder of the unanticipated foreign exchange receipts to saving and to the reduction of our domestic debt. This will contribute to strengthening Mauritania's external position and to paving the way for the successful implementation of the foreign exchange market reform and the restoration of the convertibility of the ouguiya in accordance with the obligations arising under Article VIII of the IMF Articles of Agreement.

8. We have made further progress in preparing the foreign exchange market reform. We have drafted the legislation organizing the market and taken accompanying measures, including: the adoption of regulations on the commercial banks' foreign exchange position and on the reserve requirements on banks' foreign currency deposits; the gradual

[1] Except as otherwise indicated, all references to GDP in the present memorandum mean non-oil GDP.

liberalization of fish export proceeds, through the reduction of surrender requirements for the national fishing company (SMCP) from 70 percent of export proceeds in early 2005 to 25 percent in October 2006, and the elimination of surrender requirements on other fish exports proceeds; and the reorganization of manual foreign exchange operations through the raising of the thresholds above which prior authorization from the BCM is required. Furthermore, on October 27, we eliminated the remaining restriction on payments for current external transactions.

9. We are also modernizing the institutional framework for the payments system. In August 2006, we adopted a new law on electronic means of payment. In addition, we have adopted decrees setting up the framework to combat money laundering and the financing of terrorism and establishing the commission responsible for these issues, whose governing bodies we appointed.

10. Consistent with our commitment to economic transparency, we have created a national hydrocarbon revenue fund (FNRH), managed by the ministry of finance and the BCM under the terms of a contract approved by the Council of Ministers in June 2006. The FNRH has been operating since that date and all government revenues from the hydrocarbon sector are now transferred to this fund. Each month, we produce and publish a report on the oil sector, with details on the production and its sharing, exports by participant, prices, and government oil revenue. We have set up an Extractive Industry Transparency Initiative (EITI) Committee and launched the procedure for recruiting an international consulting firm to monitor the implementation of this initiative. Lastly, the retail prices of refined petroleum products have been adjusted every two months to reflect changes in international prices. These adjustments, which were conform with the existing adjustment mechanism, prevented a further accumulation of revenue losses by the distribution companies.

III. Medium-Term Macroeconomic Framework

11. Over the medium term, we intend to reduce poverty substantially and improve household living standards. The PRSP2 aims at reducing the incidence of poverty from 47 percent in 2004 to less than 35 percent en 2010. Its primary objectives are: (a) raising growth; (b) improving economic opportunities for the poor; (c) developing human resources and increasing access to basic social services; (d) strengthening governance; and (e) developing an efficient monitoring and evaluation system.

12. Consistent with these objectives, our economic program for the period 2006–09 aims at: (a) raising average annual non-oil GDP growth to 5½ percent; (b) bringing inflation under 5 percent; and (c) building up official reserves to ensure a coverage equivalent to about three months of imports from end-2007 onward. We intend to achieve these targets through the growth of the private sector, which will, in particular, stem from the start-up of oil, gold, and

copper extraction, the continuation of prudent macroeconomic policies, the implementation of major infrastructure programs to open up the country, and the pursuit of structural reforms.

13. **Fiscal policy** will be the principal instrument for implementing the economic policy framework defined in the PRSP2. Our economic program provides for a significant increase in poverty reducing expenditures during the period 2007–10. The execution and financing of these expenditures will be consistent with macroeconomic stability and allow for the continued reduction of government debt to the banking system in general and the BCM in particular. The use of oil resources to finance the budget will take into account the limited life of Chinguetti oilfield, the uncertainties relating to future oil revenue, the still limited absorptive capacity of our economy, and the risk of loss of competitiveness for our economy that could result from an excessive real exchange rate appreciation. Our medium term fiscal projections are based on the hypothesis that two new oilfields, Thiof and Tevet, will be developed in 2008, which will allow for a substantial increase in oil revenues starting 2010. **Oil revenue management** will remain transparent through the conduct, by internationally renowned firms, and publication of annual audits of government revenue (in the context of the EITI) and FNRH accounts.

