International Monetary Fund

Islamic Republic of Afghanistan and the IMF

Press Release:
IMF Executive Board Completes Sixth Review under the PRGF Arrangement for the Islamic Republic of Afghanistan
January 13, 2010

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

December 16, 2009

LETTER OF INTENT

Kabul, December 16, 2009

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington DC 20431

Dear Mr. Strauss-Kahn,

The purpose of this letter and the attached Supplementary Memorandum of Economic and Financial Policies is to inform you about the implementation of our economic program supported by the Poverty Reduction and Growth Facility, set out policies for the remainder of the fiscal year 2009/10, and request a waiver for nonobservance of one performance criterion. We also request the seventh disbursement following the completion of the Sixth Review under the arrangement, an extension of the program until June 25, 2010, and a rephasing of the last disbursement. The extension would allow us to implement our structural reform agenda and negotiate a new arrangement with the Fund.

We observed all of the end-June 2009 performance criteria, with the exception of the minimum accumulation of net international reserves. The nonobservance does not reflect a policy slippage since it resulted from an unexpected inflow of allied forces' deposits that raised the end-March stock of reserves and made the actual change in reserves between March and June smaller than targeted (the accumulation target was based on an estimated reserve figure for end-March that did not include these deposits).

Despite a challenging security situation, we implemented all the structural measures envisaged under the Sixth Review and we are determined to strengthen tax and customs administration and set the basis for sustainable increases in revenue collection in the period ahead. In addition, we are pressing ahead with the restructuring of the electricity sector and a financial review of key public enterprises.

We believe that the policies and measures described in this memorandum are adequate to achieve the objectives of the program and stand ready to take additional measures if needed. We will consult with Fund staff on the adoption of such measures and provide Fund staff the information required to assess progress in implementing the program. Lastly, we consent to the publication of the staff report for the Sixth Review under the PRGF arrangement, the Supplementary Memorandum of Economic and Financial Policies, and the Technical Memorandum of Understanding.

Sincerely yours,

/s/	/s/
Omar Zakhilwal	Abdul Qadeer Fitrat
Minister of Finance	Governor, Da Afghanistan Bank

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2009/10

October 30, 2009

1. This supplementary memorandum documents the implementation through September of the 2009/10 economic program supported by the PRGF and the policy commitments for the remainder of the extended program, including the proposed quantitative targets and structural benchmarks for the Seventh Review (Tables 1 and 2).

A. Recent Developments and Outlook

2. **Growth**. After a severe drought last year, the agricultural sector is expected to grow by 29 percent in the 2009/10 fiscal year. The pace of economic activity outside agriculture is being sustained by high donor inflows and increased security spending. As a result, we have revised our real GDP growth projection from 9 percent to 15 percent in 2009/10. We have also revised upward our import projections and expect the external current account deficit including grants to be around 4 percent of GDP.

3. **Inflation**. A prudent monetary policy and lower food prices have cut headline inflation from a peak of 43 percent in May 2008 to minus 14 percent in October. Nonfood inflation slid from 12 percent in November 2008 to zero percent in October. We maintain our target for the 12-month rate of inflation not to exceed 6 percent in March 2010.

4. **Fiscal performance**. The overall fiscal balance for the first two quarters of 2009 was better than programmed. In the first half of the fiscal year, we collected more revenues than targeted, reflecting the continuing momentum of the measures we enacted in 2008 and early-2009, including tighter control of fuel imports and introduction of the business receipts tax on imports. However, revenue performance weakened somewhat during August-September 2009 owing to increased political uncertainty and insecurity. In addition, development expenditures have been constrained by security problems, delays associated with the Ministry of Economy's management of development budget allotments, and insufficient discretionary cash balances in early 2009/10. Thanks to renewed efforts in recent months, we have been successful in increasing the execution rate of development spending.

5. **Public enterprises**. We experienced minor delays with two structural measures related to public enterprises but remain committed to move ahead with their implementation. The audit of the state fuel company (FLGE), originally scheduled for completion by end-June, was completed at end-September and the respective reports including the management letter were also published. The initiation of the work on compiling and improving the state electricity company's operating and financial indicators was delayed in part because the transfer of the assets and liabilities of the old state electricity utility (DABM) to the new state electricity company (DABS) was delayed. The transfer, originally planned for June, took place in September, and we will begin publication of the data in December.

