International Monetary Fund

Islamic Republic of Afghanistan and the IMF

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July 7, 2008

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

June 23, 2008

ISLAMIC REPUBLIC OF AFGHANISTAN: LETTER OF INTENT

Kabul, June 23, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn,

The attached memorandum supplements and updates the commitments contained in our Memorandum of Economic and Financial Policies (MEFP) of January 28, 2008. It reports on quantitative performance through March 2008 and on implementation of structural reforms under the Poverty Reduction and Growth Facility (PRGF)-supported program. It proposes quantitative targets through March 2009, including quantitative performance criteria for September 2008 and March 2009, and supplements understandings with regard to the government's policies for the remainder of the program, including prior actions for completing the fourth review, and structural conditionality for future disbursements.

We met all the March 2008 quantitative performance criteria, with the exception of the floor for fiscal revenue, which we missed mainly due to a significant slippage in the collection of customs duties. Despite the revenue shortfall, we maintained fiscal discipline and met the end-2007/08 indicative target for the operating budget deficit. We believe that the measures committed to in the attached memorandum ensure that, moving forward, our revenue performance will be in line with program targets. On this basis, we request a waiver of nonobservance with respect to the March 2008 performance criterion on fiscal revenue of the government. In the face of unexpectedly high inflation, we tightened our monetary policy stance and, despite the surge in money demand in the last quarter of 2007/08, met the original end-year currency in circulation target. We also observed the continuous zero ceilings on contracting or guaranteeing of new medium- and long-term nonconcessional external debt, on short-term external debt, and on new lending from state owned banks to, or government-guaranteed borrowing by, enterprises in need of restructuring. In addition, we met the continuous performance criterion prohibiting accumulation of new external payments arrears.

Structural conditionality for the fourth review proved challenging, and we fell behind in the implementation of several program commitments. We met the structural benchmarks on the submission of the core budget to parliament and publication of the schedule of fees charged by the state-owned petroleum trading enterprise (FLGE). We also ensured automatic monitoring of the operations of the central bank's six regional branches from the central bank's headquarters and repealed the requirement for commercial banks to invest 80 percent of their deposits in domestic economy. Nonetheless, we missed the structural benchmark on the preparation of a restructuring/privatization plan for the public enterprises that are not covered by the law on state-owned enterprises and are currently excluded from the privatization process. While we made significant progress toward restructuring of our state-owned electricity provider (DABM), we missed the structural benchmark on concluding an agreement between the Ministry of Finance and the DABM on quarterly reform benchmarks in exchange for subsidy disbursements. We believe that the remedial measures that we committed to in the attached memorandum will enable us to regain reform momentum in these critical areas. We also incurred a minor delay in reconciling the central bank's accounting records with the monthly data reported by the central bank for program monitoring purposes. This reconciliation has now been completed and the 2008/09 program will be monitored based on the data sourced directly from central bank's accounting records.

The government and Da Afghanistan Bank (DAB) believe that the economic and financial policies set forth in the attached memorandum provide an adequate basis for achieving the objectives and targets of the program. During the period of the arrangement, we will consult with the Fund on the adoption of any further measures that may be appropriate, at the initiative of the government or DAB, or whenever the Managing Director of the IMF requests such a consultation. In addition, we will provide the Fund in a timely manner with all information necessary to monitor implementation of the program. The fifth review under the PRGF arrangement will be completed on or after January 15, 2009.

On the basis of this performance, and on the strength of the policies set forth in the attached memorandum, we request that the IMF complete the fourth review under the PRGF arrangement and approve the fifth disbursement (in the amount of SDR 11.3 million). After the period of this arrangement and while Afghanistan has outstanding financial obligations to the IMF, we will periodically consult with the IMF, at the initiative of the government or DAB, or whenever the Managing Director of the IMF requests consultation on Afghanistan's economic and financial policies.

We remain committed to transparent policy-making and are keen on making the contents of this letter and those of the attached supplementary MEFP and technical memorandum of understanding, as well as the staff report for the fourth review under the PRGF arrangement, available to the public and hereby authorize their posting on the Fund's website subsequent to Executive Board consideration of this request.

Sincerely yours,

Anwar Ul-Haq Ahady	Abdul Qadeer Fitrat
Minister of Finance	Governor
Ministry of Finance	Da Afghanistan Bank
/s/	/s/

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2008/09

June 23, 2008

1. **This memorandum supplements our Memorandum of Economic and Financial Policies (MEFP) of January 28, 2008 with regard to the policies to be undertaken by the Government of the Islamic Republic of Afghanistan and Da Afghanistan Bank (DAB) in the context of the economic program for 2008/09**, the last year of the three-year arrangement under the Poverty Reduction and Growth Facility. The supplement covers: (i) the quantitative program for 2008/09, including the proposed quantitative performance criteria for the sixth and seventh disbursement under the PRGF arrangement (Table 1); and (ii) a revised timetable for commitments—whose implementation have been delayed—and additional commitments identified to strengthen program performance, including prior actions for the completion of the fourth review, and additional structural conditionality for 2008/09 (Table 2).

A. Recent Economic Developments and Performance Under the Program

2. **The revised estimates for the 2006/07–07/08 national accounts and latest economic activity and price indicators imply significant changes to the assessment of macroeconomic performance in 2007/08 and our projections for 2008/09**. The final GDP figure for 2006/07 shows a significant upward revision on the grounds that the decline in agriculture was not as dramatic as previously estimated. Consequently, the ensuing rebound in 2007/08—albeit from a higher base—was less pronounced than previously estimated. Moreover, given the negative impact of the harsh winter on livestock and relatively low private sector merchandise imports (reported to have grown by only 3.7 percent in nominal terms in 2007/08, although this is likely to be significantly understated due in part to the undervaluation of fuel imports by customs), the overall growth in economic activity in 2007/08 appears to have been weaker than expected. As a result, real GDP growth in 2007/08 is now estimated at 11.5 percent (rather than 13.5 percent). Due to a sharp increase in prices of imported food and fuel in the second half of the year, CPI growth in 2007/08 exceeded expectations, with end-period inflation reaching 20.7 percent and average inflation 13 percent. For 2008/09, the GDP growth forecast has been revised downward to 7.5 percent on account of rainfall shortage during the germination period. The surge in food price inflation—fueled by the imposition of export restrictions on wheat by key regional trade partners—continued in the first two months of 2008/09, during which the CPI increased by a further 20 percent. Assuming that the disruption of wheat imports will be temporary and that the upward pressure from the world-wide increase in commodity prices will subside in the latter part of the year, inflation in 2008/09 may moderate to about 15½ percent by year's end. Nevertheless, average CPI inflation in 2008/09 is expected to be at least 24 percent (program assumption). Moreover, the inflation outlook is subject to a considerable upside

risk and the program may need to be revisited if the inflation trend through mid-year departs significantly from the program path.

3. **Program implementation in the second half of 2007/08 presented us with a difficult challenge**. We met all quantitative performance criteria and indicative targets for end-2007/08, with the notable exception of the criterion on the domestic revenue, which was missed by Af 2.3 billion or 6 percent of the annual target due to a significant decline in customs duties collection. We also experienced important setbacks in the implementation of structural conditionality (only four out of seven structural benchmarks were implemented) for the fourth review, and we fell behind on most of the commitments in our MEFP of January 28, 2008.