14. **Tax reform** will seek to reduce the adverse impact of the current structure on private sector growth and to broaden the tax base (in particular with regards to the VAT) without penalizing the consumption of the most vulnerable. Measures in that sense will comprise: (a) the rationalization of import taxation, by adopting a new tariff schedule consistent with a simple economic categorization of products, broadening the tax base by reinstating the VAT on products that should not be classified as essential, and lowering the statistical tax rate; (b) the improvement of the VAT administration, through the implementation of an efficient credit reimbursement mechanism and the raising of the registration threshold common to the VAT and the corporate tax (*régime du bénéfice réel*); (c) the gradual reduction of the minimum presumptive corporate income tax; and (d) the strengthening of the tax administration capacity. With the technical assistance of our external partners, we will also complete an overall review of the tax system and prepare additional measures, in particular with regards to direct taxation and the strengthening of the VAT.

15. We will improve the quality and regional distribution of **public expenditure** and increase its social impact. The sectoral resource allocation will be aligned with PRSP2 targets and priority will be given to social sectors and poverty reducing programs. The medium-term fiscal framework, which will play a stronger role in the multiyear programming of investment spending during the program period, targets almost a doubling in the appropriation ceilings for poverty reduction spending between 2006 and 2009. The improvement in public expenditure transparency and effectiveness will be a critical component of the program and will include the strengthening of ex-ante and ex-post controls and the revision of the public procurement code.

16. **Monetary policy** will continue to be geared toward controlling inflation. Its implementation will take into account the expected increase in government foreign currency receipts and the reduction in government debt to the banking system. Broad money growth will be limited to a pace equivalent to that of nominal non-oil GDP. To meet these objectives, the BCM will keep its policy interest rates at a positive real level and will strengthen bank liquidity management. Lastly, we will encourage the development of a secondary market for securities, which should help increase their liquidity, and securitize a portion of the government debt to the BCM.

17. We plan to develop **a more flexible exchange rate policy**, which will help us better manage the consequences of a possible real exchange rate appreciation and of oil-related external shocks. Following the elimination of the remaining foreign exchange restriction, we will develop a foreign exchange market, initially limited to an auction system managed at the BCM, and then expanded to an interbank market.

18. Following the assessment carried out in the context of the Financial Sector Assessment Program (FSAP), we intend to implement reforms aimed at **strengthening the financial sector** while improving access to financial services in a competitive environment. These reforms will focus on: (a) strengthening the financial sector's legislative and regulatory environment; (b) enhancing the transparency of financial sector accounting practices and the reliability of financial statements; (c) strengthening the capacity of the different institutions in charge of the supervision of financial institutions; (d) improving the legal framework for collateral and the implementation of regulations on combating money-laundering and the financing of terrorism; (e) gradually developing financial markets, with the deepening of the money market, (f) the establishment of the foreign exchange market, and (g) the promotion of private bond issues.

19. We also intend to build **capacity in the public sector**, in particular by: (a) modernizing the civil service; (b) combating corruption; (c) improving the qualifications and system of remuneration of civil servants. We will also improve the **management and oversight of state-owned enterprises (SOE)**, primarily by developing a performance-based culture and adjusting public utilities' rates on a regular basis in order to keep their operating accounts in balance and reduce the risks of drains on the budget.

IV. Program for the Period October 2006–September 2007

20. In 2007, the pace of growth will be strongly influenced by the oil production outlook. We prudently assume the maintenance of oil production at an annual average of 30,000 barrels per day during the remainder of the year. Our objective is to achieve a non-oil sector growth of 6.1 percent in 2006 and 7.3 percent in 2007, while bringing year-on-year

inflation down to 7 percent at end-2007. The growth target for 2007 assumes, in particular, normal rainfall, a marked recovery in the manufacturing sector, and a consolidation of the recovery in the construction sector.

A. Monetary and Exchange Policies

21. The monetary authorities will maintain a prudent monetary policy stance, guided by the inflation and international reserves targets, in a context of greater exchange rate flexibility. In view of the BCM's intention to absorb a substantial amount of bank liquidity in 2007 while leaving enough room for the expansion of credit to the private sector, the monetary program for 2006 and 2007 projects broad money growth at 15.8 percent in 2006 and 17.3 percent in 2007. In 2006, the projected reduction in net credit to the government is expected to be more than offset by a strengthening of commercial banks' net foreign asset position, entailing a modest increase in private sector credit. The Monetary Policy Council will determine on a monthly basis the intervention rates consistent with the program targets.