6. **Monetary policy**. We have kept currency in circulation within the program limits, but we were unable to observe the end-June quantitative performance criterion on the accumulation of net international reserves. This nonobservance was not a policy slippage as it was caused by a large temporary increase in coalition forces' deposits that raised the end-March stock of reserves and made the actual change in reserves between March and June smaller than targeted (the accumulation target was based on an estimated reserve figure for end-March that did not include these deposits).

7. **Financial sector**. The central bank's supervision department has increased the number of onsite teams and visits, recruited new staff, and separated onsite from offsite supervision. With assistance from World Bank staff, we have initiated the automation of offsite examinations by establishing electronic links to banks, and are upgrading our analytical capacity. We have also established AML/CFT and Islamic banking sections within the central bank and are drafting an Islamic banking law.

8. **Trade policy.** As planned, we have lowered the tariff on soft drinks from 40 percent to 20 percent, effective March 2010. In addition, we are working on simplifying our import tariffs and on becoming a member of the World Trade Organization. We remain committed to an open and transparent trade environment to foster economic activity.

9. **HIPC Completion Point**. We have implemented eight of the eleven HIPC triggers and made substantial efforts to implement the remaining three. We will intensify these efforts in coming weeks, especially on the mining and the pension triggers. We remain committed to further policy reforms in the areas identified by the triggers in close consultation with IMF and World Bank staff.

B. Fiscal Policies

10. **Revenues and fiscal balance**. Based on the good revenue performance during the first half of 2009/10 and our commitment to revenue mobilization and fiscal sustainability, we are raising our domestic revenue target for the year from Af 51 billion to Af 54.5 billion. This will allow the tax-to-GDP ratio to increase from an average of 7.1 percent in the past three years to over 8 percent this year. As part of the midyear budget review, and given the need to increase defense outlays, the operating deficit excluding grants is expected to rise from Af 32.8 billion in the original program to Af 42.5 billion.

11. **Operating expenditures**. Our midyear budget review provides for net additional operating spending of Af 13.2 billion. The increase in the wage bill equals Af 13.5 billion, of

which Af 13.3 billion is security-related.[1] The goods and services category shows a net decline of Af 0.7 billion. This amount reflects an increase of Af 4.9 billion (primarily because of a one-off expenditure of Af 1.5 billion to build up the strategic wheat reserve and an additional Af 2 billion in security) and a reduction of Af 5.7 billion (due to a displacement of Af 5.5 billion in security spending transferred to the external budget, and savings of Af 0.2 billion on other goods and services). In addition, we will maintain a balance of about Af 10 billion for cash management purposes and as a way to reduce the impact of volatile donor assistance and uncertainty in the execution of the development budget. Lastly, we remain committed to cut operating spending should revenues fall short of targets, and not to incur expenditure arrears. Given the need for further increases in security-related spending and in order to ensure long-term fiscal sustainability, we plan to contain nonsecurity recurrent spending in coming years.

12. **Development expenditures**. Despite the deteriorating security in parts of the country, we commit to keep working on improving the execution of development expenditures in the second part of the fiscal year onward. We will work closely with donors to expedite the execution of donor-financed capital expenditures. To this end, the management of development budget allotments was returned from the Ministry of Economy to the Ministry of Finance in July.

13. **Tax administration**. We are implementing with success our short-term revenue action plan. We have also begun successfully collecting income tax from traders who were notified last year, with small taxpayers having a transitional option this year of paying a fee instead. We have established a task force to develop, by February 2010, a strategy to improve the efficiency of the Revenue and Customs Departments. In line with recent technical assistance, the task force will focus on human resources issues, particularly recruiting and firing, budgetary and procurement processes, and organizational issues, including increasing the responsibility and accountability of the Revenue and Customs Departments for their provincial offices. The objective of this reform is to reduce corruption and create a modern national tax administration that is effective, efficient, and fair. This will require the Revenue Department to have increased responsibility and accountability for its provincial offices.

