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Cape Verde: Letter of Intent, Supplementary Memorandum of
Economic and Financial Policies, and Technical Memorandum of
Understanding

January 13, 2005

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

January 13, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Rato:

1. On April 10, 2002, the Executive Board of the IMF approved a three-year arrangement for Cape Verde under the Poverty Reduction and Growth Facility (PRGF) in the amount of SDR 8.64 million (90 percent of quota). The purpose of this letter is to inform you of the progress in implementing the third-year economic program, and to request the sixth loan disbursement upon completion of the fifth review under the arrangement.
2. The attached memorandum of economic and financial policies (MEFP) supplements the MEFPs of March 11, 2002; December 6, 2002; June 9, 2003; December 2, 2003, and July 23, 2004. It sets out the objectives and policies the government of Cape Verde will pursue during the remainder of 2004 and in the first half of 2005.
3. Cape Verde's economic performance through September 2004 was in line with the PRGF arrangement. All performance criteria and indicative targets for end-June 2004 and end-September 2004 were observed, as were most structural performance benchmarks. As signaled in the previous review, there have been some delays concerning benchmarks on the completion of an assessment on tax exemptions and on the adoption of regulations for determining electricity and water tariffs, owing to the difficulties in finding consultants to conduct this work. However, the assessment of tax exemptions has recently been completed and regulations for tariff adjustments are expected by end-December 2004. In addition, consultants have recently been engaged to help resolve the complex financial relationship between the government and Electra (the water and power company).
4. The government believes that the measures it has taken and the policies it intends to pursue in 2005 (as described in the attached MEFP) will help to establish the conditions for achieving a high rate of sustainable economic growth and a reduction in poverty. On this basis, the government of Cape Verde requests the completion of the fifth review under the arrangement. The government also requests a short extension of the arrangement to end-July 2005 to provide sufficient time for the completion of the final review and for the final disbursement.
5. Looking ahead, the government is determined to maintain its excellent working relationship with the IMF. It will seek to reach agreement with the Fund over the next few months on what form of financial arrangement with the Fund would be most appropriate following the end of the current PRGF arrangement. In these discussions, the government's

policy program will continue to be directed toward ensuring macroeconomic stability, debt sustainability, and support for the PRSP.

6. The government believes that the measures and policies set forth in the attached memorandum are adequate to achieve its program objectives, but will take any further actions that may prove necessary for this purpose. For as long as Cape Verde has outstanding financial obligations to the Fund arising from the loans under the arrangement, the government will consult with the Fund, at the initiative of the government or whenever the Managing Director requests consultation, on Cape Verde's economic and financial policies.

7. The government authorizes the Fund to provide this letter, the attached memorandum, and the associated staff report to all interested parties that request them, including through the Fund's external website.

Sincerely yours,

/s/

João Serra

Minister of Finance and Planning

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

CAPE VERDE

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR NOVEMBER 2004—APRIL 2005

I. INTRODUCTION

1. **Cape Verde's ongoing program of economic stabilization and reform is being supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) which began in April 2002.** Consistent with the goals set out in our memorandum of economic and financial policies dated March 11, 2002, and updated most recently on July 23, 2004, this supplementary memorandum reviews the implementation of the program through September 2004, and sets out the government's policies through the end of the program in 2005.

II. ECONOMIC AND POLICY DEVELOPMENTS THROUGH SEPTEMBER 2004

2. **Economic performance through September 2004 was broadly in line with the program.** Some recent developments have caused real growth projected for 2004 to slow to about 4 percent relative to the 5.5 percent originally expected, but these influences are expected to be short-lived. In particular, agricultural output has been negatively affected by poor rainfall and a locust infestation; execution of the public investment program has been lower than expected; and tourism appears to have slowed slightly relative to 2003. As in other oil-importing countries, economic activity has also been adversely affected by the impact of higher international oil prices.