22. We will pursue a more active liquidity management. By end-November 2006, we will establish a committee for monetary and fiscal coordination and a procedure for preparing weekly liquidity forecasts. By end-2006, we will adopt new regulations promoting interbank transactions (based on unsecured products, repos, and secondary market securities) and simplifying the tax treatment of bonds' interest. At the same time, the BCM will introduce a new liquidity management instrument (central bank certificates of deposit), which will contribute to disconnecting liquidity management from the pace of T-bill issuances. In addition, the BCM will test open market operations on T-bills in 2007, and securitize a portion of its claims on the government in the form of medium- and long-term government bonds. Lastly, the penalties for noncompliance with reserve requirements will be reduced so as to allow for a more flexible cash management by the commercial banks.

23. The new foreign exchange market will open by end-December 2006. Before that date, the requirement to surrender 25 percent of SMCP export proceeds to the BCM will be eliminated. The foreign exchange market management software program will be tested and validated by end-November. Once this market is operational, the main objective of the intervention policy will be to smooth daily fluctuations.

B. Fiscal Policy

24. During the last months of 2006, fiscal policy will aim at meeting a basic non-oil deficit (excluding grants, interest on external debt and foreign-financed expenditure) objective of UM 25 billion (equivalent to 4.4 percent of non-oil GDP), a level slightly lower than the deficit implied by the supplementary budget (UM 28 billion). To this end, the additional spending needs that were identified after this budget adoption will be more than

offset by savings on nonpriority operating expenditure and the report to 2007, owing to the usual administrative delays, of some disbursements for ongoing investment projects.[2]

25. The 2007 budget will be consistent with a slight increase in the basic non-oil deficit to UM 26 billion (corresponding to a ½-percent decline in the deficit-to-GDP ratio), mainly to finance priority investment programs. This budget is based on prudent non-oil revenue assumptions (in particular with regard to the impact of import taxation reforms to be introduced in 2007) as well as on comprehensive and realistic expenditure projections.

26. Owing to the low taxation of new mining projects and the stability of fishing receipts, non-oil revenue (excluding collection of tax arrears) is projected to increase only moderately in 2007 in nominal terms. A new customs tariff, which is largely in line with the tariffs applied in the neighboring West African Economic and Monetary Union region, will enter into effect in January 2007. A number of exceptions to the tariff classification principles will be gradually eliminated during the program. With regards to rice (whose production is heavily protected and subsidized), the present tariff rate (20 percent) will be revised in the 2008 budget law at the latest as part of the implementation of a restructuring plan for the sector, in the context of a new strategy for the development of rainfed agriculture. Moreover, the rate of the presumptive corporate income tax will be lowered by half a point, from 4 percent to 3.5 percent; the statistical tax will be extended to all imports and its rate reduced to 1 percent; and value-added tax exemptions on 11 products (meats and some dairy products) will be eliminated. Lastly, we will introduce a 7.5 percent excise tax on sugar. Overall, these measures are expected to generate about 0.4 percent of non-oil GDP in additional revenue. The government also intends to initiate reforms to improve the taxation of the informal sector and simplify the tax on wages and salaries (ITS) and the general income tax (IGR).

27. As regards current expenditures, the 2007 budget provides for: the second phase of wage increases initiated in 2006 (a key measure to combat corruption in the civil service); a slight decrease in expenditure on goods and services; and an appreciable contraction in subsidies to public enterprises. The stabilization of the wage bill in percentage of non-oil nominal GDP is consistent with a substantial increase in base wages (*salaire indiciaire*) and staff increases in the priority sectors of health and education. The start-up, scheduled for January 2007, of activities of the national health insurance fund for employees and retired of the civil service and military will be limited in 2007 will not result in additional costs for the government, as the broadening of the coverage of health benefits would be covered by a new user contribution. The growth in general government operating expenditure will be contained

[2] The new expenditure needs include cost overruns for the electoral process, emergency intervention by the Food Security Commissariat in some regions, and coverage of the operating losses of the national water company (SNDE).

despite additional allocations for the functioning of the new parliament. Centralized expenditure as a percentage of GDP will fall by 2.0 percent as a result of savings identified in 2006. The gradual rise in public utility rates will imply appreciable savings, of around 1 percent of GDP, in transfers to public enterprises in 2007 (see paragraph 40). The allocation for incidental and unforeseen expenditure will be limited to 5 percent of the budget amounts for goods and services and transfers.

