International Monetary Fund

Central African Republic and the IMF

Press Release:
IMF Executive Board Completes Third Review Under the PRGF Arrangement for the Central African Republic and Approves US$9.1 Million Disbursement
December 22, 2008

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

December 4, 2008

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

LETTER OF INTENT

Bangui, December 4, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, DC, 20431
USA

Mr. Strauss-Kahn:

1. The government of the Central African Republic has successfully implemented the measures contained in the economic and financial program with the support of the International Monetary Fund through its Poverty Reduction and Growth Facility (PRGF).

2. The attached memorandum of economic and financial policies (MEFP) supplements previous memoranda attached to the letters dated November 30, 2006, September 7, 2007, and June 3, 2008. The latter sets quantitative and structural performance criteria for end-June 2008 for completion of the third review (fourth disbursement) of the PRGF arrangement.

3. The quantitative performance criteria for the completion of the third review under the PRGF arrangement were observed except for the ceiling on the accumulation of external payments arrears and the ceiling on net credit from commercial banks. For the ceiling on the accumulation of external payments arrears we request a waiver because the deviations were temporary and for the ceiling on net credit from commercial banks we request a waiver because the deviation was minor. We also request a waiver for implementing the structural performance criterion on publishing a strategy for the repayment of arrears with a delay of two months and a waiver for the temporary deviation in the application of the automatic petroleum price formula. On the basis of our overall performance and on the strength of the policies set forth in the attached memorandum, we request completion of the third PRGF review and disbursement of the fourth loan in the amount of SDR 5.885 million, including SDR 2.785 million from the augmentation of access of June 2008. We also request disbursement of interim HIPC assistance in the amount of SDR 3.119 million, which will be used to cover about 96 percent of PRGF principal payment obligations due during January through December 2009.

4. The government believes that the policies set forth in the attached MEFP will enable it to meet its program objectives but is ready to take any other measures that might be necessary. The Central African Republic will, in accordance with Fund policy, consult with the Fund on adoption of any measures that may be appropriate and before revising the

policies set out in the attached MEFP. The fourth review of the PRGF arrangement is expected to be completed no later than the end of June 2009.

5. The government intends to make the contents of this letter, the attached MEFP, the Technical Memorandum of Understanding (TMU), and the related staff report available to the public. Therefore, it authorizes the IMF to post these documents on its web site once the Executive Board concludes the review.

6. The government implemented one prior action before Executive Board consideration of our request for completion of the third review of the PRGF-supported program. The prior action was the presentation to parliament of a draft budget for 2009 in line with the program as defined in the TMU.

Sincerely yours,

________/s/________

Prof. Faustin Archange Touadéra
Prime Minister

Attachments: - Memorandum of Economic and Financial Policies
- Technical Memorandum of Understanding

Attachment I

CENTRAL AFRICAN REPUBLIC

Memorandum of Economic and Financial Policies, 2008–09

December 4, 2008

I. INTRODUCTION

1. Since the Government of the Central African Republic (C.A.R.) began implementing its medium-term macroeconomic and financial program in late 2006 with Fund support, economic conditions have improved noticeably, and the nation's living standards have started rising after a long period of decline. However, new problems are posing renewed challenges. Global food price hikes and fuel price volatility could undermine growth and compromise achievement of the Millennium Development Goals. In addition, the global financial crisis could have an impact on the demand for our exports. Moreover, a recent breakdown at our main hydro power plant caused very serious power outages that need to be resolved quickly in order to avoid significant negative economic and social impact.

2. Our economic and financial policies continue to be guided by the Poverty Reduction Strategy Paper (PRSP) that the government adopted on June 30, 2007, after extensive consultations with major stakeholders. With the support of the international community we have made significant progress in restoring debt sustainability. Following the agreement in April 2007 with Paris Club creditors to reschedule debt on highly favorable terms, the C.A.R. in September 2007 reached the decision point for the enhanced Heavily Indebted Poor Countries (HIPC) Initiative. With steadfast implementation of macroeconomic policies and structural reforms, we hope to reach the completion point soon.

3. Implementing our poverty reduction strategy will require not only firm economic management but also extensive financial and technical assistance from the international community. The mid-term review of the October 2007 Brussels donor conference that took place in Bangui in June 2008 made it apparent that the promised aid commitments are not only slow to materialize but also not sufficient to satisfy our vast development needs, which have become more pressing as recent difficulties start posing additional threats to our medium-term goals. We still hope, though, that well-designed policies and forceful program implementation will help us attract a substantial increase in aid in the years ahead. We will therefore continue implementing our poverty reduction strategy in close collaboration with our development partners.

II. RECENT ECONOMIC PERFORMANCE AND POLICIES

A. Macroeconomic Performance

4. The government is confident that our medium-term economic and financial program is bringing about economic recovery. In spite of the lack of regular electricity supply over the

past few months, a slow down in our main exports and some loss of purchasing power from increased inflation, we still expect GDP growth to be 3½ percent in 2008 compared to 4.9 percent expected previously. Inflation has turned out to be higher than expected, mostly because of food price developments, which caused a price jump of 10.3 percent on a year-on-year basis in August 2008. This together with domestic fuel price increases will likely imply an increase in average inflation from 1 percent in 2007 to almost 9 percent in 2008.

5. Fiscal performance through June was encouraging considering the recent electricity crisis. Total domestic revenue met the target though customs revenues were affected negatively by personnel changes in April 2008. We also maintained tight control on cash expenditures and thus the performance criterion (PC) on the domestic primary balance was met. The PC for the net claims of the commercial banking system on the government for January–June 2008, which is adjusted on account of grant shortfalls, was missed by a small amount because of a delay by the BEAC in depositing the June IMF disbursement. Moreover, we were able to channel resources to priority expenditure areas, notably in health and education, where spending reached the related quantitative benchmark. However, temporary arrears were accumulated with the African Development Bank (AfDB)) and the Arab Bank for Economic Development in Africa (BADEA), thus breaching the continuous performance criterion on external arrears. Due to cash constraints we were unable to meet the quantitative target on arrears repayment of CFAF 5 billion, but we reduced them by CFAF 3.6 billion.