14. **Public financial management**. We are committed to implementing a simple program classification to unify budget presentation in order to improve allocation and management. We are revisiting the existing conceptual framework and program design in order to simplify both the program structure and its associated chart of accounts.

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[1] Military and police. The total increase in security spending, Af 15.8 billion, includes Af 9.8 billion that was already in the budget but contingent on the availability of external financing, as part of our goal to increase the size of the army by 23,000 soldiers this year. Other security-related spending, including the increase in the police force by 14,800, adds up to Af 6 billion.

15. **Public enterprises**. The state electricity company will begin publishing by end-December 2009 four-monthly reports on its financial indicators with the outturn for the first eight months of 2009/10 and forecasts for the coming year. We expect the company to improve operations and reporting after its recent corporatization. In addition, to strengthen oversight of public enterprises, we will shift by end-February 2010 the corresponding directorate from the umbrella of the Administration Department to the Finance Department or the Office of the Minister.

C. Monetary and Financial Policies

16. **Monetary program**. The recent drop in inflation has created room for monetary policy easing and we have adjusted our currency in circulation target accordingly. The revised monetary program also envisages an increase in net international reserves of about $339 million during 2009/10. Afghanistan's share of the SDR allocation, amounting to SDR 129 million, will be used to increase net international reserves. With this buildup, we project that gross international reserves will be about 13 months of imports by end-March 2010. We will continue to closely monitor inflation developments and stand ready to tighten monetary policy should nonfood inflation exceed 5 percent. We will also maintain a managed floating exchange rate policy aimed at preserving our inflation objectives.

17. **Financial sector**. We are committed to improving the efficiency and soundness of banks and their CAMEL ratings. We will be stepping up supervision and monitoring of banks, strengthening actions to enforce collection of bad loans, and sharing with Fund staff information and updates about the implementation of required corrective actions in banks with weak CAMEL ratings. In addition, we will broaden the scope of financial supervisors' examinations to cover banks' information technology risks, disaster recovery plans, and fraud detection capacity. Lastly, we will work closely with Fund staff on AML/CFT issues and on accepting obligations under Article VIII of the Fund's Articles of Agreement.

D. Program Modifications and Monitoring

18. **Modifications.** In light of the revised economic outlook, the midyear budget review, and the understandings documented in this Memorandum and the revised Technical Memorandum of Understanding (TMU), modifications are warranted on the quantitative targets and structural measures (Attachment II, Tables 1 and 2). We are also requesting an extension of the arrangement until June 25, 2010 to facilitate completion of the envisaged structural reforms and allow sufficient time for discussions on a new arrangement supported by the Fund. In this context, we also request a move of the test date for the Seventh Review from December 2009 to March 2010 and a rephasing of the last disbursement. Completion of the Seventh Review is envisaged on or before June 10, 2010.

19. **Monitoring.** The last six months of the program will be monitored through indicative quantitative targets for end-December 2009, quantitative performance criteria for March 2010, and structural measures (Attachment II, Tables 1 and 2). The attached Technical Memorandum

of Understanding (Attachment III) contains definitions of all targets and reporting requirements. The Seventh Review will continue to track progress in the key areas of fiscal sustainability, revenue collection, and risks from public enterprises.

Table 1. Islamic Republic of Afghanistan: Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, December 2009–March 2010 1/
(Cumulative changes from March 20, 2009; unless otherwise indicated)

	Mar. 20, 2009 Stocks	Dec. 21, 2009 Indicative targets	Mar. 20, 2010 Performance criteria
		(In billions of Afghanis)	
Floor on fiscal revenues of the government	…	41.1	54.5
Ceiling on currency in circulation	76.8	14.0	16.9
Ceiling on net central bank financing of the government	-30.7	-5.4	2.0
Indicative target (ceiling) on the operating budget deficit of the government, excluding grants	…	24.4	42.5
Indicative target (ceiling) on reserve money	106.3	3.0	8.4
		(In millions of US dollars)	
Floor on net international reserves of DAB	3,272	316	339
Ceiling on contracting or guaranteeing new medium- and long-term nonconcessional external debt by the government and DAB 2/	…	0.0	0.0
Ceiling on short-term external debt owed or guaranteed by the government or DAB 2/	…	0.0	0.0
New external payments arrears, excluding interest on preexisting arrears 2/	…	0.0	0.0
Ceiling on lending from state-owned banks to public enterprises in need of restructuring or government guaranteeing borrowing by these public enterprises 2/	…	0.0	0.0
		(In billions of Afghanis)	
Memorandum items:			
Operating budget balance of the government, including grants		3.7	-0.7
Reference projections for the adjustors			
Core budget development spending		31.3	51.3
External financing of the core budget and sale or transfers of nonfinancial assets		59.9	91.8
Externally financed expenditures transferred to the core operating budget		0.0	0.0

Source: Fund staff estimates.