28. The substantial increase in investment expenditure will reflect the priorities of the PRSP2, particularly as regards infrastructure and poverty reduction. This increase will be more marked for domestically financed expenditure, reflecting mainly the expected substantial carryover to 2007 of unused 2006 appropriations.

29. The budget deficit will be financed mainly by a transfer from the FNRH and by concessional loans. The FNRH transfer will be limited to UM 38.8 billion, the expected oil revenue in 2007 (assuming a "Chinguitty" price of $56.3 per barrel). Any additional oil revenue will accrue to the FNRH.

C. Tax Administration and Public Expenditure Management

30. We have strengthened further the General Tax Directorate (DGI) through the adoption by the Cabinet of an ordinance transferring to the directorate the tax collection authority that is currently concentrated in the Treasury, as well as by computerizing its departments. Programs to monitor collection enforcement and to reduce and control tax exemptions will be developed in 2007.

31. We also plan to strengthen the customs administration by simplifying and computerizing customs procedures and making them more secure against fraud. Specific measures will include: upgrading human and physical resources; installing a more recent version of the ASYCUDA computer software; introducing modern management tools; and establishing an antifraud operational mechanism.[3] The customs administration will also continue to strengthen its control methods for oil exports. Data reconciliation between the customs administration and the preshipment inspection company (SGS) will continue on a regular basis.

32. We will continue to abide by the principles of transparent management of oil resources introduced in the ordinance of March 2006, including the domiciliation of all hydrocarbon revenue in the FNRH and the inclusion in the budget law of a ceiling on the authorized transfer to the Treasury. A draft law on the optimal management of oil resources will be prepared during the first quarter of 2007 with IMF technical assistance by the

[3] This mechanism will, in particular, provide for tightened controls on fuel supply to small fishing boats.

working group established for this purpose, and submitted, by end-August 2007, to the future legislature for adoption. In addition, the EITI Committee will publish its 2005 report by end-2006 and its 2006 report by end-July 2007. The BCM will select by end-December 2006 the international firm that will conduct the audit of the FNRH and will transmit by end-March 2007 the first annual audit report to the ministry of finance. An investment committee will be established by end-2006 and will be given the task of preparing operational recommendations on how FNRH resources should be invested. Lastly, by July 2007, the oil sector legal framework will be revised by an ordinance promulgating the oil code and by a new model for production-sharing contracts. The ordinance will provide for the publication of individual contracts and will introduce greater transparency into the awarding of contracts.

33. We will pursue the implementation of the public finance management reform that was initiated in 2005. In this context, the transfer to line ministries of the payment order authority will be finalized, with a view to refocusing the ministry of finance on its basic mission. In fact, despite upward trends in the volume of public expenditure and increasingly developed government structures, budget execution remains heavily concentrated in the central directorates of the ministry of finance. The result is a long, complex, and scarcely performing expenditure circuit that makes it difficult to track budget execution at both commitment and payment order levels. In 2007, we intend to generalize the use of the RACHAD computer application (which has already been tested in three ministries).

34. We will also strengthen the control institutions, in particular the IGE, the Audit Office (*Cour des comptes*), and the Finance General Inspectorate (IGF). In addition, the annual IGE and IGF reports will be published by end-June 2007 and the annual Audit Office report by end-October 2007. The IGE report will mention cases that may constitute administrative infractions, management deficiencies, and financial offenses, and the administrative and judicial actions that were taken in these cases.

35. We will adopt a new procurement code by end-June 2007. The new code will revise the current institutional framework with a view to improving effectiveness, strengthening ex-ante control of budget appropriation, and separating the responsibilities of regulation, awarding of contracts, audit, and appeal.

D. Civil Service Reform

36. With World Bank support, we will pursue the civil service reform. We adopted in October 2006 several decrees defining the specific provisions applicable to 15 staff categories (*corps*) and plan to complete the streamlining of the respective pay scales for these categories by end-June 2007. With the exception of higher education teachers, for which an increased appropriation has already been granted in 2006, the adoption of these new scales

will not entail an overall increase in the wage bill. Other measures for streamlining the remuneration system will be incorporated into the 2008 budget law, based on the conclusions of a study that should be finalized by September 2007.