B. Progress in Structural Reforms

6. The government has recently implemented a number of important structural reform measures. On June 1, we adopted an automatic quarterly petroleum product pricing formula that ensures full pass-through to the consumer of all costs, distribution margins, and taxes, including VAT at the regular rate. The specific excise included in the price of gasoline thus became positive. In view of the dramatic decline in international oil prices, we were not able to raise prices by 10 percent on average on October 1, as required by the formula, because it would have risked potentially serious adverse social reactions. However, excises for December are now higher than originally programmed and we have eliminated subsidies on diesel fuel and heavy fuel oil. Subsidies on kerosene were reduced substantially and will be eliminated during 2009. We therefore request a waiver for this continuous structural performance criterion because the deviation was temporary. In order to ensure future adherence to our policy of passing through changes in international prices to consumers, in November 2008, we issued the formula that defines the minimum petroleum product prices as a ministerial instruction (arrêté). In addition, we have already published the retail prices for January 2009, which are consistent with the projections for minimum excises. Should international prices rise by the end of December we will ensure that the retail prices remain in conformity with the formula. Implementation of these policies required a continuation of our public communication and consultation strategy in order to avoid social unrest. We stressed that subsidies on petroleum products are not pro-poor and that additional revenues are needed to increase priority expenditures including to deal effectively with the electricity crisis. At the same time, measures were taken to mitigate the impact on vulnerable groups,

including reduced VAT rates on basic necessities and the extension of school feeding programs, with the help of the World Bank and the World Food Program.

7. Actions were taken to strengthen revenue administration and expenditure management. The government revoked its contract with Unitec Benin and staffed the *Guichet Unique* in Douala with customs personnel to improve customs administration over the medium term. Although this measure temporarily affected customs performance, we are confident that custom revenues will improve in the second half of 2008. Despite efforts to improve tax collection enforcement, our stock of tax arrears increased mostly due to the nonpayment of taxes by public enterprises, and we did not meet the related quantitative benchmark. To improve effectiveness of tax administration and deter corruption, a taxpayer service desk "*bureau d'accueil des usagers*" was established. Furthermore, after a short delay related to extensive consultation with stakeholders, the government set up a liquidity committee for aligning government cash flows with expenditure commitments (structural benchmark for end-June) in preparation for our new financing strategy based on accessing the regional financial markets. The electricity crisis and the consequent disruption to the water supply, however, have prevented us from adjusting utility tariffs (structural benchmark for end-June) for electricity and water, but we remain committed to the objectives of this important measure as described below.

III. THE PROGRAM FOR 2008–09

8. The government plans to address the current energy crisis while still adhering to the medium-term objectives and policy framework of this three-year economic and financial program. Building on our recent achievements, the government will reinforce the program in 2008-09 by preserving a prudent fiscal stance, reducing arrears, continuing reform of the petroleum sector, and addressing the financial weakness of state-owned enterprises (SOEs).

A. Fiscal Policy for the Second Half of 2008

9. We believe that we can exceed the revenue target for 2008 of CFAF 92 billion (10.5 percent of GDP) by almost CFAF 2 billion, mostly on account of strong consumption tax revenues. Moreover, we have intensified and will continue to intensify our revenue mobilization efforts through the following measures:

- Establish an audit department to improve audit operations by end-2008, including by setting up an audit program, and the evaluation of auditors.
- Review on a quarterly basis the performance of the private import and export fraud detection company, SODIF, and ensure due process in its assessment of penalties.
- Strengthened collection enforcement by seizing property and enforcing third-party guarantees in order to achieve the quantitative benchmark on no net accumulation of tax arrears. At the same time, we recognize that professional behavior of all government officials is crucial for maintaining tax compliance, and we have instructed the financial control unit (CEMIFI) to ensure due process in all of its activities.

- In consultation with Fund technical experts, we determined that raising the harmonized threshold for VAT and the large taxpayer category to CFAF 50 million would not yield a sufficiently large number of large taxpayers, we decided to keep the VAT threshold at CFAF 30 million annual turnover for all taxpayers. We will therefore issue a ministerial instruction to align the large taxpayer threshold with the VAT threshold at CFAF 30 million (using turnover only). Taxpayers would thus be separated into large taxpayers subject to the regular taxation system, medium taxpayers subject to simplified taxation, and small taxpayers subject to presumptive taxation. In addition, to satisfy the related structural benchmark, in the 2009 budget law we will clarify that turnover is the only criterion for VAT registration, which also applies to physical persons and is independent of the economic activity of the taxpayer.
- In view of the changes being introduced to the taxpayer segmentation, we will only be able to achieve our audit targets for the large taxpayers and not yet for medium taxpayers (structural benchmark), but we intend to achieve the target over the medium term.
- We are firmly committed to maintaining the collection function at the Tax Department. To this effect, we will amend by end-2008 article 62 of decree No. 7-093 dated July 12, 2007 on public accounting to avoid the reintroduction of the “enrôlement” procedure for taxes and the collection of taxes by the Treasury.

10. Emergency operations to address the energy crisis had to be accommodated within the fiscal framework. The immediate cost in 2008 is about CFAF 1.7 billion (0.2 percent of GDP) related to the repayment of some government arrears to the company and the government assumption of domestic commercial bank debts of the electricity company ENERCA. In addition, the government assumed commercial bank debts of the cotton company, SOCOCA (CFAF 2.7 billion), and the liquidated bank, UBAC (CFAF 1.3 billion) as a first step in public enterprise reform. The combined effect of increased revenues and expenditures will lower the domestic primary surplus for 2008 by 0.3 percent of GDP to zero for the year as a whole.