1/ The performance criteria and indicative targets envisaged under the program, and their adjustors, are defined in the Technical Memorandum of Understanding (Attachment III).

2/ These performance criteria apply on a continuous basis.

Table 2. Islamic Republic of Afghanistan:
Structural Benchmarks for the Seventh Review under the PRGF Arrangement, October 2009–March 2010 1/

	Target Dates
Begin publication of four-monthly reports and forecasts for financial flows and other key variables for DABM/S.	December 31, 2009
Finalize a comprehensive review of the financial situation of Afghan Telecom, Ariana, DABM, and FLGE and their fiscal relations with the government in terms of tax owed, subsidies (if applicable), and other payables or receivables. The review will include regularization of tax payments and other cross debts and reduction of subsidies (if applicable); closure of unauthorized bank accounts; review of corporate governance procedures; business plans; and plans for divestiture, restructuring, or privatization for these enterprises.	March 30, 2010
Transfer the directorate responsible for monitoring and managing public enterprises in the Ministry of Finance from the Administration Department to the Finance Department or the Office of the Minister.	February 28, 2010
Adopt and implement the business model of border controls clarifying the role of each ministry at the border consistent with internationally accepted best practices in consultation with other stakeholders (Ministry of Commerce and Industry and Ministry of the Interior) for better customs controls at the border.	February 28, 2010
Implement the ASYCUDA transit module along Zaranj-Nimroz axis and declaration processing module at Nimroz.	March 30, 2010

1/ Selected structural measures are specified in the attached Technical Memorandum of Understanding (Attachment III).

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum reflects understandings between the Afghan authorities and Fund staff in relation to the monitoring of the PRGF-supported program until June 2010. It defines selected structural benchmarks (Section I), valuation for monitoring quantitative targets under the program (Section II), quantitative performance criteria and indicative targets (Section III), adjustors (Section IV), and specifies data reporting (Section V).

I. STRUCTURAL BENCHMARKS

2. Structural benchmarks for the Seventh Review are specified in Table 2 of the Supplementary Memorandum of Economic and Financial Policies (SMEFP). The following section elaborates only on those measures that require specification.

3. Seventh Review:

- Da Afghanistan Breshna Moasisa/Sherkat (DABM/S) will begin publishing by end-December 2009 and with a three-month lag, four-monthly (i.e., three times per year) financial flows and other key variables for Kabul and other jurisdictions for the preceding year and forecast for the coming year as specified in the attached template. The first report will comprise (i) March 21–July 20, 2009, (ii) selected variables for 2008/09, and (iii) forecasts for the next three four-month periods. DABM/S will use a detailed template agreed with Fund staff (see Attachment III, Table 1 below), and the variables reported comprise sources of revenues and other receivables, power generation, expenditures, subsidies received, overall and primary balances, technical and nontechnical (theft) losses including own use, collection rates, revenues at 100 percent collection rates, and financing and other payables. Revenues and subsidies will distinguish among cash, credits, other government obligations, and payment of bills on behalf of DABM/S.

- With support from qualified external experts, the Ministry of Finance will finalize by March 30, 2010 a comprehensive review of the financial situation of Afghan Telecom, Ariana, DABM/S, and FLGE and their fiscal relations with the government in terms of tax owed, subsidies (if applicable), and other payables or receivables. The review will include regularization of tax payments and other cross debts and reduction of subsidies (if applicable). Specifically, the review will include (i) payment of bills and service charges by the line ministries; (ii) payment of taxes by these public enterprises; (iii) transfers of these public enterprises' profits to the single Treasury account; (iv) closure of unauthorized bank accounts; (v) review of corporate governance procedures detailing how decisions are made, approved, and reviewed and definition of the roles of external and internal auditors and directors, as well as the status of management information systems; (vi) business plans for these enterprises; and (vii) plans for divestiture, restructuring, or privatization.