37. To eliminate the significant overstaffing in the civil service, we will prepare by end-September 2007 a plan (including accompanying measures) to adjust staffing to the government's functional needs. This plan will be based on a comprehensive census of government employees (to be carried out during the first quarter of 2007), and on an assessment of functional needs by ministry (to be achieved by end-June 2007).

38. In the context of our anticorruption campaign, we will adopt by end-2006 a code of ethics for civil servants and other government employees, designed to instill and consolidate moral and professional values. This code will include rules governing employee conduct with regard to public funds, institutions, and users. To that avail, the code will clarify the existing rules of law, which are enumerated, among others, in the General Civil Service Statute and the Penal Code of Mauritania. The code of ethics will be disseminated to all government employees and will be published on the government's website. The anticorruption campaign strategy will be finalized before end-June 2007.

E. Reform of the Financial Sector

39. With technical assistance from the IMF and the World Bank, we have started implementing the principal recommendations of the FSAP and other policies to promote the financial sector, with a view to:

Strengthening the legal framework, with the adoption of laws governing the central bank, banking activity, and microfinance by end-2006;

Facilitating bank mergers and investment by new partners, by increasing the banks' minimum capital to UM 1 billion by end-2006;

Enhancing the transparency and reliability of accounting practices, with the completion of the international audit of the 2005 financial statements for all commercial banks by end-March 2007 and monitoring the implementation of the auditors' recommendations; and the launching of an awareness-raising campaign about the financial statements of banks and enterprises;

Modernizing the payment systems, with the launching of the interbank electronic card in early 2007;

Improving financial sector supervision, by strengthening on-site controls and requirements with regard to the provisioning of nonperforming loans, including by maintaining the prohibition of distribution of dividends while provision shortfalls persist.

F. Public Enterprises and Administered Prices

40. We intend to put the SOE on a more solid financial footing—while reducing the government role in administrating prices—and to strengthen the oversight of their management. Government arrears to SOE will be cleared and rate adjustments, particularly for water and electricity, will be implemented every six months starting in January 2007 if necessary to balance the projected operating accounts of these enterprises. In the first semester of 2007, we will start implementing a price adjustment mechanism for bottled butane gas, which will include simple, targeted measures to protect low-income households' consumption and the environment. A subsidy of no more than UM 1.5 billion to SOMAGAZ and other gas bottling companies will be budgeted in 2007. In addition, the prices of petroleum products will be adjusted every two months to reflect international market prices and eliminate distribution companies' revenue losses by end-August 2007. Performance contracts with the national electricity company (SOMELEC), the water company (SNDE), and the hydrocarbon company (SMH) will be signed by end-June 2007. Starting in January 2007, the BCM will monitor their indebtedness to the banking system on a monthly basis.

G. Improvement of Economic Statistics and Safeguards Assessment

41. The improvement of economic statistics, which is essential for adequately monitoring the implementation of PRSP2 and the present program, will be the subject of a statistical development action plan to be adopted by the National Statistics Council by end-March 2007. This plan will focus on business surveys, national accounts, and balance of payments statistics as sectoral priorities and will identify actions needed for the implementation of the General Data Dissemination System (GDDS). Specifically:

The National Statistical Office (ONS) will publish a monthly industrial production index beginning in July 2007;

Final national accounts for 2003, semifinal accounts for 2004, and provisional accounts for 2005 will be published by end-2006;

Balance of payments data collection and processing will be further enhanced, and monthly foreign trade data will be published by the ONS, starting in December 2006.

42. The BCM will continue to improve its management and accounting procedures, in particular by implementing the recommendations of the IMF safeguards assessment reports. These include the application of international accounting standards and the strengthening of internal audit procedures. The BCM will perform annual audits of its financial statements, and publish them within six months following the closing of accounts.

V. External Sector Policies and Financing

43. The development of oil and mining exports will dominate the outlook for the external sector and should result in a notable improvement of the external position in the medium to long term. While the level of oil exports is now expected to plateau during the next three years, Mauritania will benefit from the projected increase in the national industrial and mining company (SNIM) production and the impending start-up of mining activities at Akjoujt (copper and gold) and Tasiast (gold). In the fishing sector, the new agreement with the EU will translate into large and steady revenue flows to the government, while the recent measures in favor of the national fleet should support fish exports. Mauritania's recent qualification for debt relief under the MDRI will imply a substantial debt service reduction, of around \$11 million in 2006 and \$22 million in 2007.