3. **Inflation remained subdued through October 2004, with annual inflation likely to reach only about 1.5 percent over the year.** Strong agricultural performance in the 2003-2004 season helped to lower food prices, with further downward pressure on prices coming from reductions in customs tariffs at the beginning of the year. While the impact of higher oil prices has been dampened by constant energy prices for domestic consumers and by the weaker U.S. dollar, retail fuel tariffs were adjusted in June and November to reflect higher international prices.

4. **The fiscal program is on track.** Preliminary data indicate that revenues increased by about half a percent of GDP in the first half of 2004 relative to the same period a year earlier. Higher-than-expected revenues from the new value-added tax (VAT) and from non-tax revenues more than offset lower revenues from international trade taxes (reflecting reforms to customs tariffs and excises). VAT collections during the first six months of 2004 stand at about 60 percent of the total projected for the year. Revenue performance is expected to improve further once the VAT is fully operational, so that VAT collections for the whole year may be substantially above initial expectations. On the expenditure front, the wage bill has been contained and is on track to meet the program target for the end of the year. All other spending items are considerable below their levels for the same period in 2003 (in percent of GDP). As noted above, the capital investment program has moved

slowly, with the low pace of execution associated with administrative delays in managing the programming cycle. These delays slowed the pace of disbursements for many projects, including from the World Bank and the European Union.

5. **In 2004, Cape Verde has implemented the most comprehensive fiscal reform in its history.** These measures have encompassed a rationalization and reduction of taxes on imports, and substitution of an inefficient sales taxes for a modern VAT. Significant progress has also been achieved in implementing structural reforms to strengthen fiscal management. A VAT Service and Information Unit to assist taxpayers to comply with the new law is now fully functional, and VAT processing offices in charge of registering taxpayers, receiving tax forms, and compiling data are also fully functional in four main districts, with more than 9,000 taxpayers already registered in the system.

6. **Monetary developments through September 2004 were in line with the program.** Net international reserves (NIR) of the Bank of Cape Verde (BCV) continued to rise, reaching €89.5 million (equivalent to 2.2 months of imports). Growth of credit to the economy slowed slightly compared to 2003, reflecting in part the slowdown in economic activity and high domestic lending rates of commercial banks. Broad money increased by 11.2 percent year-on-year in September, although some deceleration appears to have occurred in the fourth quarter.

7. **Cape Verde has observed all the quantitative and structural performance criteria for end-June 2004, and all but three structural performance benchmarks for end-June and end-September 2004.** An assessment of the costs of tax exemptions and incentives was delayed owing to the difficulty of finding an appropriate consultant for this study. Following our request for technical assistance from the IMF, a mission visited Praia in October to conduct this assessment. In addition, as signaled in the fourth review of the program, the benchmark on the adoption of regulations for the methodology to determine electricity and water tariffs at the independent Economic Regulatory Agency (ARE) has been delayed to December 2004, with the World Bank assisting ARE in the preparation of this methodology.

8. **The government has made progress in identifying and settling old domestic arrears and previously disputed claims.** It has cleared its arrears to Electra (the electricity and water utility) on its consumption of water and electricity, and has initiated an arbitration process with Electra to identify the government's liabilities (which had been an end-September benchmark).¹ These include obligations arising from the non-adjustment of electricity tariffs during 2000-2002 when world oil prices increased significantly. Once the arbitration process is concluded, the government will agree on a payment plan that will cover its remaining liabilities to Electra. In addition, the government has cleared arrears

¹ The World Bank is providing technical assistance for this project.

with Cape Verde Telecom and Shell Oil company, and is in the process of clearing arrears with other suppliers.

9. **In February 2004, ARE implemented a mechanism to adjust retail gasoline and diesel prices according to changes in import prices of oil products.** Following a first round of price changes in June 2004 under the new mechanism, the subsequent adjustment did not occur until November as a result of some difficulties that ARE encountered in implementing the mechanism, including in its negotiations with oil suppliers. ARE expects that more frequent and systematic price adjustments will occur from January 2005 as these difficulties are resolved.