- The Ministry of Finance (Customs Department) will adopt and implement the business model of border controls clarifying the role of each ministry at the border in consultation with other stakeholders (Ministry of Commerce and Industry and Ministry of Interior) for better customs controls at the border. The basic framework for this business model will be developed in accordance with internationally accepted best practices with TA support already at the disposal of the Ministry of Finance. Ministry of Finance shall coordinate with the Ministry of Commerce and Industry, Ministry of Interior, Ministry of Transport, and other ministries who have representation at the borders to arrive at an agreement. The Ministry of Finance will give a full implementation report focusing specifically on the changes affecting customs controls and physical placements, if any, by February 28, 2010.

- The Ministry of Finance (Customs Department) will implement the ASYCUDA transit module along Zaranj-Nimroz axis and Declaration Processing Module at Nimroz by March 30, 2010. Ministry of Finance will provide the necessary resources to the ASYCUDA program to ensure its timely implementation.

II. Program Exchange Rates and Gold Valuation

4. Program exchange rates are used for formulating and monitoring quantitative targets. All foreign assets and liabilities denominated in U.S. dollars will be converted into Afghanis at a program exchange rate of 52.1375 Afghanis per U.S. dollar, which corresponds to the cash rate of December 19, 2008. Gold holdings will be valued at US$838.28 per ounce, the price as of December 19, 2008. Assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at their respective exchange rates of December 19, 2008, as reported in the following table. Gold holdings will be valued at US$838.28 per ounce, the price as of December 19, 2008.

Exchange Rate	Program Rate
US dollar/Canadian dollar	0.820200
US dollar/U.A.E. dirham	0.272300
US dollar/Egyptian pound	0.181800
US dollar/Euro	1.391200
US dollar/Hong Kong dollar	0.129020
US dollar/Indian rupee	0.021150
US dollar/Pakistani rupee	0.012598
US dollar/Polish zloty	0.336300
US dollar/Iranian rial	0.000101
US dollar/Saudi rial	0.266600
US dollar/Russian ruble	0.035490
US dollar/Swiss franc	0.906000
US dollar/United Kingdom pound	1.492000
US dollar/SDR	1.545010

III. Quantitative Performance Criteria and Indicative Targets

5. The quantitative performance criteria for March 2010 specified in Table 1 of the SMEFP are:

- Floors on fiscal revenue of the central government and net international reserves (NIR); and

- Ceilings on currency in circulation (CiC); net central bank financing (NCBF) of the central government; contracting and/or guaranteeing new medium- and long-term nonconcessional external debt by the government or the Da Afghanistan Bank (DAB), the central bank, (continuous); short-term external debt owed or guaranteed by the government or the DAB (continuous); accumulation of external payment arrears, excluding interest on preexisting arrears (continuous); lending from the central bank or state-owned banks to, or government guaranteed borrowing by, public enterprises in need of restructuring (continuous).

6. The above variables also constitute indicative targets for December 2009. In addition, the program includes the following indicative targets for the next two quarters:

- Ceilings on the operating budget deficit of the central government excluding grants; and

- Ceilings on reserve money.

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

8. **Net central bank financing of the government** is defined as the difference between the central bank's claims on the government and government deposits at the DAB. These deposits exclude deposits held at the DAB's branches because of the unavailability of reliable and timely data from the DAB's branches.

9. **Net international reserves** (NIR) are defined as reserve assets minus reserve liabilities of the DAB, both of which are expressed in U.S. dollars.

- Reserve assets of the 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 the DAB, and are readily and unconditionally available for the 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 the DAB, but excluding cash held in the 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; 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).

- Reserve liabilities are defined as short-term (original maturity) foreign exchange liabilities of the 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. **Revenues** of the central government are defined in line with the Government Financial Statistics Manual (GFSM 2001) but on a cash accounting basis, excluding 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 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.

- Revenues should be recognized on a cash basis and flows should be recorded when cash is received. The official Afghanistan Government Financial Management Information System (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.