44. The BCM's official reserves will cover more than two months of imports (excluding imports by the extractive industries and imports financed by foreign assistance) by end-2006. In the medium term, the import coverage of reserves should continue to grow, to three months by end-2009. The achievement of these objectives is based on the assumption that additional external financing totaling about \$120 million will be mobilized for the period 2006–09. In particular, satisfactory program execution should facilitate the rapid mobilization of two tranches of concessional balance of payments support from the Arab Monetary Fund for a total of about \$23 million. The program is fully financed during its first year. Additional financing sources will need to be identified in 2008 and 2009.

45. Our external borrowing will be consistent with debt sustainability and carefully monitored. An external debt strategy has been prepared by the National Public Debt Committee (NPDC) with technical assistance from a firm specializing in this area. The strategy includes a medium- and long-term debt sustainability analysis (DSA), which will guide our borrowing policy and help us consolidate the external debt reduction achieved under the MDRI. In particular, we will have recourse solely to concessional resources. Furthermore, each new financing offer will be assessed by the NPDC to ensure the project's quality and its consistency with the priorities of the PRSP2 and with the debt strategy. The NDPC will update the DSA at least every year in the context of preparation of the medium-term fiscal framework and the budget law. Finally, to bring back Mauritania's outstanding external debt to a sustainable level, we will continue our efforts to negotiate a settlement of our arrears to certain bilateral partners, including Kuwait and Libya, on terms comparable to those granted by the Paris Club creditors.

VI. Risks

46. Two major risks could jeopardize the achievement of the program objectives: (a) uncertainties regarding the commercial viability of the proved hydrocarbon deposits and hence the volume of hydrocarbon production; and (b) the vulnerability of the Mauritanian

economy to exogenous shocks, such as fluctuations in the prices of its principal exports (iron, hydrocarbons, and fish) and the hazards of agriculture and livestock-raising in an arid zone (rainfall, locusts).

47. Mindful of the risks posed by the uncertainties surrounding the volumes of hydrocarbon production and exogenous shocks, we used caution in projecting the related revenue. Furthermore, the accumulated reserves in the FNRH should represent $60 million by end-2006, a level sufficient (except in extreme cases) to ensure the financing of the budget programmed for 2007, even in case of developments affecting resources, or, after consultation with staff, additional emergency expenditure warranted by a natural disaster. The FNRH will therefore play from its inception the role of a macroeconomic stabilization fund, in addition to its long-term function of accumulating savings for future generations. However, if the final decision on investments in the Thiof or Tevet oilfields is not taken by end-2007, the non-oil budget deficit targets for 2008 and 2009 will be revised downward in order to maintain a sustainable medium-term fiscal position.

VII. Program Monitoring

48. To ensure the effective implementation of this program, the government will adopt a budget ordinance for 2007 consistent with the policies that are laid out in this memorandum (in particular in paragraphs 25–29) before the IMF Executive Board considers the request for a three-year PRGF arrangement.

49. To monitor program execution, there will be quantitative performance criteria for end-December 2006 and quantitative indicators for March, June, and September 2007 (Table 1). The quantitative indicators for end-June 2007 will be converted to performance criteria at the time of the first program review. These quantitative criteria and benchmarks are defined in the attached technical memorandum of understanding (TMU), along with the adjusters in case of unforeseen events (the TMU also lists the information that will be transmitted, within the indicated time frames, to IMF staff for program monitoring purposes).Table 2 identifies structural performance criteria and benchmarks and the corresponding deadlines. The non accumulation of external payment arrears (as defined in the TMU) will constitute a continuous performance criterion.

50. Program implementation will be assessed every six months in consultation with IMF staff. The first and second reviews are scheduled to be completed by March 31, 2007 and September 30, 2007, respectively.