B. Outlook and Policies for 2009

11. In 2009, we expect an improvement relative to the broad macroeconomic trends of 2008 with the economy growing at about 4½ percent and some moderation of average inflation to about 6 percent. Project grants and foreign direct investment—particularly in the forestry and mining sectors—are expected to increase substantially, which would lead to a strengthening of the overall balance of payments position despite an increase in the current account deficit. We will continue our prudent fiscal policies as outlined below.

The 2009 Budget

12. Our priorities for the 2009 budget are to (i) continue raising the domestic revenue-to-GDP ratio; (ii) broaden budget coverage by fully incorporating government consumption of utilities and integrating extrabudgetary activities; (iii) implement the new financing strategy;

and (iv) continue paying domestic arrears as described in the strategy adopted in December 2008. The presentation to parliament of a draft budget for 2009 in line with the program is a prior action (see TMU for details).

13. Domestic revenues should rise by 0.7 percentage points to 11.3 percent of GDP on account of fuel taxes, VAT law changes, and revenue administration improvements. Thanks to the full-year effects of petroleum excise increases during 2008 and further moderate increases planned for 2009, gross petroleum revenues should increase by CFAF 12 billion (1.2 percent of GDP) relative to 2008. In addition, petroleum revenues (and their associated expenditures) increase by CFAF 2 billion by bringing on budget previously extrabudgetary taxes. As a result, total net fuel taxes in 2009 would be about CFAF 7 billion in 2009 (0.7 percent of GDP) compared to CFAF 0.8 billion (0.1 percent of GDP) in 2008. Administrative measures in the area of customs, VAT registration, and auditing should further enhance revenue (see below). However, some one-time additions to nontax revenues will not recur in 2009, which will lower these revenues by ¼ percentage point of GDP. We will work to ensure that taxes are collected efficiently and there is no new net accumulation of tax arrears (quantitative benchmark).

14. Domestic current primary spending would increase by 0.8 percentage points of GDP after taking into account ½ percent of GDP savings in fuel subsidies. These resources would be used primarily to fully provide for government electricity, water, and telecommunications consumption and to accommodate some of the repair work prompted by the energy crisis. So far, the government has only paid for part of its utility consumption, which led to severe decapitalization of these state-owned enterprises and directly contributed to the current electricity crisis. The estimated additional cost of fully integrating the utility spending into the budget is about CFAF 2 billion (0.2 percent of GDP) and we are committed to fully paying our commitments in this area (quantitative benchmark). Wages are projected to increase by 6 percent reflecting a small increase in employment in the health and education sectors. This wage increase should be affordable even though we fully integrate utility payments into the budget, provide financing for energy sector reform, and continue paying arrears. We also allocated CFAF 1 billion in additional resources to school feeding programs and other social programs. Finally, we have created room for additional investment in the electricity sector to help address the crisis (see below).

15. The domestic primary balance should reach 0.7 percent of GDP. Together with the envisaged financing in the regional financial markets of about CFAF 30 billion, this would allow us to clear domestic arrears by 1.5 percent of GDP and repay our debt to the commercial banks. We expect the government debt-to-GDP ratio to decline from 76 percent in 2008 to 69 percent in 2009.

Addressing the energy and public enterprise crises

16. Solving the current energy crisis is our highest priority and requires particular attention and resources. Together with the French Development Agency (AFD), we are implementing a project financed by a €4.2 million grant to secure the supply from the Boali I and II hydro power plants. We also plan to rehabilitate the thermal power stations in Bangui, improve the distribution of electricity, and improve payment discipline through installation of

meters with the help of a $6.5 million grant from the World Bank. However, the main problem the electricity sector is facing is a lack of supply, which is only about 18 megawatts compared to compressed demand of about 25 megawatts. In principle, it would be relatively inexpensive to add 10 megawatts by installing two turbines in the already prepared infrastructure of Boali II at an estimated cost of about CFAF 10 billion (1 percent of GDP). We have not yet identified donor financing for this project and are actively exploring our options; however, we have provided the necessary room in the budget for this project under externally financed capital spending.

17. Reducing the quasi-fiscal deficits of the public utility companies has become critical to the success of our program, and we are determined to work to improve their financial performance, particularly the electricity company, ENERCA. Currently, the combined collection ratio (cash collections divided by amount billed) for the three major utility companies (electricity, water, and telecommunications) is about 66 percent. We are targeting an increase in the combined collection ratio of 15 percentage points during 2009 (quantitative benchmark). The full payment of utility bills by the government will help achieve this improvement. Moreover, we will not install any new electricity or water connections without a meter and will accelerate installation of meters for existing customers. The large stock of utility arrears of the government and tax arrears by the public utility companies reflect severe past financial problems. In 2009, the government will repay part of its remaining arrears to ENERCA (about CFAF 1 billion), SODECA (about CFAF 3 billion), and SOCATEL (almost CFAF 12 billion) as specified in the arrears repayment plan. This will allow them to repay their tax arrears, which are as follows: ENERCA (CFAF 1½ billion), SOCATEL (CFAF 3½ billion), and SODECA (almost CFAF 1 billion).

18. Improving intergovernmental relations between the central government and the municipality of Bangui will also contribute to improving the financial health of the utility companies. The municipality of Bangui has accumulated arrears of almost CFAF 7 billion to ENERCA. At the same time, the central government has arrears to the municipality of Bangui of CFAF 1 billion because in the past it did not always fully transfer the resources that are shared or pay regular transfers. In 2009, the central government will pay a part of its debt to the municipality directly to ENERCA to enable ENERCA to acquire additional meters. Moreover, as in recent years the government will continue to fully transfer any shared revenues and pay the regular transfers to the municipality of Bangui (about CFAF 350 million), thus helping the municipality to become current on its utility payments.