11. **External debt.** 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: (i) 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); (ii) suppliers' credits (i.e., contracts where the supplier permits the obligor to defer payments until after the date on which the goods are delivered or services are provided); and (iii) 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.

12. The ceiling on **medium- and long-term external debt** applies on a continuous basis to the contracting or guaranteeing by the government or the 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 Public Finance and Expenditure Management (PFEM) Law, the Ministry of Finance 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 11 of this memorandum, and also to commitments contracted or guaranteed for which value has not been received. For the purposes of the program: (i) external debt will be considered to have been contracted at the point the loan agreement or guarantee is signed by the Ministry of Finance (on behalf of the

government) or the DAB Governor; and (ii) the guarantee of a debt arises from any explicit legal obligation of the government or the 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 the 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.

13. 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 12 of this memorandum) or the DAB, with an original maturity of up to and including one year.

- It applies to debt as defined in paragraph 11 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.

14. A continuous performance criterion applies to the **nonaccumulation of new external payments arrears** on external debt contracted or guaranteed by the central government or the 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: (i) arrears arising from interest on the stock of arrears outstanding as of March 20, 2006; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

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

- For the purposes of this performance criterion: (i) "state-owned banks" refers to those banks that are wholly or majority owned by the government (as defined in paragraph 12 of this memorandum); including Bank Millie, Bank Pashtany, and Export Promotion Bank; (ii) "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 1386 and 1387; (b) public enterprises that have been identified by the Ministry of Finance for liquidation; (c) public enterprises that do not have Cabinet-approved restructuring plans; (iii) "public enterprises" refers to enterprises wholly or majority owned by the government, including those covered by the State-Owned Enterprise (Tassady) Law, and 14 state-owned corporations[2] 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 the central bank or state-owned banks to public enterprises in need of restructuring, and also to any new government guarantees (as defined in paragraph 12 of this memorandum) of borrowing undertaken by these public enterprises. It applies to loan agreements and guarantees for which value has not been received.

16. **Operating budget deficit of the central government** excluding grants is defined as revenues of the central government minus operating budget expenditure recorded in AFMIS.

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

IV. Adjustors

18. The floor on NIR and the ceiling on the NCBF of the government are consistent with the assumption that core budget **development spending** in 2009/10 will amount, on a cumulative basis from March 21, 2009, to:

December 20, 2009	Af 31.3 billion
March 20, 2010	Af 51.3 billion

19. 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

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

between the actual level (up to the appropriated amount) and the projected level of development spending.

20. The NIR floor and NCBF ceiling are defined consistent with the assumption that the external financing of the core budget and receipts from the sale or transfer of nonfinancial assets will amount, on a cumulative basis from March 21, 2009, to:

December 20, 2009	Af 59.9 billion
March 20, 2010	Af 91.8 billion

21. 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.

22. 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 (i) 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 (ii) 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.

23. Should the central government undertake **security-related operating expenditures** based on spending plans agreed between the central government and donors, the indicative target (ceiling) for the operating budget deficit of the central government, excluding grants, will be adjusted upward and, should there be quarterly discrepancies between disbursements and executions, the NIR floor will be adjusted downward, and the NCBF ceiling upward by the sum of: (i) Af 1.8 billion, contingent on the final 2009/10 Afghan National Army (ANA) headcount exceeding 86,000, with the adjustment for any force size between 86,000 and 109,000 calculated on a prorated basis; (ii) Af 4.5 billion for augmentations ("top-ups") to the salaries of the 109,000 ANA force size with the adjustment for any force size between 86,000 and 109,000 calculated on a prorated basis; (iii) Af 2.2 billion for the salaries of the 16,000 soldiers recruited in 2008/09; (d) Af 900 million for equipment purchases by the Ministry of Defense; (iv) Af 400 million for equipment purchases by the Ministry of the Interior; and (v) Af 599 million for increasing the food allowances of the Afghan National Police. The cumulative downward adjustment to the NIR floors at each test date will be capped at US$199.5 million. The cumulative upward adjustment to the NCBF ceilings and the indicative targets (ceilings) for the operating budget deficit of the central government, excluding grants, at each test date, will be capped at Af 10.4 billion.