III. THE PROGRAM FOR NOVEMBER 2004–APRIL 2005

10. **Our key macroeconomic objectives for 2004-05 are set out in the following table:**

Cape Verde: Key Macroeconomic Objectives				
	2002	2003	2004	2005
	Prel.	Prel.	Proj.	Proj.
(In percent, unless otherwise indicated)				
Real GDP growth	5.0	5.3	4.0	6.0
Inflation (period average)	1.8	1.2	-1.6	2.0
Broad money growth	14.3	8.6	8.2	8.6
Credit to the economy growth	12.0	15.4	9.7	8.3
Growth of banking system net credit to government/GDP	3.6	1.1	0.5	0.1
Revenue/GDP	22.1	21.3	23.7	23.7
Expenditure/GDP	33.0	29.9	32.3	31.5
Fiscal deficit including grants/GDP	-2.5	-3.2	-2.9	-3.7
Current account balance including grants/GDP	-11.0	-9.2	-7.8	-8.2
Reserves/Imports (months)	2.0	1.9	2.2	2.4

A. Growth and Inflation

11. **Real growth is projected to reach 6 percent in 2005, owing largely to strong growth projected for the tourism sector and increased public investment.** The completion of the new international airport in Praia, the construction and improvement of airports in Boa Vista and Sao Vicente, as well as the completion of a large hotel on Sal, should support increased tourist traffic and local commerce. Project financing from donors

will be channeled into public and social investment initiatives, including projects set out in the PRSP, and some projects that were not executed in 2004 will carry over to 2005. The government also intends to attract foreign direct investment and to spur export activity through a newly established free trade zone and the completion of an industrial park in Mindelo.

12. **Inflation is likely to be around 2 percent in 2005** (on an annual average basis), influenced primarily by higher food prices caused by poor agricultural performance in 2004 and increases in domestic energy prices arising from higher international oil prices. The measurement of domestic price movements will also be improved through changes in the methodology for calculating the CPI.

B. Fiscal Policy

13. **The fiscal program through April 2005 reaffirms the government's commitment to maintain macroeconomic stability and pursue the investment agenda laid out in our recent Poverty Reduction Strategy Paper (PRSP)**, while providing the necessary support to build up international reserves to sustain the exchange rate peg. Performance for the first four months of 2005 will be in line with a primary recurrent surplus of 5 percent of GDP projected for the whole year. Domestic revenue is projected to reach nearly 24 percent of GDP, reflecting efficiency gains in the VAT, strong growth in import-based taxes (including the VAT), the elimination of exemptions to the previous consumption tax, and the incorporation of the budgets of autonomous agencies into the national budget. Total expenditure will be contained at 31.5 percent of GDP, stemming from prudent expansion of wages and salaries and a strategic approach to capital spending, focusing on PRSP priorities. Net official financing (including grants) already committed and a modest amount of domestic bank financing will enable the government to clear the remaining domestic arrears by about 0.5 percent of GDP.

14. **We will focus our efforts on implementing a strategic plan for strengthening tax administration**, following the recommendation of a recent mission from the Fund's Fiscal Affairs Department (FAD). Given the introduction of the VAT and the new import tariff structure, the government does not intend to introduce any new taxes in 2005. We are in the process of implementing a strategy to modernize domestic revenue administration by improving its organization and operations, and by securing improvements in work processes, management, and services. Drawing on recommendations of the FAD mission, the introduction of all VAT returns into the VAT computer system by December 2004, and implementation of new rules for tax collections through the commercial banks by February 2005, will be structural benchmarks under the program.

C. Monetary and Financial Sector Policies

15. **The BCV's monetary policy in 2005 will continue to be oriented toward maintaining price stability and accumulating international reserves.** These policy objectives are necessary for sustaining the exchange rate peg and market confidence.

Growth of broad money and of credit to the economy is projected to be 8-9 percent in 2005, consistent with nominal GDP growth.