Table 1. Mauritania: Quantitative performance criteria and indicative targets for the first year of the PRGF-supported program 1/

(Cumulative change from end-June 2006 for the 2006 targets, and from end-December 2006 for the 2007 targets)

	Initial level Estimate	Preliminary Estimate	Program			
	End-June 2006	End-September 2006	End-December 2006 2/	End-March 2007	End-June 2007 3/	End-September 2007
Quantitative targets						
Net international reserves of the BCM (floor); in $ million 4/	-103.7	30.6	88.4	16.2	34.9	145.7
Net domestic assets of the BCM (ceiling); in UM billion 4/	95.9	-1.6	-16.9	-0.8	-3.2	-31.1
Basic non-oil government balance (floor); in UM billion 5/	-12.4	-19.4	-13.0	-11.0	-11.2	1.9
New medium- and long-term nonconcessional debt contracted or guaranteed by the government and the BCM (ceiling); in $ million	0.0	0.0	0.0	0.0	0.0	0.0
Short-term debt (ceiling); in $ million	10.9	24.7	31.6 6/	-10.4	-10.4	-42.4
New external payments arrears (continuous ceiling); in $ million	0.0	…	0.0	0.0	0.0	0.0
Treasury float (ceiling); in UM billion 7/	6.2	7.7	1.8	0.0	0.0	0.0
Poverty-reducing expenditures (floor); in UM billion 5/ 7/	20.8	…	32.0	12.9	31.1	46.1
Adjustors (in $ million)						
Net international assistance	0.0	-2.9	-9.3	-2.8	-9.2	-12.2
Cumulative disbursements of official loans and grants in foreign currency	0.0	0.0	0.0	0.0	0.0	0.0
Impact of any additional debt relief	0.0	0.9	0.9	0.0	0.0	0.0
Cumulative amounts of external cash debt service payments	0.0	-3.8	-10.2	-2.8	-9.2	-12.2
FNRH contribution to the budget	57.2	39.8	125.8	36.1	72.2	108.3
Memorandum item:						
UM/$ exchange rate (program)	268.6					

Sources : Mauritanian authorities; and Fund staff projections.

1/ For definitions and adjustors, see the technical memorandum of understanding.
2/ Performance criteria, unless otherwise indicated.
3/ Will be revised and set as performance criteria at the time of the first review.
4/ Adjusted upward (NIR) and downward (NDA) by net international assistance and FNRH contribution to the budget.
5/ The end-June 2006 estimate corresponds to the flow over the first six months of 2006.
6/ A last disbursement of $8 million was made in early October 2006 under a short-term nonconcessional facility of $40 million that was granted by the Islamic Development Bank in 2006 to strengthen official reserves before the launching of the foreign exchange market.
7/ Indicative target.

Table 2. Mauritania: Structural Performance Criteria and Benchmarks for the First Year of the PRGF-Supported Program

	Date
Prior action:	
• Government adoption of 2007 budget ordinance consistent with paragraphs 25–29 of the MEFP.	
Performance criteria:	
• Elimination of the requirement to partially surrender fish export proceeds to the BCM.	End-December 06
• Adoption by Cabinet of ordinance on the statutes of the central bank that will establish price stability as the primary objective of the BCM, protect the governor of the central bank from arbitrary dismissal, and place stronger limits on direct monetary financing of the government.	End-December 06
• Adoption by Cabinet of ordinance on commercial banking that will limit loans to related parties and ensure separation between bank managers and owners.	End-December 06
Structural benchmarks:	
• Introduction of a new instrument for bank liquidity management.	End-January 07
• Semiannual adjustment of water and electricity rates based on the estimated operating balance.	End-January 07
• Transmission to Fund staff of the computerized monthly monitoring of budget execution with a lag of no more than a month (budget allotments, commitments, payment orders).	End-January report available at end-February 2007 1/
• Publication of the audit of BCM's 2006 financial statements.	End-June 07
• Submission to parliament of a draft law on a transparent and optimal oil revenue management, consistent with paragraph 32 of the MEFP.	End-August 07

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

Technical Memorandum of Understanding

1. This memorandum sets out the definitions of the quantitative targets for the period October 1, 2006–September 30, 2007, 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 to IMF staff 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 reference date defined in Table 1 until the end of the month indicated.

VIII. Definitions

3. **Net international reserves** (NIR) of the Central Bank of Mauritania (BCM) are defined as the reserve assets of the BCM (i.e. the 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*) minus the foreign exchange liabilities of the BCM to residents and nonresidents. The gold holdings will be evaluated at the gold price in effect on June 30, 2006 ($613.50 per oz.), and the U.S. dollar value of reserve assets (other than gold) and foreign exchange liabilities will be estimated using **program exchange rates,** namely: the June 30, 2006 exchange rates between U.S. dollar and the ouguiya (268.6 ouguiya/$), the SDR (1.4794 $/SDR), the Euro (1.2713 Euro/$) 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 comprises: (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 foreign assets not included in the reserve assets, minus 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 paragraph 3.

