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Islamic Republic of Afghanistan: Staff-Monitored Program: Supplementary Letter of Intent

June 10, 2006

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Kabul, June 10, 2006

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

Dear Mr. de Rato,

1. This letter supplements our Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) of May 15, 2006, which set out our medium-term economic program for which we requested the support of the IMF through an arrangement under the Poverty Reduction and Growth Facility (PRGF).
2. Following parliament's rejection of our initial budget proposal on May 21, 2006, we have conducted discussions with members of parliament and the donor community in an effort to address, to the extent possible, some of the concerns raised by the parliamentarians while preserving our overriding objective of maintaining fiscal discipline. As a result of this dialogue, the government submitted to parliament a revised budget that was approved on June 3.
3. Reflecting the government's commitment to medium-term fiscal sustainability, the revised budget is consistent with the same operating budget deficit for 2006/07 envisaged in the MEFP. The modifications introduced in the revised budget are as follows:
 - The 2006/07 fiscal program now includes a Af 300 increase (effective from September 21, 2006) in the monthly basic salaries of civil servants (excluding the police and the military), and a Af 100 increase in monthly pensions for the disabled and martyrs (from March 21, 2006), with a total cost estimated at Af 713 million (0.16 percent of GDP) in 2006/07.
 - To keep the programmed operating deficit (excluding grants) unchanged at 2.9 percent of GDP (MEFP; ¶26), these increases are fully offset by reducing other programmed expenditures, principally for goods and services (0.08 percent of GDP), and by using a portion of the contingency reserves envisaged in the original budget (0.07 percent of GDP).

4. These amendments ensure that the 2006/07 program remains in line with the quantitative targets and performance criteria set out in our May 15 MEFP (Table 3; Staff Report: 5/15/06).

5. In keeping with the broader objectives of our medium-term fiscal strategy, we remain conscious of the need to establish an expenditure framework that does not unduly impinge on day-to-day budgetary flexibility and ensures medium-term fiscal sustainability. To this end, the revised budget seeks to minimize the use of the contingency reserves, preserving over 80 percent of the previously programmed level (nearly 0.3 percent of GDP). We are also committed to refraining from additional across-the-board wage increases during the remainder of fiscal year 2006/07, and to linking future selective increases to the pay and grading reforms envisaged under the program (MEFP; ¶27). Finally, any consideration of additional expenditures at the time of the midyear budget review (MEFP; ¶26), will: (i) depend on revenue collection exceeding the September 2006 performance criterion and being expected to do so for the remainder of the fiscal year; and (ii) give priority to unwinding the expenditure offsets identified above (¶3).

6. The Government of Afghanistan continues to stand by all the other commitments included in the LOI and MEFP of May 15, 2006.

Sincerely yours,

/s/
Anwar Ul-Haq Ahady
Minister of Finance
Ministry of Finance

/s/
Noorullah Delawari
Governor
Da Afghanistan Bank