16. **The BCV is working toward the introduction of indirect monetary policy instruments, which would enhance competition in the banking sector.** We intend to request technical assistance from the Monetary and Financial Systems Department to support the development of a comprehensive strategy in this area. The BCV will assess the scope for reducing unremunerated reserve requirements for commercial banks (currently at 19 percent) while improving management of banks' liquidity.

17. **The BCV recognizes that continued fiscal prudence to minimize government recourse to domestic bank credit is essential for reducing key interest rates.** The BCV's efforts to lower reserve requirements, together with donor-supported programs to improve commercial banks' ability to assess project risks, will allow commercial banks to reduce the costs of financial intermediation. The regional chambers of commerce, with donor assistance, are helping their members strengthen financial transparency, which will improve their prospects for gaining access to commercial bank credit. Finally, the government and the BCV will continue monitoring the financial system and strengthening banking supervision.

D. Enterprise Reform

18. **Private sector-led economic growth is a crucial component of Cape Verde's poverty reduction strategy and external viability.** Critical to this element of the strategy is the reform of large public service enterprises that are either owned or regulated by the state.

19. **In this regard, the government is taking steps to address past and current difficulties arising from its complex financial relationship with Electra:**

- The government has recently engaged consultants to support a negotiated settlement of the government's accumulated liabilities to Electra.
- The government has requested that Electra provide data to identify separately the diesel consumption of electricity generation plants in the main urban areas as opposed to those in rural areas. With this information, the government intends that diesel subsidies be targeted on poorer rural households and funded by urban consumers, so that there would be no overall budgetary subsidy to Electra.
- The government will remain current in its payments to Electra for the government sector's consumption of electricity and water.
- By end-December 2004, the Board of ARE will approve an automatic and transparent mechanism for adjusting electricity and water tariffs on the basis of costs, which will be published in the official gazette (a performance criterion).

20. **TACV's financial performance has improved over the past year.** Operating losses have been reduced and the company is meeting its current obligations, including to the airport and air navigation authority for operating expenses and passenger fees. A new management team will take control of TACV in January 2005, with the aim of restructuring the company and streamlining operations in preparation for privatization, which is expected to take place in early-2006.

21. **The remaining public enterprises scheduled for privatization—Arca Verde, CABNAVE, EMPROFAC, ENAPOR, and Interbase—remain on track to be transferred from government ownership or to allow for private concession contracts by end-2005.** The development of regulatory capacity to cover the privatized industries and sectors is proceeding in tandem with the privatization process.

IV. THE PRSP AND MEDIUM-TERM MACROECONOMIC OBJECTIVES AND STRATEGY

22. **The recently presented PRSP contains the foundations of Cape Verde's strategy to enhance growth and alleviate poverty.** The document was widely discussed with different sectors of society and reflects a consensus view on how to unleash the country's potentials. Our strategy is based on the following pillars:

- promoting good governance, reinforcing effectiveness, and guaranteeing equity;
- fostering competitiveness to enhance economic growth and employment creation;
- developing and upgrading human capital;
- improving and developing basic infrastructure, promoting land use management, and protecting the environment;
- improving the effectiveness and sustainability of the social protection system.

23. **In support of the PRSP, the government has begun to develop a medium-term expenditure framework for 2005-07 with assistance from our development partners.** The key macroeconomic assumptions underpinning this framework are broadly consistent with those of the PRGF arrangement: (i) real GDP growth on the order of 5 to 7 percent; (ii) inflation of around 2 percent; and (iii) a gradual increase in gross international reserves to the equivalent of 2½–3 months of imports of goods and services by end-2007. Broad money is projected to grow broadly in line with nominal GDP, and credit to the economy would need to grow somewhat more rapidly to provide the necessary support to the private sector. The government anticipates the need for additional budget support during this period and will convene a donor conference in the first half of 2005 to seek the support of our development partners. The priorities of the investment plan of the government are fully aligned with the PRSP.