B. Fiscal Performance in 2007/08 and Program for 2008/09

4. **Despite a revenue shortfall of 0.5 percent of (revised) GDP, the fiscal position was slightly better than envisaged due to under-expenditure of the operating budget**. Revenue is estimated to have reached Af 33.4 billion in 2007/08. As a result, the revenue-to-GDP ratio declined from 7.5 percent in 2006/07 to 7.0 percent in 2007/08. While part of the revenue shortfall could be attributed to a lower than expected volume of taxable imports, policy inertia, inadequate enforcement efforts, and our customs valuation policy were the main contributing factors. Operating expenditures are estimated to have been lower than programmed at Af 50.7 billion or 10.6 percent of GDP. Consequently, the operating budget deficit (excluding grants) is estimated to have been slightly lower than envisaged under the program, at 3.6 percent of GDP. At the same time, development expenditures are estimated to have been broadly in line with program projections at Af 45 billion or 9.4 percent of GDP.

5. **In the face of significantly higher than expected inflation, the revised fiscal program for 2008/09 aims to stabilize the revenue-to-GDP ratio**. Many components of our tax base will not respond immediately to the recent increase in the inflation rate, which is mainly driven by growing food prices (these have doubled during the 12-months ending in May 2008). Taxation of food imports was reduced last year to alleviate the impact of price increases and the bulk of domestic food production is not captured by current tax collections. Consequently, our 2008/09 domestic revenue target (program floor) of Af 44.5 billion (7.0 percent of GDP) reflects a baseline revenue projection of 6.6 percent of GDP plus revenue measures geared at yielding additional revenue equivalent to 0.4 percent of GDP (¶8–10) Our operating expenditure envelope for 2008/09 is Af 65.0 billion (10.2 percent of GDP); this is Af 1.6 billion higher, and is weighted more towards salaries than its variant discussed with the IMF staff in November 2007. The program also allows, as a contingency, for additional security spending (¶6). Regarding development outlays, we aim at a significant

improvement in project preparation and implementation, and at executing at least 80 percent of the core development budget envelope of Af 69.4 billion (10.9 percent of GDP) approved by parliament.

6. **We have reconciled our operating budget envelope with the cash projection for expenditure under the fiscal program for 2008/09 consistent with the understandings reached with IMF staff in November 2007**. The operating budget envelope approved by parliament was Af 65.4 billion or Af 1.9 billion higher than reflected in the understandings reached with the IMF staff in November 2007. This additional allocation is a contingency that allows us to accelerate recruitment of the Afghan National Army and will be added to the program (via an adjuster) should the Afghan National Army (ANA) headcount exceed the 70,000 troops budgeted for 2008/09. However, the operating budget envelope approved by parliament does not yet reflect the Af 1.6 billion that was added to the program in consultation with Fund staff (¶5); this will be submitted to Parliament for approval as part of midyear budget review. Following the receipt of in-kind fuel donations for the Ministry of Interior, we took the opportunity to reallocate the cash set aside (Af 1.5 billion) for that purpose to increase the food allowances for the army and police, as a response to the food price increases, and also to mitigate the impact of the National Directorate of Security coming on to the core budget.

7. **The Government intends to mitigate the impact of increased wheat prices on the poor by working with donors to elaborate mechanisms to provide assistance to the needy**. Separately, the Government purchased $50 million of wheat from neighboring countries at a price lower than the current market price in Afghanistan. This imported wheat would be sold domestically, and the government intends to recover fully the costs of its procurement. The Government will sell this wheat in a manner that would not create major price distortions in the domestic market. While the Government recognizes the limited impact this operation will have on poverty alleviation and on addressing social concerns related to the increase in world market prices for wheat, we believe that the additional supply from this operation might lead to lower domestic prices.

C. Policies to Strengthen Domestic Revenue

8. **We recognize the risks to the program caused by the nonobservance of the domestic revenue target for 2007/08**. We also share the concerns of the IMF staff and the international community regarding the prospects for fiscal sustainability, and the slow progress in broadening the tax base and addressing governance issues. To ensure successful implementation of our economic program for 2008/09, we are prepared to take additional measures to strengthen our revenue performance. To this effect, we commit to implementing the following measures as **prior actions** before the IMF Executive Board discussion of the fourth review of the program:

- Ministry of Finance (MOF) will issue an instruction for Afghan Customs Department (ACD) to ensure timely updates of reference prices for petroleum products, which will be applied in assessing the amount of applicable duties and taxes collected at the border (TMU ¶2).

- MOF will collect at least Af 79 million on the business receipt tax (BRT) and nontax (landing/parking right fees) liabilities due by airlines and outstanding at end-2007/08. (TMU ¶2).

- MOF and the Ministry of Commerce and Industry (MOCI) will sign a memorandum of understanding to clarify working arrangements of both ministries and the Fuel and Liquid Gas Enterprise (FLGE) with a view to granting customs officials full access to depot and storage areas and the authority to verify independently the amount and the quality of fuel being imported by FLGE and private importers before it is taken into FLGE's custody (TMU ¶2).

In addition, we will implement the following actions which we deem critical to ensuring continued improvement in the revenue performance:

- Notify traders of the expiration of exemption from the general income tax regime and inform them that they will be expected to file and pay their tax liabilities for 2008/09 according to the general provisions applying to corporate income tax payers (structural benchmark for end-July 2008).

- Expand operations of the Large Taxpayer Office (LTO) to Herat, Jalalabad, and Mazar-e-Sharif (structural benchmark for end-September 2008).

- Pass amendments to the income tax legislation (including the introduction of BRT on imports) (structural benchmark for end-November 2008).

- Implement the ASYCUDA transit and Declaration Processing Module (DPS) in Nangarhar and Herat, and Kabul Airport inland clearing depots (ICD) (structural benchmark for end-March 2009).

- Collect the remainder of airlines' tax and nontax liabilities outstanding at end-2007/08 that have been agreed with IMF staff to be collected in 2008/09 (altogether at least Af 158 million) and maintain regular collection of BRT and landing right fees throughout 2008/09 (structural benchmark for end-March 2009).

9. **To strengthen our efforts to broaden the revenue base**, we will establish an inter-ministerial Revenue Board, which would include key ministers that will be responsible to Cabinet and the President for revenue collection and modernization.

10. **In addition to policy actions listed in ¶25 of our MEFP of January 28, 2008, we will take measures to strengthen control mechanisms at customs**. To this effect, we will properly staff and resource the Internal Control/Audit unit at ACD, improve internal data processing, and conduct regular internal audits of customs duty exemptions. We are also committed to implementing vigorously the measures envisaged under ACD's 5-year strategy.

D. Public Financial Management Reforms

11. **We remain committed to the Pay and Grade reform to modernize the civil service**. To ensure the timely implementation of this reform we will: (i) allocate the workforce of the ten largest ministries according to the new grade structure by end-June 2008 (Civil Service Commission); (ii) cost the new structure according to the agreed pay scale for the ten ministries by end-September 2008 (MOF); and (iii) negotiate the transition in the ten ministries, subject to the budget envelope established by the MOF, and begin implementation by end-November 2008.