19. We will undertake a tariff study for electricity and water by June 2009, using domestic and, if possible, donor resources, to determine the level of prices that would reflect full long-term cost recovery including investment spending, improved revenue collection, full payment of tax obligations, and substantially reduced technical losses. Based on the results of the study, we will assess the need to change the tariffs for electricity and water, with a view to moving toward long-run cost recovery levels as soon as feasible.

Tax policy and revenue administration reforms

20. Accelerating fiscal structural reforms will also be central to the government reform agenda. In the area of tax policy and revenue administration, we will increase budgetary revenues by the following actions:

- We will start applying VAT on all petroleum products starting in January 2009. To eliminate subsidies on kerosene, we will increase the minimum excise to minus CFAF 16.7 per liter in January (implying a subsidy) and increase it by CFAF 39.9 per liter every quarter thereafter, as specified in the TMU (Table 4). Similarly, we will increase the minimum excise on gasoline to CFAF 242.2 per liter and diesel to CFAF 168.2 per liter in January, as specified in the TMU (Table 4). The gross increase in petroleum-related revenues in 2009, including VAT, is projected at CFAF 12 billion and the net increase is CFAF 6 billion after subtracting savings in fuel subsidies and VAT input credits. Moreover, at the beginning of the next season for importation of fuel by river in mid-2009, we are considering increasing the difference in the margin for importation of petroleum products by river versus by road to provide a greater incentive to import by river, which is much less costly for the budget. We are also working with the World Bank on measures to combat the fraudulent use of subsidized kerosene and other mechanisms to strengthen incentives to import fuel products by river as much as possible.

- In 2009 we will eliminate the lower VAT rate that was introduced in 2008 on building materials (CFAF 0.4 billion). We will ensure the full deductibility of VAT payments for all products and activities (loss of CFAF 1.7 billion) and will improve the payment of VAT refund requests. We will eliminate the 10 percent VAT withholding that was introduced in the 2008 budget law.

- We will unify all tax-related legislation into a single tax code that will be published on the Internet by June 2009 and kept updated thereafter in preparation for comprehensive tax reform. We will ask the Fund's Fiscal Affairs Department for technical assistance in both tax policy and tax administration for 2009.

- We will abolish all toll collection stations on our roads, which only provide CFAF 120 million to the budget, but impose significant economic costs on society. To provide greater resources for road maintenance, we will increase the earmarked road fund tax by CFAF 5 per liter of gasoline and diesel.

- We will continue our policy of auditing 30 percent of large taxpayers, all stop-filers among large taxpayers and all VAT declarations with a credit or zero balance. Moreover, we intend to maintain the stop-filer ratio at below 10 percent by notifying stop filers within seven days.

- We will make better use of cross-checking information by interconnecting the tax administration's SYSTEMIF and customs administration's ASYCUDA++ computer systems by end-June 2009 (structural benchmark). We will also create the category of inactive taxpayers in SYSTEMIF.

Public financial management reforms

21. In the area of budget management and public financial management, it is imperative to increase budget coverage, provide realistic expenditure allocations, improve the tracking of expenditures; and strengthen liquidity management. We intend to ask for Fund technical assistance for implementation of the treasury single account, liquidity planning, and for the general reform of our public financial management system.

- We will include all revenue, expenditure, and financing items of public agencies (notably those related to the petroleum, telecommunications, and electricity regulatory agencies) in the annual budget.
- To better monitor our expenditure developments, we will measure delays in processing expenditure at all stages after commitment. We will ensure that the stock of arrears declines on a net basis during 2009 (quantitative benchmark). For program purposes, new expenditure arrears would be measured as payment orders issued (*ordonnancement*) and not paid after 60 days.
- We have made progress toward establishing a Treasury Single Account (TSA) by closing several accounts at both commercial and central banks. More time is needed to properly implement the TSA, which is now expected to be to be fully operational by end-June 2009 (structural benchmark).
- Starting in January 2009, we will publish monthly reports on the activities, particularly the recommendations of the liquidity committee.
- By March 2009, thanks to the implementation of the new harmonized budgetary and accounting nomenclature and progress in computerization of the expenditure chain, we will also be in a position to produce monthly treasury reports on revenues, expenditures, and cash flows. We will also ensure that treasury and Central Bank data regarding the net treasury position are reconciled every month.
- By end-December 2008, as agreed with the World Bank, we are planning to audit all conventions signed between the government and domestic commercial banks, as a first step toward consolidation and refinancing of our debt with them. Moreover, we will revise these conventions to ensure that commercial banks no longer have control over government resources. Also, all government receipts will be deposited in the main treasury account at the central bank (BEAC) (end-June 2009 structural benchmark).
- By end-June 2009, we will revise the 1988 law and decree on government guarantees, to strengthen our legal framework for issuing government guarantees by requiring that the recipient pays a fee for any such guarantee. In addition, we will clarify that all domestic and external guarantees need to be signed by the Minister of Finance and recorded in the debt statistics (end-June 2009 structural benchmark). These guarantees also need to be included ex-post in the annual budget law.

22. We have established a credible plan to clear domestic arrears to restore confidence in our fiscal management, although with a small delay. The plan, which we have published, includes a summary of all arrears as of end-2007 (although the numbers for 2005–07 are still estimates) and a timetable for payments (September 2008 structural performance criterion). In 2009, we intend to pay CFAF 6 billion in arrears even if we do not have access to the

financial markets. Should we be able to access the financial markets, the repayment could reach CFAF 15 billion. Given the supply constraints in the economy, we have given some priority to repaying suppliers' arrears, in particular those related to utility arrears. We will not securitize any of our arrears and will pay cash only. Over the next 10 years, we have established minimum annual payments of 0.6 percent of GDP and a transparent system of accelerating payments should more financing become available. Effective implementation of our financial strategy would require issuance of government securities in the regional market; we expect this to take place by mid-2009. We have asked the Fund to assist us in this process with technical assistance.