V. PROGRAM MONITORING

24. **Program implementation through the end of the current PRGF arrangement will be monitored according to the performance criteria and benchmarks presented in Tables 1 and 3.** The definition of the variables monitored as quantitative performance criteria and benchmarks and reporting requirements are set out in the attached technical memorandum of understanding (TMU). The TMU is unchanged from that of the fourth review of the PRGF. As noted in the Letter of Intent, the government requests a short extension of the arrangement to end-July 2005 to provide sufficient time for the sixth review and final disbursement.

Table 1. Cape Verde: Quantitative Performance Criteria and Benchmarks for 2004-05 Under the PRGF Arrangement 1/ 2/

	Cumulative flows from End-December 2003										
	2003 Dec. Level Actual	March			June			Sep.		Dec.	2005
		Indicative target (unadjusted)	(adjusted)	Prel.	Performance criteria (unadjusted)	(adjusted)	Prel.	Indicative target	Prel.	Performance criteria	Indicative target
(In billions of Cape Verde escudos)											
Quantitative targets											
Ceiling on net domestic credit to the central government from the banking system 3/ 4/	14.9	1.1	0.9	0.0	0.8	1.2	-0.5	0.7	-0.2	0.3	0.5
Ceiling on net domestic assets of the central bank 3/	9.2	-0.6	-0.8	-0.4	0.0	-0.3	-1.0	-0.1	-0.8	-0.1	1.0
Ceiling on the accumulation of new domestic payment arrears by the central government	...	0	...	0	0	...	0	0	0	0	0
(In millions of U.S. dollars)											
Ceiling on the accumulation of new external debt arrears by the central government 5/	0.0	0	...	0.0	0	...	0	0	0	0	0
Ceiling on the contracting or guaranteeing of non-concessional external debt with original maturity of more than one year by the central government 5/ 6/	...	10	...	5.0	10	...	10	...	...	20	20
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one year by the central government 5/ 7/	0.0	0	...	0.0	0	...	0	...	...	0	0
(In millions of euros)											
Floor on net international reserves of the Bank of Cape Verde (BCV) 8/	68.3	5.5	4.3	2.8	8.5	5.2	10.3	7	21.2	11	26.9
(In billions of Cape Verde escudos)											
Memorandum item:											
Floor on the primary current fiscal balance (indicative target)	...	0.0	...	...	0.3	...	...	-0.9	...	3.2	8.7
(In billions of Cape Verde escudos)											
Program assumptions											
Nonproject external financial assistance, including credit line (program assumption)	...	0.4	...	0.4	0.8	...	0.4	1.0	0.4	2.5	4.0
External debt service 9/	...	0.6	...	0.4	1	...	1.0	1.4	1.5	2.6	4.8
Cash payments of domestic arrears	...	0	...	0	0	...	0.0	0.4	0.4	0.4	0.9

1/ Quantitative performance criteria and benchmarks are described in the technical memorandum of understanding. The targets are performance criteria for June and December, and indicative targets for March, September, and for 2005.

2/ For purposes of calculating program adjusters, foreign currency amounts will be converted at program exchange rates.

3/ The ceiling will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

4/ The ceiling on net domestic credit to the central government from the banking system will be adjusted downward by the shortfall in cash payments of domestic arrears relative to program assumptions.

5/ This performance criterion is on a continuous basis. The \$20 million ceiling on nonconcessional external debt with original maturity of more than one year takes effect as of completion of the Fourth review.

6/ This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000),

but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion are rescheduling arrangements, the Portuguese credit line, and borrowings from the Fund.

7/ The term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt. Excluded from this performance criterion are rescheduling arrangements,

the Portuguese credit line, borrowings from the Fund, and normal import-related credits.

8/ The floor on net international reserves of the Bank of Cape Verde will be adjusted upward (downward) by exchange valuation gains (losses), by the cumulative downward (upward) deviations in external debt service, and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

9/ Beginning end-December 2003, external debt service projections have been corrected downwards by CVEsc 550 million to eliminate the double counting of projected repayments of the Portuguese credit line, which are already captured in projected non-project external financial assistance.