12. **We are cognizant of the need to ensure that our financial management systems are robust enough to cope with the challenge of scaled-up aid in the context of the ANDS**. We have undertaken simple program budget pilots to help align public spending priorities with the ANDS and have initiated Treasury reforms to strengthen tracking of poverty related spending through reporting on government budget execution. Nonetheless, both the MOF and line ministries have run into difficulties with implementing these measures. We plan to use a METAC technical assistance mission to review progress jointly with budget, Treasury, and the pilot ministries to identify practical ways forward that will allow us to plan and report on expenditure in a way that facilitates a focus on, and discussion of, service delivery to the most vulnerable.

13. **We will follow up on our commitments regarding the regularization of the relations between the budget and public enterprises**. To this effect, we will promptly initiate the review of the fiscal relations between the government and key state-owned enterprises (SOEs), as committed in ¶23 of the January MEFP. The results of the review will be reported to the IMF staff (structural benchmark for end-December 2008).

E. External Sector Developments and Policies

14. Our external position continued to strengthen in 2007/08 as a result of an improving trade balance and stronger than expected aid inflows. The current account deficit (excluding grants) receded from 70 percent of GDP in 2006/07 to 66.9 percent in 2007/08, mainly because of weaker than expected private sector merchandise imports and strong growth of exports, albeit from a low basis. The net international reserves target for end-2007/08 was met with a significant margin. As a result, DAB's international reserves coverage of imports improved from just under 10 months at end-2006/07 to more than 11 months at end-2007/08

and the coverage of commercial bank foreign currency liabilities remains comfortable (above 200 percent)

15. **Looking forward, we project a further improvement in our external current account, on the expectation that export growth continues apace and FDI increases on the back of large-scale investment projects in the mining sector**. The largest FDI to date, Aynak Copper project, was competitively bid, and another bid for Hajigak Iron Ore is under preparation. We are confident that these projects will contribute to future growth and are committed to ensuring that a transparent fiscal regime is applied to mineral extraction operations and to the resources transferred to the core national budget.

F. Monetary Policy and Strengthening of DAB's Reporting Framework

16. **Despite upward pressure on money demand exerted by higher than expected inflation, we have increased confidence in the Afghani and strengthened our monetary policy framework**. Despite the surge in money demand in the last quarter of 2007/08, we met the end-year currency in circulation (CiC) ceiling. In the event, CiC grew at 17 percent in 2007/08, significantly below the growth of nominal GDP, which helped mitigate the inflationary pressure brought about by higher import prices. Strengthening of the Afghani via increased foreign exchange interventions in the last quarter of 2007/08 and a significant increase in the issuance of capital notes were instrumental in this regard. We intend to increase further our reliance on capital notes (CNs) as a policy instrument, the use of which will be guided by the indicative ceiling on reserve money (in addition to the quantitative performance criterion on currency in circulation). DAB's operations in CNs will also be carried out with due consideration for interest rate developments.

17. **To enhance the conduct of monetary policy**, we intend to start open market operations in CNs and promote the development of a secondary market. To this effect, we will create an electronic registry of CNs at DAB (structural benchmark for end-September 2008). To assist in integrating CNs in the monetary policy framework, we will strengthen our liquidity forecasting and monitoring. We will also increase the frequency of the government's liquidity forecast from monthly to biweekly and broaden it to include a forecast of core development budget expenditure. At the same time, we will develop a framework for monitoring commercial bank liquidity on a weekly basis (ahead of announcing the volumes of the primary CN auctions).

18. **The parameters of the quantitative monetary program for 2008/09** have been aligned with the projection of nominal GDP and an assessment of growth prospects in commercial bank activity. Consequently, we commit that the growth of CiC in 2008/09 will not exceed the projected growth of nominal GDP (33.1 percent), and will attempt to keep the CiC at 2–3 percentage points below the linear monthly growth path consistent with that projection to ensure that CiC growth contributes to disinflation. The quarterly indicative

targets for reserve money will be set in line with the annual growth projection for reserve money (33.5 percent), which reflects an assumption of growth in commercial bank deposits of 50 percent and a tightening of control over banks' excess liquidity. Should growth of reserve money exceed the targeted quarterly path, we will consult with the IMF staff to clarify whether increased issuance of CNs is in order. Likewise, we will refrain from adjusting the reserve requirement without prior consultation with IMF staff.

19. **We will ensure that the 2008/09 program will be monitored using reliable monetary data that will be reconciled with DAB's accounting records**. We have incurred a delay in monetary data reconciliation and missed the April 20, 2008, structural benchmark, but the extension of the accounting system to six regional branches and timely commencement of the end-2007/08 external audit provide good basis for a durable improvement in the areas of accounting, reporting, and internal control. The reconciliation of the data used for monetary program monitoring with DAB's accounting records has now been completed. We will strengthen further our data reporting and accounting framework, drawing, among others, on the results of the external audit (expected to be published by end-June 2008). We are also committed to implementing the recommendations of the November 2007 safeguards recommendation update, and follow through on the recommendations of technical assistance from METAC in the areas of accounting and control.

G. Financial Sector Supervision

20. **We have monitored closely the rapid growth of banking sector activity and have continued to improve banking supervision, but we are yet to strengthen our enforcement procedures**. To address emerging risks in the banking sector, we continued with examinations of weak banks and restricted their credit growth to 5 percent per quarter as long as their CAMEL ratings continued to be assessed by DAB as 4 or 5. We also suspended the issuance of licenses for new branches of these banks. We established a risk management department at the DAB, drafted a number of guidelines on risk management, and began training of staff. We also created a Non-banking Supervisory Section in the Financial Supervision Department.

21. **DAB will develop an action plan to address the gaps in the legal framework based on the weaknesses identified in the self-assessment against the Basle Principles (structural benchmark for end-September 2008)**. Also by end-September 2008, we will (i) issue guidelines on operational risk management, corporate governance risk management, liquidity risk management, and market risk management. By end-June 2008, we will (i) prepare, on the basis of the third round of on-site supervision reports, a second summary report on banks' compliance with prudential regulations; and (ii) develop an off-site supervision form detailing sectoral loan concentration. We will enforce strictly and promptly corrective measures warranted by on-site examinations and increase our targeted

examinations in order to ensure that banks are in compliance with DAB's enforcement actions.

H. Structural Reforms in Public Enterprises

22. **We have made significant progress toward restructuring our electricity provider (DABM) but we acknowledge the need for an immediate strengthening of fiscal control over its financial operations**. On March 17, 2008, the Cabinet adopted the articles of incorporation (transforming DABM into DABS, with the MOF taking the largest, 45 percent, stake in the company and playing a dominant role at the Board of Directors) enabling it to continue operating as a public entity but on a strictly commercial basis. We will promptly publish DABS' articles of incorporation in the Official Gazette and will sever financial links between DABS and the Ministry of Energy and Water by end-June 2008. We are committed to appointing a competent management for DABS, with a strong mandate to reform the company and a responsibility for fulfilling conditions that the MOF will insist upon in exchange for the disbursement of subsidy toward fuel purchases by DABM/DABS (in line with the understandings listed in ¶26 of the January MEFP). In addition, the submission of DABS' audited financial statements for 2006/07–2007/08 will be a structural performance criterion for end-September 2008.