C. Program Monitoring

23. The program will be monitored through biannual reviews of quantitative performance criteria (PCs) for end-2008 and June-2009 (Table 1), and structural PCs and benchmarks for 2008/09 (Table 2). Detailed definition and reporting requirements for all quantitative PCs and structural conditions are contained in the accompanying Technical Memorandum of Understanding (TMU, Attachment II). The government will make available to Fund staff all core data, appropriately reconciled, on a regular and timely basis, as specified in the TMU.

Table I.1. Central African Republic: Quantitative Performance Criteria and Benchmarks under the PRGF Arrangement, September 2008-September 2009

(billions of CFA francs; cumulative from December 31, 2007 for 2008 and from December 31, 2008 for 2009; ceilings, unless otherwise indicated)

	Program Benchmark	Program	Adj. Program	Program Benchmark	Program Performance Criteria	Program Benchmark
		Performance Criteria				
	End-Sep. 2008	End-December 2008		End-Mar. 2009	End-Jun. 2009	End-Sep. 2009
Performance criteria						
Floor on total government revenue [1]	69.0	91.5	92.3	26.0	51.4	78.4
Floor on domestic primary balance [2]	3.0	2.5	-0.7	2.9	4.3	4.1
Change in net claims of the commercial banking system on the government, excluding bonds issued on the regional market	2.7	-12.8	6.8	0.6	-3.8	0.0
New nonconcessional external debt [3 4]	0.0	0.0	0	0	0	0.0
Accumulation of government external payments arrears [4]	0.0	0.0	0	0	0	0.0
Indicative targets						
NPV of external debt	...	350	350	...	...	...
Floor on poverty-related spending [5]	14.0	18.5	18.5	5.0	10.0	15.0
Reduction in domestic payments arrears	8.0	14.0	9.0	0.0	1.0	7.5
Net accumulation of tax arrears	0.0	0.0	1.4	0.0	0.0	0.0
Floor on cash collections of utility companies (in percent)	...	...	...	69.4	73.4	77.4
Floor on government payment of utility bills (in percent)	...	...	...	98.0	98.0	98.0
Memorandum items:						
Projected grants for budget support	11.9	12.1	11.9	2.4	5.7	5.7
Projected bonds issued in the regional market	0.0	20.7	0.0	0.0	0.0	15.5
Of which: held by domestic commercial banks	0.0	0.0	0.0	0.0	0.0	10.5
Maximum adjustor for government net claims on commercial banks in case of grants shortfalls	5.0	5.0	5.0	2.4	5.0	5.0
External financing without project loan disbursement	...	...	5.8	2.0	3.1	5.1

Sources: C.A.R. authorities; and IMF staff estimates.

[1] Domestic revenue, which excludes foreign grants and divestiture receipts (see the Technical Memorandum of Understanding, TMU, for more details).
[2] The domestic primary balance (cash basis) is defined as the difference between government domestic revenue and government total expenditure, less all interest payments and externally-financed capital expenditures.
[3] Contracted or guaranteed by the government (see the TMU).
[4] These performance criteria will be monitored continuously.
[5] Total spending on health and education including wages and salaries and goods and services.

Table I.2. Central African Republic: Structural Conditionality, 2008–09

Measure	Conditionality/ Timeline	Macroeconomic Rationale
PETROLEUM PRICING AND PUBLIC ENTERPRISES		
Continue applying the automatic quarterly petroleum product pricing formula that ensures full pass-through to the consumer of all costs, distribution margins, VAT, and a specific excise by product. The formula includes a timetable for petroleum taxation (MEFP ¶20 and TMU ¶16).	Continuous structural performance criterion	Protect the budget from risks of fluctuating petroleum prices; create room for well-targeted measures to mitigate the social impact of petroleum price changes.
REVENUE ADMINISTRATION AND BUDGET 2009		
Submit to parliament a draft budget for 2009 in line with the program's macroeconomic parameters. Budget to include previously extrabudgetary revenues, full provision of government consumption of utility services, reversal of VAT reductions for cement and galvanized sheets, full deductibility of VAT payments; and elimination of VAT withholding (TMU ¶15).	Prior action	Maintain macroeconomic stability and improve transparency and usefulness of the budget as a tool for macroeconomic management.
Use turnover as the sole criterion for taxpayer classification with a turnover of CFAF 30 million as the minimum threshold for large taxpayers, VAT registration, and the standard tax system (MEFP ¶9).	Structural benchmark/ end-December 2008	Enhance revenue generation potential by focusing on large taxpayers and streamline the structure of VAT, the largest revenue source.
Increase the number of audits in 2008 to cover (i) at least 30 percent of large taxpayers per year; (ii) all stop-filers; and (iii) all filers with VAT credit claims or zero balance returns (MEFP ¶20).	Structural benchmark/ end-December 2008	Enhance revenue generation potential by reducing the scope for tax evasion.
Interconnect the tax administration's SYSTEMIF and customs administration's ASYCUDA++ computer systems (MEFP ¶20).	Structural benchmark/ end-June 2009	Enhance revenue generation potential by reducing the scope for tax evasion.
PUBLIC FINANCIAL MANAGEMENT		
Set up and publish a plan to repay domestic arrears (MEFP ¶22 and TMU ¶17).	Structural PC/ end-September 2008	Reestablish the credibility of the government with respect to the public; reduce debt overhang.
Implement a treasury single account (TSA) (MEFP ¶21).	Structural benchmark/ end-June 2009	Reduce financing costs for the government and increase transparency of government operations..
Revise the 1988 law and decree on government guarantees, to strengthen our legal framework for issuing government guarantees by requiring that the recipient pays a fee for any guarantee,. Clarify that all domestic and external guarantees need to be signed by the Minister of Finance and recorded in the debt statistics (MEFP ¶21).	Structural benchmark/ end-June 2009	Limit contingent liabilities for the budget and provide better incentives for public or private enterprises.
Revise conventions with commercial banks to ensure that they no longer have control over government money. Thus, all government receipts will be deposited in the main treasury account at the central bank (BEAC) (MEFP ¶21).	Structural benchmark/ end-June 2009	Reestablish government control over its finances and increase the transparency of government operations.
DEBT MANAGEMENT		
Fully computerize the debt management unit and enable it to provide debt service projections for various scenarios.	Structural benchmark/ end-December 2008	Increase the reliability of debt forecasts and develop ability to take early corrective actions to maintain medium-term debt sustainability.