Table 2. Cape Verde: Structural Performance Criteria and Benchmarks Under the Third Annual Program Supported by the PRGF Arrangement

Measures	Test Dates	Status or Amended Test Dates
Structural performance criteria		
Refrain from providing budgetary subsidy to Electra until MOU on monitoring signed.	Continuous	Observed.
Refrain from providing budgetary subsidy to TACV.	Continuous	Observed.
Structural benchmarks		
Complete comprehensive assessment of the cost of all tax exemptions and incentives.	June 2004	Assessment conducted in November, 2004.
Adopt regulations establishing the methodology for determining electricity and water tariffs at the Economic Regulatory Agency.	June 2004	Still in preparation. Implementation delayed to end-December.
Submit report of fiscal operations for the first quarter of 2004 to the National Assembly.	June 2004	Observed.
Establish VAT Service and Information Unit.	September 2004	Observed.
Conclude report on government's financial liabilities to Electra.	September 2004	Negotiations with Electra under way.
Present report on fiscal operations in the first half of 2004 to the National Assembly.	September 2004	Observed.

Table 3. Cape Verde: Supplementary Structural Performance Criteria and Benchmarks Under the Third Annual Program Supported by the PRGF Arrangement

Measures	Test Dates
Structural performance criteria	
Refrain from providing budgetary subsidy to Electra for current operating expenses.	Continuous.
Refrain from providing budgetary subsidy to TACV for current operating expenses.	Continuous.
Approval by the Board of the ARE of an automatic and transparent mechanism for adjusting electricity and water tariffs on the basis of costs, and publication of such mechanism in the official gazette.	End-December 2004.
Structural benchmarks	
Establish VAT processing offices in four main districts. 1/	End-December 2004.
Present budget incorporating reduction of tax exemptions to the National Assembly.	End-December 2004.
Introduction of all VAT returns into the VAT computer system.	End-December 2004.
Implementation of new rules for tax collections through commercial banks.	End-February 2005.

1/ As noted in the MEFP, this benchmark has already been met.

CAPE VERDE

Technical Memorandum of Understanding

1. This memorandum sets out the understandings between the Cape Verdean authorities and the IMF staff regarding the definition of the quantitative performance criteria and indicative targets and reporting requirements under the second annual program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement.

I. QUANTITATIVE PERFORMANCE CRITERIA AND INDICATIVE TARGETS^{2 3}

A. Government Finances

2. Total government revenue is defined as the sum of all tax and nontax revenues, domestic capital participation, and net lending, cumulative since the start of the calendar year, excluding privatization proceeds and external grants. Tax revenue and nontax revenue are defined in accordance with the *Government Finance Statistics Manual (GFS) 1986*, Section IV.A.1.

3. The floor on the primary current fiscal balance cumulative from the beginning of calendar-year 2004 constitutes an indicative performance target. The primary current fiscal balance is defined as the difference between total government revenue (defined above in para. 1) and current primary expenditures on a commitment basis. Current primary expenditures equal total government expenditures on a commitment basis less interest obligations on external and domestic debt, capital expenditures, extraordinary expenditures on social emergency measures, and retrenchment payments made as part of the public enterprise privatization and liquidation reform.

4. For the purposes of this memorandum, privatization proceeds will be understood to mean all monies received by the government from the sale or concessioning of a public company, organization, or facility to a private company or companies, organization(s), or individual(s), as well as any proceeds generated from the liquidation of a public company, less restructuring costs.

5. **Reporting requirements.** Data on the implementation of the budget compiled by the Ministry of Finance and Economic Planning will be provided on a quarterly basis, to be

² See Table 1 of the memorandum on economic and financial policies (MEFP).