23. **Regarding the preparation of the strategic plan for the non-Tassady enterprises**, given the capacity shortfall and the lack of consensus among the key stakeholders on the future of these enterprises, we are not in a position to commit to a timeline for the preparation of the comprehensive plan. Instead, we will focus on the actions needed to put the most important enterprises in that group on a sound financial footing with a view to creating conditions for their restructuring or privatization. Building on the successful restructuring of Afghan Telecom (AT), we plan to launch its privatization in June 2008. Regarding the national airline Ariana, in the absence of audited financial statements and a restructuring plan, we will continue to refrain from directing or guaranteeing lending to Ariana and will not use the state-owned banks to recapitalize it. Given the deteriorating financial and technical condition of the company, the Cabinet will take steps to find a durable resolution for Ariana, and will take immediate measures to preserve the assets of the company, while safeguarding the budget from potential fiscal drains.

24. **We have undertaken steps to improve the transparency in the domestic petroleum sector and are preparing for the privatization of the FLGE**. We posted a schedule of fees charged by FLGE, as committed in our MEFP of January 28, 2008. The external audit of FLGE is currently underway and we intend to post its report by end-November 2008, as envisaged. We also started the preparations for the privatization of the FLGE. To that end, we have invited Expressions of Interest (EoI) from companies interested in managing the process and we intend to privatize FLGE by March 2009, in accordance with our commitment under the Afghanistan Compact.

25. **We have made significant progress toward strengthening the legal framework for financial transactions and private sector development but uncertainty continues to surround the application of the new commercial laws**. We submitted to Parliament the Secured Transaction Laws of Moveable and Immoveable Property 2008, sponsored by DAB, and plan to submit the Negotiable Instruments Law (also sponsored by DAB) by September 2008. The Parliament continues to review the four laws sponsored by MOCI (Commercial Arbitration Law, Commercial Mediation Law, Business Partnerships Law, and Law on Business Corporations and Limited Liability Companies), which were published in the Official Gazette in January 2007 following their approval by President Karzai, but had not been discussed by Parliament prior to their presidential approval.

I. ANDS and HIPC-related Issues

26. **We have finalized our ANDS and submitted it to the IMF and World Bank Boards for consideration**. We are mindful that successful implementation of our ambitious strategy will require the costing of additional sector strategies, and improvements in the statistical base necessary for monitoring of results. We remain mindful of the potential adverse effects that the dramatic scaling-up of aid in the context of the ANDS may have on macroeconomic stability, and are committed to improving the coordination of monetary and fiscal policies to avoid overheating, and to pursue the structural reforms necessary to safeguard competitiveness.

27. **We continued our efforts to regularize relations with our external creditors as required under the Enhanced HIPC Initiative**. Saudi-Arabia agreed in January 2008 to write off most of our debts eligible for relief under the Enhanced HIPC Initiative (approximately $25.5 million) and restructure on soft terms the remainder. Iraq agreed in May 2008 to forgive all its claims on Afghanistan (totaling approximately $9.6 million). Negotiations on a debt relief agreement are underway with the Kuwait Development Fund. Discussions with the OPEC Fund for International Development continued during the Spring Meetings of the IMF and the World Bank in April 2008. We are also working to validate unverified claims—originally to the Czech Republic, but now held by a private company in Germany—by undertaking a legal review of the loan including, if needed, using an outside legal firm. In addition, we will undertake a review of DAB's records regarding an unverified claim by Iran (pre-cutoff debt) and we aim to confirm the validity of this claim by the end of the second quarter of 2008/09. If the validity of the claim is confirmed, we will promptly approach the Iranian authorities to negotiate a debt rescheduling agreement. In our negotiations with our creditors we remain mindful of our commitment not to accord any category of creditors a treatment more favorable that that accorded to the Paris Group of Countries. We will continue to rely primarily on grants and highly concessional loans to meet our financing needs. To that end, the government and DAB will not contract or guarantee any nonconcessional external debt (continuous performance criterion).

J. Measures to Strengthen Statistical Capacity

28. **We commit to redoubling our efforts to support the Central Statistical Office (CSO)**. We recognize the urgency of improving data collection and dissemination, particularly in the areas of national accounts and poverty indicators. The implementation of ANDS and its monitoring underscore the need to strengthen our statistical capacity and ensure that the economic policies under the ANDS are properly designed, executed, and monitored. We are making progress toward improving our balance of payments (BoP) statistics. A FDI survey was launched in April 2008 and we will work with the companies involved with an aim to complete the survey by end-June 2008. The compilation of BoP has also been complicated by inadequate merchandise trade data collected by CSO and by inconsistencies between CSO data and those recorded by customs. As committed in the last MEFP (¶50), we intend to strengthen CSO's ability to compile accurate and timely merchandise trade data, including data on duty-free imports. We will seek donor support for CSO; however, in its absence, we are prepared to use the needed funding from our discretionary development expenditure to revamp and properly equip the CSO and strengthen its professional capacity, based on an action plan with a specific timetable to be agreed with IMF's STA department.

Table 1. Islamic Republic of Afghanistan: Performance Criteria and Indicative Targets for 2007/08–2008/09 1/

(For 2007/08, cumulative changes from March 20, 2007 and for 2008/09, cumulative changes from March 19, 2008; unless otherwise indicated)

	Mar. 20, 2007	Dec. 21, 2007			Mar. 19, 2008			Jun. 20, 2008		Sep.21, 2008		Dec. 20 ,2008	Mar. 20, 2009
	Stocks	Indicative Targets		Actual	Performance Criteria		Actual	Indicative	Revised	Indicative	Performance	Indicative	Performance
		MEFP	Adjusted		MEFP	Adjusted		Targets 2/	Targets	Targets 2/	Criteria	Targets	Criteria
Quantitative performance criteria and benchmarks													
							(In millions of Afghanis)						
Floor on fiscal revenue of the government	...	24,600	…	23,562	35,721	...	33,438	10,207	8,521	20,983	18,354	30,045	44,501
Ceiling on currency in circulation 3/	50,329	7,798	…	8,218	9,435	...	8,570	2,899	5,373	5,798	10,745	15,118	19,490
Ceiling on net central bank financing of the government	-28,343	81	-191	-2,565	6,201	3,518	-6,326	-1,154	1,428	724	5,263	-2,662	271
Indicative target (ceiling) on the operating budget deficit of the government, excluding grants	...	12,032	…	10,924	17,608	...	17,229	2,481	4,487	7,565	10,914	15,483	20,539
Indicative target (ceiling) on reserve money	...	...	...	...	...	...	64,426 4/	...	6,315	...	12,229	17,143	21,557
							(In millions of U.S. dollars)						
Floor on net international reserves of DAB	1,991.1	230.3	234.2	382.9	166.3	218.4	388.2	110.3	72.4	127.2	93.0	329.6	338.1
Zero ceiling on contracting or guaranteeing new medium- and long-term nonconcessional external debt by the government and DAB 5/	0	0	...	0	0	...	0	0	0	0	0	0	0
Zero ceiling on short-term external debt owed or guaranteed by the government or DAB 5/	0	0	...	0	0	...	0	0	0	0	0	0	0
Nonaccumulation of new external payments arrears, excluding interest on preexisting arrears 5/	0	0	...	0	0	...	0	0	0	0	0	0	0
Zero ceiling on lending from State-Owned Banks to SOEs in need of restructuring or government guaranteeing borrowing by these SOEs 5/	...	0	...	0	0	...	0	0	0	0	0	0	0
Memorandum items:													
Operating budget deficit of the government, including grants	...	-2,728	...	-720	-6,009	…	-5,902	-2,438	-217	-3,502	330	-981	-2,980
Reference Projections for the Adjustors													
		Program	Actual	Deviation	Program	Actual	Deviation	Program	Revised	Program	Revised	Program	Program
Core budget development spending		27,063	26,370	-694	45,483	45,043	-440	7,107	7,038	21,320	21,114	35,190	56,304
External financing of the core budget and sale or transfers of nonfinancial assets		38,980	39,252	272	56,889	59,572	2,683	10,742	10,098	28,161	26,765	53,335	76,572
Expenditure currently financed outside the budget moved onto the operating budget		...	...	...	...	...	…	...	...	...	...	...	...