5. **Government balance** is defined for program monitoring purposes as non-oil central government basic balance excluding grants, which is equal to **non-oil government revenue** (excluding grants) minus **government expenditure** (excluding foreign-financed investment expenditure and interest due on external debt). The government balance will be measured based on treasury data. Revenue are defined in accordance with the Government Financial Statistics manual (GFSM 2001) excluding the revenue related to oil- and other hydrocarbon-related activities and transfers from the National Hydrocarbon Revenue Fund (FNRH) to the budget. They will be monitored on a cash basis (*recettes encaissées par le Trésor*).

Expenditure will be monitored on the basis of the registration of payment orders by the treasury *(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. The **new medium- and long-term external nonconcessional debt contracted or guaranteed by the government and the BCM** is defined as the foreign currency debt, with maturities of one year or longer, contracted or guaranteed by the government or the BCM with a grant element (defined as 1 minus the NPV to face value ratio and estimated on the basis of the currency- and maturity-specific discount rates reported by the OECD (commercial interest reference rates)) of less than 35 percent. 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.[4]

7. The **short-term debt** is defined as the stock of foreign currency debt, with original maturity of less than one year, owed or guaranteed the government or the BCM. This definition applies 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). This definition excludes foreign currency deposits with BCM.

8. **External payments arrears** are defined as overdue payments (principal or interest) on external debt contracted or guaranteed by the government or the BCM.

9. **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.

10. **Poverty-reducing expenditures** will be estimated in accordance with the definition consistent with the public expenditures functional classification based on the recommendations of report of the IMF Fiscal Affairs Department's January 2006 technical assistance mission ("Les réformes en cours de la gestion budgétaire et financière", March 2006).

IX. PROGRAM ADJUSTORS

11. **NIR, and NDA targets** are derived based on the projected amounts of **the FNRH contribution to the budget** and the projected amounts of **net international assistance.** The latter is defined as the difference between: (a) the sum of the cumulative disbursements of

[4] Although this definition excludes borrowing by public enterprises (without government guarantee), such borrowing should be avoided except in exceptional circumstances and after consultations with IMF staff.

official loans and grants (budget support; excluding HIPC assistance and project-related loans and grants) in foreign currency and of the impact of any additional debt relief obtained after June 30, 2006; and (b) the cumulative amounts of external cash debt service payments (including interest on foreign liabilities of the BCM).

12. 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 an amount equivalent to the difference between the actual levels and the projected levels. In the case of NDA, this amount will be converted into ouguiya at the program exchange rates. The cumulative downward adjustments to NIR will be limited to $25 million. The cumulative upward adjustments to NDA will be limited to the ouguiya equivalent of $25 million at program exchange rates.

X. Reporting Requirements

13. 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) 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. These data will be provided 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. These data will be provided 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. These data will be provided 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 Departments monthly revenue collection reports (*Rapports mensuels des recettes*). These data will be provided 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 Development

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 government, its agencies, and by public enterprises by creditor and by currency of disbursement. These data will be provided 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.

14. All data will be transmitted electronically. Any revision to previously reported data accompanied by an explanatory note shall be promptly communicated to IMF staff.

XI. Central Government Operations Table

15. The treasury will prepare a monthly budget execution report in the format of a Central Government Operations Table (TOFE). In preparing this table, the following definitions shall be used:

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 and (*partie BE et BA*)); and foreign program grants for budget support, including the multilateral HIPC debt relief on the government external debt budget and HIPC debt relief on the external debt of BCM and SNIM (including the part of the AFD/BFD 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 minus 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 payment arrears to public enterprises (utilities), international organizations, procurement contracts, and court orders).

External financing is defined as the sum of: the opposite of the change in the net position of the FNRH; net disbursements of foreign loans; and exceptional financing. The latter is composed of: (a) the accumulation of arrears on passive debts and of technical arrears, as defined in paragraph 9; and (b) debt relief obtained on external government net of the HIPC assistance that is treated as **grants**.