Attachment II

CENTRAL AFRICAN REPUBLIC

Technical Memorandum of Understanding

December 4, 2008

1. This Technical Memorandum of Understanding describes the definitions that are intended to clarify the measurement of the quantitative performance criteria and indicators in Table 1 of the Memorandum of Economic and Financial Policies, 2008, attached to the authorities' Letter of Intent. It also specifies the periodicity and deadlines for transmission of data to the staff of the International Monetary Fund (IMF) for program monitoring purposes. Unless otherwise specified, all 2008 quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from December 31, 2007, and all 2009 quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from December 31, 2008.

D. Provision of data to the Fund

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

E. Definitions

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

4. **Government expenditure**, on a cash basis (except for interest payments), is as reported in the TOFE and includes all earmarked spending, treasury operations, the domestic counterpart to foreign-financed projects, and offsetting operations. Poverty-related spending on health and education will be reported from the functional classification of government expenditure. Starting in 2009, detailed government expenditure in the TOFE will be reported on a commitment basis (engagement), and this information would be complimented by the change in the aggregate stock of expenditures committed without payment order (*dépenses engagées non-ordonnancées*), and the change in the aggregate stock of expenditures with payment orders not paid (*dépenses ordonnancées non-payées*), which would be divided into those younger than 60 days and those older than 60 days.

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

- The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the Executive Board of the IMF on August 24, 2000 (Decision No. 12274-00/85, August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received. For purposes of these guidelines, the term "debt" is understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

F. Quantitative Performance Criteria

Government domestic revenue (floor)

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

Domestic primary fiscal balance (floor)

7. The **domestic primary fiscal balance**, on a cash basis, is defined as the difference between **government domestic revenue** and **government expenditure**, excluding all interest payments and externally-financed capital expenditure. Starting in 2009, the domestic primary balance will be measured on a commitment basis (base engagement). The **domestic primary fiscal balance** will be calculated from above the line with the data provided in the TOFE.

Adjuster

8. The floor on the domestic primary fiscal balance will be adjusted downward for any excess in foreign budget support grants relative to program projections.

Change of net claims of the commercial banking system on the government (ceiling)

9. The end-of-period **stock of net claims of the commercial banking system on the government (net of purchases of government securities)** is defined as the difference between deposits held by the government in commercial banks and outstanding loans and overdrafts as reported in the monetary survey minus commercial bank purchases of government securities.

Adjuster

10. The ceiling on the **change of net claims of the commercial banking system on the government (net of purchases of government securities)** will be:

- (i) increased by 100 percent of any cumulative shortfalls in external budget support grants compared to program projections up to the limit specified in Table 1 of the MEFP; and

- (ii) decreased by 57 percent of regional bond issuances (see example in Table 3 attached to this TMU).

- (iii) increased (decreased) by 100 percent of any cumulative excess (shortfall) compared to program projections in external financing (without project loan disbursements).

Nonconcessional external debt or guarantees (ceiling, continuous)

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

12. Loan concessionality is assessed on the basis of the commercial interest reference rates (CIRRs) established by the Organization for Economic Cooperation and Development (OECD). A loan is said to be on concessional terms if, on the date the contract is signed, the

ratio of the present value of the loan, calculated on the basis of the reference interest rates, to its nominal value is less than 65 percent (that is, a grant element of at least 35 percent, which does not apply to refinancing operations). For debts with a maturity exceeding 15 years, the ten-year reference interest rate published by the OECD is used to calculate the grant element. For shorter maturities, the six-month market reference rate is used. To both the 10-year and six-month averages of the reference rate, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–29 years; and 1.25 percent for 30 years or more.

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

External payment arrears (ceiling, continuous)

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

G. Prior action

Submission of the 2009 budget to Parliament

15. The 2009 budget should:

- (i) be broadly based on the macroeconomic framework described in the Memorandum of Economic and Financial Policies;
- (ii) provide for the full allocation of government consumption of services to be provided during 2009 by the following utility companies: Enerca, Socatel and Sodeca;
- (iii) include in the regular budget all expenditure, revenues and financing of the following regulatory agencies: *Agence de Stabilisation et Régulation des Produits Pétroliers* (ASRP); *Agence de Régulation de Télécommunication* (ART); *Agence Autonome de Régulation du Secteur de l'Électricité en République Centrafricaine* (ARSEC); *Agence Autonome de l'Électrification Rurale de Centrafrique* (ACER);
- (iv) change the VAT law to allow for deductibility of VAT credits for petroleum products;
- (v) eliminate the 10 percent VAT withholding;
- (vi) unify the VAT rate at 19 percent for cement and galvanized steel; and
- (vii) impose VAT at the regular rate for kerosene (*pétrole lampant*) and heavy fuel oil (*fuel 1%*).

H. Structural performance criteria

Automatic petroleum product pricing formula (continuous structural performance criterion)

16. **The automatic petroleum product pricing formula** is designed to ensure full pass-through to the consumer of all costs, distribution margins, a minimum specific excise inclusive of customs duties by product, and VAT at the regular rate.