Sources: Afghan authorities; and Fund staff estimates and projections.

1/ The performance criteria and indicative targets envisaged under the program, and their adjustors, are defined in the Technical Memorandum of Understanding.
2/ As projected at the time of the third review.
3/ March 20, 2007 data revised as a result of reconciliation of DAB's Monetary Policy Department data with its Accounting Department data; the concomitant revisions of data for Sep. 20, 2007 do not affect performance assessment.
4/ Stock.
5/ These performance criteria apply on a continuous basis.

Table 2. Islamic Republic of Afghanistan: Structural Performance Criteria and Structural Benchmarks, July 2007–March 2009

Fourth Review Under the PRGF Arrangement

Prior Actions (TMU ¶2 Section A).	**Target Dates**	**Status**
MOF will issue an instruction for Afghan Customs Department (ACD) to ensure timely updates of reference prices for petroleum products, which will be applied in assessing the amount of applicable duties and taxes collected at the border.	Five business days before Board meeting	Implemented
MOF will collect at least Af 79 million on the business receipt tax (BRT) and nontax (landing/parking right fees) liabilities due by airlines and outstanding at end-2007/08.	Five business days before Board meeting	Pending
MOF and MoCI will sign a memorandum of understanding to clarify working arrangements of both ministries and the Fuel and Liquid Gas Enterprise (FLGE) with a view to granting customs officials full access to depot and storage areas and the authority to verify independently the amount and the quality of fuel imported by FLGE and private importers before it is taken into FLGE's custody.	Five days before Board meeting	Implemented
Structural Benchmarks (TMU of January 28, 2008 ¶2 Section B).	**Target Dates**	**Status**
Submit core budget to parliament according to the PFEM Law and accompanied by a MTFF.	February 3, 2008	Implemented
Publish a schedule of the fees charged by the FLGE for its services.	February 29, 2008	Implemented
MOF will conclude an agreement with the DABM on quarterly reform benchmarks to be met by DABM throughout 2008/09 in exchange for the subsidy disbursements.	March 21, 2008	Not implemented
Adopt a comprehensive restructuring/divestment plan for the public entities and government agencies engaged in commercial activities but not covered by the SOEs law.	March 31, 2008	Not implemented
DAB will issue a circular informing banks that the requirement to invest 80 percent of bank deposits in domestic economy has been repealed.	March 31, 2008	Implemented
Ensure that the accounting system at DAB's six regional hubs is automatically monitorable from DAB's headquarters.	March 31, 2008	Implemented
Reconcile DAB's accounting records and the monthly reports on DAB's operations for 2007/08 prepared by DAB's Monetary Policy Department.	April 20, 2008	Implemented in May 2008

Fifth Review Under the PRGF Arrangement (TMU ¶2 Section B)

Structural Performance Criteria	**Target Dates**	**Status**
Submit to parliament the core budget's audited financial statement for 2007/08. 1/	September 21, 2008	
Submission of DABM's audited financial statements for 2006/07–2007/08.	September 30, 2008	

Table 2. Islamic Republic of Afghanistan: Structural Performance Criteria and Structural Benchmarks, July 2007–March 2009 (concluded)

Structural Benchmarks	**Target Dates**	
DAB will produce the Monetary Survey for 2007/08 using a consistent time frame (Solar or Gregorian) for the entire banking system.	June 30, 2008	
Notify traders of the expiration of exemption from the general income tax regime and inform them that they will be expected to file and pay their tax liabilities for 2008/09 according to the general provisions applying to corporate income tax payers.	July 31, 2008	
Develop an action plan to address the gaps in the DAB's framework based on the weaknesses identified in DAB's self-assessment against the Basle Principles.	September 30, 2008	
Create an electronic registry of CNs at DAB.	September 30, 2008	
Roll out the Large Taxpayer Office (LTO) to Herat, Jalalabad, and Mazar-e-Sharif.	September 30, 2008	
Amend income tax legislation, including, by introducing BRT on imports.	November 30, 2008	
Publish external audit report of FLGE.	November 30, 2008	
MOF will review the fiscal relations between the government and Afghan Telecom, Ariana, DABM/DABS, and FLGE.	December 31, 2008	
MOF will conclude a comprehensive agreement with the DABM on a medium-term plan to reduce subsidies.	December 31, 2008	
Sixth Review Under the PRGF Arrangement (TMU ¶2 Section C)		
Structural Performance Criterion	**Target Dates**	**Status**
Reduce to 20 percent the 40 percent tariff rate on soft drinks established by Presidential Decree Nr. 96. 2/	March 31, 2009	
Structural Benchmarks	**Target Dates**	**Status**
Withdraw trader concessions on filing and paying taxes.	March 21, 2009	
Start collecting BRT on imports.	March 21, 2009	
MOF will collect at least Af 79 million on airlines' tax and nontax liabilities due by airlines and outstanding at end-2007/08 and maintain regular collection of BRT and landing right fees throughout 2008/09.	March 31, 2009	
Implement the ASYCUDA Transit and Declaration Processing Module in Nangarhar and Herat, and at Kabul Airport inland clearing depots.	March 31, 2009	

1/ In the Memorandum of Economic and Financial Policies (MEFP) of January 28, 2008, Fund staff and the authorities reached an understanding that this measure would be made a structural performance criterion for the sixth disbursement.

2/ In the Memorandum of Economic and Financial Policies (MEFP) of January 28, 2008, Fund staff and the authorities reached an understanding that this measure would be made a structural performance criterion for the seventh disbursement.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the understandings between the Afghan authorities and Fund staff relating to the monitoring of the Poverty Reduction and Growth Facility (PRGF)-supported program approved by the IMF Executive Board on June 26, 2006. It defines the structural performance criteria and benchmarks (Section I), valuation for purposes of monitoring the quantitative targets under the program (Section II), quantitative performance criteria and indicative targets (Section III); and adjustors (Section IV). It also sets out data reporting requirements (Section V).

I. STRUCTURAL PERFORMANCE CRITERIA AND BENCHMARKS

2. Prior actions for the fourth review and structural performance criteria and benchmarks for the fifth and sixth reviews are specified in Table 2 of the Supplementary Memorandum of Economic and Financial Policies (SMEFP) and defined as follows:

A. Fourth Review Under the PRGF Arrangement

Prior actions

- Ministry of Finance (MOF) will issue an instruction for Afghan Customs Department (ACD) to ensure timely updates of reference prices for petroleum products, which will be applied in assessing the amount of applicable duties and taxes collected at the border. The instruction shall provide for the: (i) method to be used in the determination of the reference prices based on a weighted average of CIF prices paid by the importers of the petroleum products over preceding three months; (ii) periodicity of updating the reference prices not to exceed three months; and (iii) the maximum percentage deviation between the reference prices and the relevant import prices not to exceed 10 percent. The formula shall be applied to calculate the reference price for aviation fuel, diesel, petrol, and kerosene. All other petroleum product imports shall be valued at the invoice price.