V. Provision of Information to the Fund

24. To facilitate monitoring of program implementation, the government of Afghanistan will provide the Fund 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 to the Technical Coordination Committee.

25. Actual outcomes will be provided with the frequencies and lags indicated below.

- DAB net international reserves: weekly, no later than two weeks after the end of each week.

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

- Core budget operations and their financing: monthly and no later than four weeks after the end of the month. The official reports for 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. 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): 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: quarterly and no later than six weeks after the end of the quarter. These will include: (i) details of new loans contracted or guaranteed during the quarter, including the terms of each new loan; (ii) the stock of debt at the end the quarter, including short-term debt, and medium- and long-term debt; (iii) loan disbursements and debt service payments (interest and amortization) during the quarter, beginning with the first quarter of fiscal year 1388 (2009/10); (iv) debt relief received during the quarter; (v) information on all overdue payments on short-term debt, and on medium- and long-term debt, including new external arrears (if any); and (vi) total outstanding amount of arrears.

- National accounts data: 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.

- Monthly consumer price indexes (CPIs) for Kabul and five other major cities ("national" CPI) with a lag of four weeks after the end of each month.

- Four-monthly financial flows and other key variables of the state electricity company (DABM/S) for Kabul and other jurisdictions for the preceding year and forecast for the coming year as specified in the attached template and with a three-month lag (see Attachment III, Table 1).

The Technical Coordination Committee (TCC) will send to the IMF reports by the end of each quarter documenting progress in implementing structural benchmarks under the program. These reports will include appropriate documentation and explain any deviations relative to the initial reform timetable, specifying expected revised completion date. 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.

Attachment III: Table 1. Islamic Republic of Afghanistan: Summary of Operations of Da Afghanistan Breshna Moasisa/Sherkat 1/

	2008/09	2009/10			2010/11
		March 21 - July 20	July 21 - November 20	November 21 - March 20	March 21 - July 20
	Act.	Act.	Est.	Proj.	Proj.
	(in millions of Afghanis unless otherwise indicated)				
Revenues	…	…	…	…	…
Total Revenues at 100 % Collection	…	…	…	…	…
Electricity Revenues Collected	…	…	…	…	…
Electricity Revenues at 100% Collection	…	…	…	…	…
Net Generation Plus Imports, mil kwh	…	…	…	…	…
Net Generation, mil kwh	…	…	…	…	…
Import, mil kwh	…	…	…	…	…
Losses (technical and nontechnical), mil kwh	…	…	…	…	…
Expenditures	…	…	…	…	…
Expenditures Excluding Interest Payments and Capital Expenditures Related to Foreign Financed Projects	…	…	…	…	…
Expenditures Excluding Interest Payments and Capital Expenditures (Current Expenditures)	…	…	…	…	…
Inputs	…	…	…	…	…
Purchased Power, mil kwh	…	…	…	…	…
Fuel, liters	…	…	…	…	…
Purchased Power Cost	…	…	…	…	…
Fuel Cost	…	…	…	…	…
Operation and Maintenance (O&M) Costs	…	…	…	…	…
Capital Expenditures	…	…	…	…	…
Errors and Omissions	…	…	…	…	…
Primary Balance 2/	…	…	…	…	…
Current Balance at 100% collection	…	…	…	…	…
Current Balance	…	…	…	…	…
Balance	…	…	…	…	…
Financing Available	…	…	…	…	…
Domestic Sources	…	…	…	…	…
Amortization, net (includes arrears reduction)	…	…	…	…	…
Tax Arrears	…	…	…	…	…
Government Subsidies	…	…	…	…	…
External Sources	…	…	…	…	…
Errors and Omissions	…	…	…	…	…
Financing Gap	…	…	…	…	…
Memorandum Items:					
Exchange Rate, Afghanis per USD	…	…	…	…	…
Nominal GDP	…	…	…	…	…

1/ This summary table is complemented by more detailed templates that include disaggregations of different categories (revenues, expenditures, and financing available) for three jurisdictions (Kabul and North-East, South and East, and West).
2/ Primary balance is defined as current revenues minus total expenditures excluding all interest payments and capital expenditures related to foreign financed projects.