- The minimum retail price for gasoline (*super*), kerosene (*pétrole lampant*), diesel (*gasoil*), and fuel oil (*fuel 1%*) will be calculated by using the price structure of petroleum products transported by river through the Democratic Republic of Congo by applying the specific excise as shown in Table 4.[1]
- The formula will be calculated at the end of each quarter, using the average f.o.b. price for the previous 90 days for each product (see Table 4) and this retail price will apply for the 3 months of the next quarter.
- The formula adds all costs, distribution margins, a specific excise by product, and VAT. Thus, the minimum retail price will be the sum of (i) the f.o.b. import price, (ii) all costs and margins, (iii) the minimum specific excise, and (iv) VAT, which is applied at the regular rate to the sum of (i)-(iii).
- The minimum specific excise is defined to include the following items (i) *droit de douane*; (ii) *taxe communautaire d'intégration*; (iii) *redevance d'usage routier*; (iv) *redevance équipement informatique finances*; (v) *C.C.I.*; (vi) *constitution du stock de sécurité*; (vii) *financement extension capacités de stockage*; (viii) *péréquation*; (ix) *contrôle et lutte contre la fraude* and (x) negative or positive TUPP as the residual.
- Should one or more actual fuel excises as defined in the preceding bullet fall below the minimum excise specified in Table 4, but the projected excise revenue for all fuel products for the relevant quarter exceeds the program target, then for program purposes, the continuous PC on the automatic adjustment would be considered met.
- VAT for all petroleum products will be applicable to all costs, distribution margins, and the specific excise starting January 1, 2009.
- For petroleum products imported by road (via Cameroon), the same amount of VAT will be charged on gasoline and diesel, and specific excises will be adjusted to yield the same final price as specified above.
- The retail price for each product would remain fixed for the quarter, however, the price structure would be issued on a monthly basis with the excise adjusting as a function of the changes in other costs. The VAT would remain unchanged.

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[1] The specific excises shown in Table 4 after April 2009 are indicative.

Domestic arrears clearance plan (structural performance criterion)

17. A plan to clear domestic arrears consists of (i) a list of all domestic payment arrears validated by audits for the period up to and including the year 2007, and differentiated by type; (ii) a schedule of minimum payments of each type of arrear by payment type to bring down arrears to zero (quarterly until 2010 and annual thereafter); (iii) a detailed description of how payments are prioritized within the plan; and (iii) a precise formula indicating additional payments to be made subject to availability of additional resources.

I. Quantitative benchmarks

Net-present-value of external debt (ceiling)

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

Reduction in domestic payments arrears (floor)

19. The reduction in domestic payment arrears is reported as part of the TOFE. For 2008, **domestic payments arrears** are understood to include those validated by the external audit undertaken during the first part of 2007 which accrued during 1998–2004 and those which pre-date 1998. These domestic payments arrears include wages and salaries and supplier's credits.

20. For 2009, the concept is moved to a net basis, which measures the change in the stock of total arrears during the period. Thus, a repayment of an existing arrear reduces the stock of overall arrears whereas the accumulation of new arrears adds to the stock. For purposes of the program a new arrear is defined on a payment order basis, i.e. as an expenditure for which a payment order has been issued (*dépense ordonnancée)* that has not been paid after 60 days. For 2009, the reduction in domestic payments arrears will be measured as the change in the total stock of arrears as defined in Table 2 of this TMU. The stock of debt at end-2008 is preliminary, because it includes the estimated arrears accumulated during 2005-08. It will be updated as new validated data becomes available, which will not affect the calculation of the net arrears accumulation in 2009.

Adjuster

21. The floor on the reduction in **domestic payments arrears** will be increased by 29 percent of the regional bond issuance (see example in Table 3 attached to this TMU).

Net accumulation of tax arrears (ceiling)

22. The net **accumulation tax arrears** is defined as the difference in the stock of tax arrears (excluding any amount under litigation) during the period plus any write-offs during that period. An example of the calculation is included in Table 5 below (Line 6).

Social spending (floor)

23. **Social spending** comprises spending on the following sectors: education, health, rural development, and social affairs, both spending for the current year and arrears repayment.

Government payment of utility bills (floor, cumulative)

24. The quantitative benchmark applies to utility bills issued by the following public enterprises: Enerca, Socatel and Sodeca and is deemed met when at least 98 percent of the combined utility bills issued by these companies are paid within 60 days of the bill issue date. For example, the benchmark for end-March 2009 would measure the payments on utility bills from January to March 2009 divided by the utility bills issued during November 2008 through January 2009. The benchmark for end-June would measure the payments on utility bills from January to June divided by the utility bills issued during November through April.

Collection ratio of utility companies (floor, cumulative)

25. The target is measured as the cumulative ratio of total period-t cash collections to total bills issued during the period with a two month lag. The target is defined jointly for the following companies: Enerca, Socatel and Sodeca. For example, the target for the first quarter would be the sum of cash collections for the three companies for January-March, 2009, divided by the value of bills issued during November, 2008–January, 2009. The benchmark for end-June would measure the sum of cash collections from January to June divided by the value of bills issued during November through April.