- Ministry of Finance (MOF) will collect at least Af 79 million on the business receipt tax (BRT) and nontax (landing/parking right fees) liabilities due by airlines and outstanding at end-2007/08. To fulfill the prior action the authorities are required to submit the relevant official revenue forms showing: a) taxpayer; b) amount collected; and c) the period in which the liability accrued (amounts to be collected as a prior action should not include BRT liabilities accrued in the fourth quarter of 2007/08, which are due in the first quarter of 2008/09).

- MOF and the Ministry of Commerce and Industry (MoCI) will sign a memorandum of understanding to clarify customs procedures for fuel products stored at Fuel and Liquid Gas Enterprise (FLGE) depot and storage areas. The memorandum shall state that: (i) customs officials have full and immediate access to any imported consignments of fuel for the purpose of verifying the quantity and quality of fuel; (ii) documentation regarding the imported consignments of fuel must be reported to customs immediately; (iii) imported consignments of fuel stored by FLGE can only be released by the written consent of a customs official once applicable duties and taxes have been paid.

B. Fifth Review Under the PRGF Arrangement

Structural performance criteria

- MOF will submit to parliament the core budget's audited financial statements for 2007/08 An audit report of the core budget financial statements to parliament will be prepared by the Control and Audit Office in accordance with international accounting practices.

- Afghanistan Electricity Company (DABS, former DABM) will submit to MOF DABM's financial statements for 2006/07–2007/08 audited by a reputable international audit firm.

Structural benchmarks

- DAB will produce and publish the Monetary Survey for 2007/08 using a consistent time frame (Solar or Gregorian calendar) for the entire banking system.

- MOF will publicly notify traders of the expiration of exemption from the general income tax regime and inform them that they will be expected to file and pay their tax liabilities for 2008/09 according to the general provisions for corporate income tax payers.

- DAB will develop an action plan to address the gaps in DAB's legal framework based on the weaknesses identified in DAB's self-assessment against the Basle Principles.

- DAB will create an electronic registry of capital notes (CNs). The registry will keep track of secondary market transactions and changes in the ownership of the claim, its residual maturity, and discounted value on a weekly basis.

- MOF will roll out the operations of the Large Taxpayer Office (LTO) to Herat, Jalalabad, and Mazar-e-Sharif.

- Parliament will pass amendments to the income tax legislation that have already been submitted (including the introduction of BRT on imports).

- Ministry of Commerce and Industry (MoCI) will publish an external audit report of FLGE. The audit shall cover FLGE's financial statements for 2007/08 and shall be conducted in accordance with international accounting principles. In addition, the audit shall cover FLGE's headcount and wage bill, and will include a review of FLGE's commercial dealings with the government and other state-owned enterprises. The audit report shall be published on MOCI's external website.

- MOF will conduct a review the fiscal relations between the government and the following state-owned enterprises (SOEs): Afghan Telecom, Ariana, DABS, and FLGE. The review will cover the period from 2005/06 onward and will focus on: (i) payment of bills and service charges by the line ministries; (ii) payment of taxes by these SOEs; (iii) transfers of these SOEs' profits to the Treasury account; and (iv) closure of unauthorized bank accounts. The results of the review showing the status of relations between each SOE and the budget and an action plan for their regularization will be summarized in a report, which shall be submitted to the IMF staff before December 31, 2008.

- MOF will conclude a comprehensive agreement with the DABS (former DABM) on a medium-term plan to reduce subsidies. The plan will be finalized by December 2008 for implementation in March 2009 and shall include steps to reduce and gradually eliminate the fuel subsidy. Key components of the plan would include: (i) operational and financial independence for DABS from the MoEW; (ii) measurable benchmarks on DABM's restructuring process; (iii) an agreement on the optimal use of existing and new generation capacity; (iv) tariff increases for premium power users as the electricity supply improves; (v) targets for improved collection from government ministries and agencies (could include centralized debits from ministry and agency budget allocations if arrears are built up); (vi) a schedule of tax payments to the Ministry of Finance; and (vii) a plan for scheduled load shedding for residential customers.

C. Sixth Review Under the PRGF Arrangement

Structural Performance Criterion

- Presidential Decree No. 96 will be amended to reduce to 20 percent the 40 percent tariff rate on soft drinks.

Structural benchmarks

- MOF will withdraw trader concessions on filing and paying taxes. Clarification: By March 21, 2009, the current agreement, whereby traders do not have to file any tax returns if they have paid the 2 percent fixed tax on imports in lieu of income tax, will cease. Registration with the tax authorities for BRT and income tax will be determined by the relevant thresholds as set out in legislation.

- MOF (Customs Department) will start collecting BRT on imports by March 21, 2009. Clarification: The BRT collected on imports (2 percent) shall be in addition to the existing 2 percent advance payment of income tax.

- MOF (Revenue Department) will collect Af 79 million on airlines' outstanding tax and nontax 2007/08 liabilities to be collected in 2008/09 (in addition to Af 79 million to be collected as a prior action for the fourth review; altogether no less than Af 158 million) and be current with all airline tax and nontax payments by the end of the fiscal year 2008/09.

- MOF (Customs Department) will implement the ASYCUDA Transit and Declaration Processing Module in Nangarhar, Herat, and at Kabul Airport inland clearing depots.

II. Program Exchange Rates and Gold Valuation

3. Program exchange rates will be used for purposes of monitoring the quantitative targets under the program. All foreign assets and liabilities denominated in U.S. dollars will be converted into Afghanis using a program exchange rate of 49.52 Afghanis per U.S. dollar, which corresponds to the average of the Af/US$ buy and sell cash rates, as reported by DAB as of March 19, 2008. For assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar, they will be converted into U.S. dollars at their respective exchange rates prevailing as of March 19, 2008, as reported in the following table. Gold holdings will be valued at US$943.65 per ounce, the price as of March 19, 2008.

1.

Exchange Rate	Program Rate
U.S. dollar/Canadian dollar	0.988240
U.S. dollar/U.A.E. dirham	0.272290
U.S. dollar/Egyptian pound	0.182000
U.S. dollar/Euro	1.564250
U.S. dollar/Hong Kong dollar	0.128614
U.S. dollar/Indian rupee	0.024780
U.S. dollar/Pakistani rupee	0.015907
U.S. dollar/Polish zloty	0.441794
U.S. dollar/Iranian rial	0.000111
U.S. dollar/Saudi rial	0.266840
U.S. dollar/Russian ruble	0.042340
U.S. dollar/Swiss franc	1.002810
U.S. dollar/United Kingdom pound	1.985350
U.S. dollar/SDR	1.630000

III. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS

4. The quantitative performance criteria (for September 21, 2008 and March 20, 2009) and indicative targets specified in Table 1 of the SMEFP are: a floor on fiscal revenue of the central government;

- a ceiling on currency in circulation (CiC);
- a ceiling on the net central bank financing (NCBF) of the central government;
- a floor on net international reserves (NIR);
- a zero ceiling on contracting and/or guaranteeing new medium- and long-term nonconcessional external debt by the government and DAB (continuous);
- a zero ceiling on short-term external debt owed or guaranteed by the government or DAB (continuous);
- a zero ceiling on the accumulation of external payment arrears, excluding interest on preexisting arrears (continuous);
- a zero ceiling on lending from state-owned banks to, or government guaranteed borrowing by, state-owned enterprises in need of restructuring (continuous);
- a ceiling for the operating budget deficit of the central government, excluding grants (indicative target); and
- a ceiling on reserve money (indicative target).

A. Currency in Circulation

5. **Currency in circulation** is defined as total currency issued by DAB. It excludes currency held in the presidential palace vault, in DAB main vault, and in the vaults of all DAB's provincial and district branches.

B. Net Central Bank Financing of the Government

6. **NCBF of the government** is defined as the difference between the central bank's claims on the government and the deposits of the government with DAB. These deposits include the deposits held at DAB headquarters, but exclude the deposits held at DAB's branches.[1]

[1] This definition differs slightly from international standards owing to the unavailability of reliable and timely government deposit data from DAB's branches.

C. Net International Reserves

7. **Net international reserves (NIR)** are defined as reserve assets minus reserve liabilities of DAB.

8. **Reserve assets of DAB**, as defined in the fifth edition of the balance of payments manual (BPM5), are claims on nonresidents denominated in foreign convertible currencies, that are controlled by DAB, and are readily and unconditionally available for DAB to meet balance of payments financing needs, intervention in exchange markets, and other purposes. They include DAB holdings of monetary gold, SDRs, Afghanistan's reserve position in the IMF, foreign currency cash (including foreign exchange banknotes in the vaults of DAB, but excluding cash held in DAB's branches), and deposits abroad (including balances on accounts maintained with overseas correspondent banks). Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered;[2] claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

9. **Reserve liabilities** are defined as short-term (original maturity) foreign exchange liabilities of DAB to nonresidents (held at DAB headquarters); all credit outstanding from the IMF; foreign currency reserves of commercial banks held at DAB headquarters; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies.

10. Reserve assets and reserve liabilities will both be expressed in U.S. dollars.

D. Revenues of the Central Government

11. **Revenues of the central government** are defined in line with the Government Financial Statistics Manual (GFSM 2001) on a cash accounting basis, excluding foreign grants. Revenue is an increase in net worth of the central government (including its units in the provinces and agencies) resulting from a transaction. Revenues of the central government include taxes and other compulsory transfers imposed by central government units, property income derived from the ownership of assets, sales of goods and services, social contributions, interest, fines, penalties and forfeits and voluntary transfers received from nongovernment other than grants. The definition for program monitoring excludes grants and

[2] In particular, assets that are counterpart of the government's foreign currency deposits that back letters of credit are excluded from the reserve assets. However, assets that are counterpart of other government deposits are included in the reserve assets.

2. other noncompulsory contributions received from foreign governments and international organizations; such transfers between central government units would be eliminated in the consolidation of the fiscal reports and not recorded as revenue. Receipts collected by central government on behalf of noncentral government units should not be counted as revenue (e.g., Red Crescent fees). Receipts from the sale of nonfinancial assets, such as privatization, and transactions in financial assets and liabilities, such as borrowing but excepting interest payments, are also excluded from the definition of revenue.

12. Revenues should be recognized on a cash basis and flows should be recorded when cash is received. The official AFMIS reports will be used as the basis for program monitoring. Exceptional advanced payments will be treated as if received on the normal due date. All revenue must be supported by the relevant documentation and revenue receivables, where a cash sum has been recorded but the revenue item has not yet been accounted for, and revenues payable, where the revenue has been reported but the cash has yet to be recorded should be separately reported on a gross basis.

E. External Debt and Arrears

13. As set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-00/85; August 24, 2000), the term "debt" will be understood to mean a current (i.e., not contingent) liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract.

- Debts can take a number of forms, the primary ones being: (a) loans, (i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future—including deposits, bonds, debentures, commercial loans and buyers' credits—and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (b) suppliers' credits (i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided); and (c) leases (i.e., arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property). Excluded from this limit are leases of real property by Afghan embassies or other foreign representations of the government.

- For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property. Arrears, penalties, and judicially-awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

14. **The ceiling on medium- and long-term external debt applies on a continuous basis to the contracting or guaranteeing by the government or DAB of new nonconcessional external debt with an original maturity of more than one year**. For program purposes, "government" includes the central government (including government departments), as well as official agencies that do not seek profit and whose budgets are issued independent of the annual operational or development budgets. Consistent with the PFEM law, the Ministry of Finance (MOF) should have sole responsibility for the contracting and guaranteeing of external debt on behalf of the government.

- **It applies to** both debt as defined in paragraph 13 of this memorandum, and also to commitments contracted or guaranteed for which value has not been received. For the purposes of the program:

    - external debt will be considered to have been contracted at the point the loan agreement or guarantee is signed by the MOF (on behalf of the government) or DAB Governor; and

    - the guarantee of a debt arises from any explicit legal obligation of the government or DAB, or any other agency acting on behalf of the government, to service such a debt in the event of nonpayment by the recipient (involving payments in cash or in kind), or indirectly through any other obligation of the government or DAB to cover a shortfall incurred by the loan recipient.

- **Excluded** from the limits are refinancing credits and rescheduling operations, credits extended by the IMF, and credits on concessional terms defined as those with a grant element of at least 60 percent. The grant element is to be calculated using currency-specific discount rates based on the Organization for Economic Cooperation and Development's Commercial Interest Reference Rates (CIRRs): for maturities of less than 15 years, the grant element will be calculated based on six-month averages of CIRRs; and for maturities longer than 15 years, the grant element will be calculated based on 10 year averages.

- Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

15. **The zero ceiling on short-term external debt** applies on a continuous basis to the stock of short-term external debt owed or guaranteed by the government (as defined in paragraph 14 of this memorandum) or DAB, with an original maturity of up to and including one year.

- **It applies to** debt as defined in paragraph 13 of this memorandum.
- **Excluded** from the limit are rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits.
- Debt falling within the limit shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective.

16. A continuous performance criterion applies to the **nonaccumulation of new external payments arrears** on external debt contracted or guaranteed by the central government or DAB. External payment arrears consist of external debt service obligations (principal and interest) falling due after March 20, 2006 and that have not been paid at the time they are due, as specified in the contractual agreements. **Excluded** from the prohibition on the accumulation of new arrears are: (a) arrears arising from interest on the stock of arrears outstanding as of March 20, 2006; and (b) external arrears that are subject to debt rescheduling agreements or negotiations.

F. Lending to, or Guaranteeing Borrowing by, State-Owned Enterprises

17. **The zero ceiling on new lending from state-owned banks to, or government guaranteed borrowing by, enterprises in need of restructuring applies on a continuous basis**.

- For the purposes of this performance criterion:
  - "state-owned banks" refers to those banks that are wholly or majority owned by the government (as defined in paragraph 14 of this memorandum); including Bank Millie, Bank Pashtany, and Export Promotion Bank;
  - "enterprises in need of restructuring" refers to enterprises that meet any one of the following: (a) enterprises (public or private) that have not had an audited balance sheet in fiscal years 1384 and 1385; (b) public enterprises that have been identified by the MOF for liquidation; (c) public enterprises that do not have Cabinet-approved restructuring plans;
  - "public enterprises" refers to enterprises wholly or majority owned by the government, including those covered by the State-Owned Enterprise

(Tassady) Law, and 13 state-owned corporations[3] and any other public entities and government agencies engaged in commercial activities but not covered by Tassady Law.