Table 1. Central African Republic: Data Provision Under the PRGF Arrangement

Data description	Reporting lag
Quarterly evaluation report of quantitative and structural measures (particularly regarding structural conditionality, see Table 2 of the MEFP), including supporting documentation	Four weeks after each quarter's end
Monetary survey, central bank and commercial bank accounts on a monthly basis	Four weeks of the end of each month
Table on monthly treasury operations	Four weeks after the end of each quarter
Government budget operations (TOFE)	Four weeks after the end of each month
End-of-period stock of domestic arrears on goods and services and wages, including unpaid pensions and bonuses	Four weeks after the end of each month
End-of-period stock of external arrears	Four weeks after the end of each month
Breakdown of expenditures recorded in the TOFE (goods and services, wages, interest, etc.)	Four weeks after the end of each quarter
Summary report on actual spending in priority sectors, including health, education, and security	Four weeks after the end of each quarter
Breakdown of revenue by institution and economic classification	Four weeks after the end of each quarter
Revenues and expenditures offset against each other without cash payment (by expenditure and revenue type)	Four weeks after the end of each quarter
Breakdown of external debt-service and arrears, including by interest and principal, and by principal creditor	Four weeks after the end of each month
Amount of new nonconcessional and concessional external debt contracted or guaranteed by the government	Four weeks after the end of each month
Actual disbursements of project and program external financial assistance, and external debt relief granted by external creditors (including date, amount, and donor)	Four weeks after the end of each quarter
Stock of tax arrears and amount recovered	Four weeks after the end of each quarter
Indicators to assess overall economic trends, such as the consumer price index, and oil product sales.	Four weeks after the end of each month
Import/export flows (in volume and value), activity in the forestry and mining sector	Four weeks after the end of each quarter
A monthly report on the structure of petroleum prices	One week after the end of each month

Table 2. Central African Republic: Stock of Government Expenditure Arrears
(In billions of CFAF)

		2008	2009 Q1	2009 Q2
1	Total debt	104.7	101.9	98.2
2	Commercial debt			
	Of which: public enterprises			
3	Social debt			
	Of which: salaries			
4.	Financial debt			
	Of which: interest			
5.	Other debt			
	Memorandum item:			
	Debt to Bangui Municipality			

Source: Central African authorities.

Table 3. Central African Republic. Adjusters for Bond Issuance
(Example for end-June 2009)

	Adjustment factors [1]	End-June Unadjusted	Adjustment	End-June Adjusted
		Bond-related variables		
		(Billions of CFAF)		
Bond issuance		0	15.5	15.5
Change in net claims of the commercial banking system on the government, excluding bonds	0.57	-3.8	-8.8	-12.7
Net change in domestic payments arrears	0.29	-1.0	-4.5	-5.5
Change in net credit from BEAC	0.14	-2.2	-2.2	-4.3

Sources: C.A.R. authorities; and IMF staff estimates.
[1] If bonds are issued, the three types of domestic debt increase according to the proportions of adjustment factors.

Table 4. Central African Republic: Minimum Excises, Estimated VAT and Minimum Retail Prices of Petroleum Products, 2008–10

	2008 Oct.	2009 Jan.	2009 Apr.	2009 Jul.	2009 Oct.	2010 Jan.
			(CFAF per liter)			
Fob price (via Kinshasa)[1] (1)						
Gasoline (Super)	351.4	214.6	206.3	212.6	219.0	234.5
Kerosene (Pétrole)	439.8	266.2	255.9	263.8	271.7	290.9
Diesel (Gasoil)	426.6	258.4	248.4	256.1	263.7	282.4
Fuel oil (Fuel 1%)	298.7	181.8	174.8	180.2	185.6	198.7
Distribution margin[1] (2)						
Gasoline (Super)	206.0	194.5	194.1	199.4	199.7	200.4
Kerosene (Pétrole)	204.9	193.3	192.9	198.2	198.5	199.3
Diesel (Gasoil)	212.0	199.9	199.5	204.8	205.1	205.8
Fuel oil (Fuel 1%)	212.2	203.2	202.9	208.1	208.3	208.8
Minimum excises including customs revenues (via Kinshasa)[2] (3)						
Gasoline (Super)	116.2	242.2	249.2	249.2	249.2	257.6
Kerosene (Pétrole)	-177.7	-16.7	23.3	63.2	103.2	143.1
Diesel (Gasoil)	-10.8	168.2	175.2	175.2	175.2	181.1
Fuel oil (Fuel 1%)	-22.9	73.1	73.1	73.1	73.1	75.5
VAT (estimate)[1] (4)						
Gasoline (Super)	73.4	123.7	123.4	125.6	126.9	131.6
Kerosene (Pétrole)	0.0	84.1	89.7	99.8	108.9	120.3
Diesel (Gasoil)	89.2	119.0	118.4	120.9	122.4	127.2
Fuel oil (Fuel 1%)	0.0	87.0	85.6	87.7	88.7	91.8
Minimum retail price (estimate)[1] (5) = (1)+(2)+(3)+(4)						
Gasoline (Super)	780.0	775.0	773.0	786.8	794.8	824.1
Kerosene (Pétrole)	500.0	526.9	561.8	625.0	682.3	753.6
Diesel (Gasoil)	750.0	745.5	741.5	756.9	766.4	796.5
Fuel oil (Fuel 1%)	500.0	545.1	536.4	549.0	555.7	574.9
Memorandum item:						
WEO oil price ($/barrel)	67.0	65.0	67.0	69.0	71.0	75.0

Sources: C.A.R. authorities; and IMF staff estimates.
[1] Estimates based on program projections for fob import prices.
[2] Starting in Q1, 2009, excises also include the following taxes, which were previously off-budget: (i) *Constitution du stock de sécurité, (ii) Financement extension capacités de stockage, (iii) Péréquation, and (iv) Contrôle et lutte contre la fraude.*

Table 5. Central African Republic: Stock of Tax Arrears

		2006	2007	2008 (QB)
		(CFAF billions)		
1	Total stock	15.0	27.2	...
2	Under litigation	1.3	10.6	...
3	Total net of litigation (1-2)	13.7	16.6	...
	Flow items			
4	Change in stocks (3(t)-3(t-1))	...	2.9	...
5	Write-offs	...	0.0	...
6	Total change in tax arrears (4+5)	...	2.9	1.4
7	Recovery	...	3.4	...
8	New arrears (6+7)	...	6.3	...
	Memorandum item:			
	Arrears of public enterprises	2.4	4.4	...

Sources: C.A.R. authorities; and IMF staff estimates.