- **It applies to** any new loans (or financial contributions) extended directly from state-owned banks to enterprises in need of restructuring, and also to any new government guarantees (as defined in paragraph 14 of this memorandum) of borrowing undertaken by these enterprises. It applies to loan agreements and guarantees for which value has not been received.

G. Operating Budget Deficit of the Central Government, Excluding Grants (Indicative Target)

3. Revenues of the Central Government as defined above (¶11) minus operating budget expenditure recorded in AFMIS.

H. Reserve Money (Indicative Target)

4. **Reserve money** is defined to include CiC and Afghani-denominated commercial bank deposits with DAB, including balances maintained by the commercial banks in DAB's overnight facility.

IV. Adjustors

18. The floor on NIR and the ceiling on the NCBF of the government are defined consistent with the assumption that core budget development spending in 2008/09 will amount, on a cumulative basis from March 19, 2008, to:

June 20, 2008	Af 7,038 million
September 21, 2008	Af 21,114 million
December 20, 2008	Af 35,190 million
March 20, 2009	Af 56,304 million

5. Should core budget development spending exceed these projections, the NIR floor will be adjusted downward and the NCBF ceiling will be adjusted upward by the difference between the actual level (up to the appropriated amount) and the projected level of development spending.

[3] Afsotar, Afghan Teor, Aftento, Af-Turk, Afghan Cart, Afghan Naichi, Astrass, Afghan Telecom, Afghan Wireless, Afghan National Insurance Company, Afghan Textile, Ariana Afghan Airlines, and Hotel Intercontinental (Baghi Bala/Kabul).

19. The NIR floor and NCBF ceiling are defined consistent with the assumption that the external financing of the core budget and the receipts from the sale or transfer of nonfinancial assets will amount, on a cumulative basis from March 19, 2008, to:

June 20, 2008	Af 10,098 million
September 21, 2008	Af 26,765 million
December 20, 2008	Af 53,335 million
March 20, 2009	Af 76,572 million

6. Should external financing of the core budget (including that associated with off-budgetary spending coming on budget) and the receipts from the sale or transfer of nonfinancial assets collectively exceed (fall short of) these projections, the NIR floor will be adjusted upward (downward) and the NCBF ceiling will be adjusted downward (upward) by the difference between their actual level and the projected level.

20. Should some expenditure currently financed directly by donors outside the budget be moved on to the operating budget, the NIR floor will be adjusted downward, and the NCBF ceiling and the indicative targets (ceilings) for the operating budget deficits of the central government, excluding grants, will be adjusted upward, by the actual amount of these expenditures on the conditions that (a) the moving on budget of these expenditures is justified by a statement from donors indicating their decision to stop financing them outside the budget and (b) they are subject to a supplementary appropriation approved by parliament. The overall downward adjustment to the NIR floors will be capped at US$300 million.

21. Should the Ministry of Defense core operating budget exceed Af 12,137 million, the NIR floor will be adjusted downward, and the NCBF ceiling and the indicative target (ceiling) for the operating budget deficit of the central government, excluding grants, will be adjusted upward, conditional on the Afghan National Army (ANA) headcount exceeding the 70,000 troops budgeted for 2008/09. The extent of the adjustment will be contingent on the final 2008/09 ANA force size, with zero adjustment for a force size of 70,000 and Af 1,919 million adjustment for a final force size of 86,000. The adjustment for any force size between 70,000 and 86,000 will be calculated on a prorated basis. The cumulative downward adjustment to the NIR floors at each test date will be capped at US$ 38.4 million. The cumulative upward adjustment to the NCBF ceilings and the indicative targets (ceilings) for the operating budget deficits of the central government, excluding grants, at each test date, will be capped at Afs 1.9 billion.

V. Provision of Information to Fund Staff

22. To facilitate the monitoring of program implementation, the government of Afghanistan and DAB will provide to Division A of the Middle East and Central Asia Department (MCD), through the office of the Resident Representative of the IMF in Afghanistan, the information specified below and summarized in the list of reporting tables provided by Fund staff to the Technical Committee.

23. In order to facilitate regular monitoring of the PRGF-supported program, actual outcomes should be provided with the frequencies and lags indicated below.

- **DAB net international reserves** should be reported weekly, no later than two weeks after the end of the week.

- **Monetary statistics, including exchange rates, government accounts with DAB, currency in circulation, reserve money, and a monetary survey** should be reported monthly and no later than three weeks after the end of the month. The monetary survey will include the balance sheet of DAB and a consolidated balance sheet of the commercial banking sector.

- **Core budget operations and their financing** should be reported monthly and no later than four weeks after the end of the month. The official reports for the purpose of program monitoring will be the monthly financial statements from the Afghanistan Financial Management Information System. The structure of financing (grants and loans should be separately identified) and expenditure data should be on a consistent cash basis. Core operating expenditures should be reported on a monthly basis using the budget appropriation economic (object) and administrative classification in addition to the program and functional classification as reported in the budget documents. Core development expenditures should also be reported separately on a monthly basis using the budget program classification in addition to the economic (object), administrative and functional classification consistent with the operating budget. All the data should also compare outturns against the approved budget (or figures reported in the budget documents). Core operating and development revenues and expenditures should also be reported by province, separately on the same monthly basis.

- **External budget operations and their financing** (i.e., donor funded spending outside the core budget treasury systems) should be reported at least semi-annually (more frequently if possible) and no later than eight weeks after the end of the period. External development expenditures should be reported on a disbursement basis (as currently defined in budget documents) using the budget program classification (and an administrative, functional and provincial classification where possible).

- **External debt data** should be reported quarterly and no later than six weeks after the end of the quarter. They will include: (a) details of new loans contracted or guaranteed during the quarter, including the terms of each new loan; (b) the stock of debt at the end the quarter, including short-term debt, and medium- and long-term debt; (c) loan disbursements and debt service payments (interest and amortization) during the quarter; (d) debt relief received during the quarter; (e) information on all overdue payments on short-term debt, and on medium- and long-term debt, including new external arrears (if any); and (f) total outstanding amount of arrears.

- **National accounts data**, with the exception of merchandise trade data, should be reported annually and no later than eight weeks after the end of the year. Merchandise trade data should be reported quarterly and no later than eight weeks after the end of the quarter.

- **Consumer price indexes (CPIs)** for the city of Kabul and for Kabul and five other major cities ("national" CPI) should be reported monthly and no later than four weeks after the end of the month.

24. The government of Afghanistan and DAB will prepare and send to the IMF reports explaining progress made in implementing structural reforms, in particular regarding those included as structural performance criteria and benchmarks in the program. These reports will include appropriate documentation to substantiate progress achieved, and will explain any deviations relative to the initial reform plans or timetable, specifying expected revised completion date.

25. Other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent document) will be sent in a timely manner to IMF staff, for consultation or information.

26. The Technical Committee of Coordination (TCC) will provide Division A of MCD with any other information that may be required by the staff of the IMF for the effective monitoring of the program. For program monitoring purposes, working meetings are planned, at least biweekly, with the participation of representatives of the designated members of the TCC, including any party that could facilitate monitoring implementation of the program.