³ The data source used to evaluate the performance criteria on net domestic credit to the central government, net domestic assets of the central bank, and net international reserves will be the Cabo Verde—Panorama Bancario tables prepared monthly by the Bank of Cape Verde (BCV) Statistics and Research Department and forwarded electronically to the IMF African and Statistics Departments.

submitted not later than five weeks after the end of each quarter, including (i) government revenue by category, including external budget support grants; (ii) government expenditure, including primary current expenditure, domestic and external interest payments, and capital expenditure, including domestic capital expenditure and estimates of externally financed capital expenditure; (iii) the gross payment and gross accumulation of domestic payments arrears; (iv) external loan receipts and principal payments; (v) external arrears payments and accumulation; (vi) bank and nonbank financing; (vii) privatization receipts; and (viii) any other revenue, expenditure, or financing not included above.

B. Net Domestic Assets of the Central Bank

6. The ceiling on the cumulative change, from the beginning of calendar-year 2004, in net domestic assets of the Bank of Cape Verde (BCV) constitutes a performance criterion. Net domestic assets (NDA) of the BCV are defined as reserve money minus net foreign assets of the BCV, evaluated at the program exchange rates presented below. The program ceilings for NDA will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates. Reserve money comprises bank reserves and deposits of the monetary institutions and private sector with the central bank, as well as cash in circulation.

7. **Reporting requirements.** The preliminary monthly balance sheets of the BCV and the consolidated commercial banks will be transmitted on a monthly basis, with a maximum delay of five weeks. The definitive version of the monthly balance sheet of the BCV will be provided as soon as available.

C. Net Bank Credit to the Central Government

8. The ceiling on the cumulative change, from the beginning of calendar-year 2004, in net credit to the central government from the banking system constitutes a performance criterion. Net credit to the central government from the banking system (NCCG) is defined as the overall position of the main central government institutions vis-à-vis the banking system—that is, the stock of all outstanding claims on the central government (loans, advances, and all other government debt instruments, such as long-term government securities) held by the central bank and by commercial banks, less all deposits held by the central government with the central bank and with commercial banks, as they are reported monthly by the BCV to the IMF. The INPS (the social security agency) is not included in central government accounts. Net bank credit to the central government excludes claims on the Trust Fund (TCMFs).

9. Claims on the central government held by the central bank comprise the following items: (i) *crédito conta corrente OGE*; (ii) *Tesouro público protocolo*; (iii) *títulos governo central—obrigações nova serie*; (iv) *créditos a regularizar m/n e m/e*; (v) *outros créditos ao*

governo; and (vi) any other claims, or claims on the central government to be regularized, held by the central bank.

10. Deposits held by the central government with the central bank comprise the following items: (i) *depósitos do governo central—depósitos a ordem m/n*; (ii) *depósitos do governo central—depósitos a ordem m/e*; and (iii) *outros depósitos do governo central*.

11. Claims on the central government held by the commercial banks comprise the following items: (i) *obrigações do Tesouro*; (ii) *bilhetes do Tesouro*; (iii) *protocolos*; (iv) *empréstimos*; (v) *outros títulos*; (vi) *outros créditos*; and (vii) any other claims, or claims on the central government to be regularized, held by the commercial banks.

12. Deposits held by the central government with the commercial banks comprise the following items: (i) *dep. governo central em m/n—D.G.T.*; (ii) *dep. governo central em m/n—serviços autônomos*; (iii) *dep. governo central em m/n—fundos autônomos*; (iv) *dep. governo central em m/n—projectos de investimentos*; (v) *dep. governo central em m/n—fundos de contrapartida*; (vi) *dep. governo central em m/n—institutos c/autonomia administ. e financeira excepto INPS*; (vii) *dep. governo central em m/e*; and (viii) *outros passivos com o governo*.

13. The program ceilings for the NCCG will be adjusted downward (upward) by the cumulative downward (upward) deviations in external debt service and upward (downward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates. In addition, the ceilings for the NCCG will be adjusted downward by the shortfall in cash payments of domestic arrears relative to program assumptions.

14. **Reporting requirements.** The preliminary monthly balance sheets of the BCV and the consolidated commercial banks will be transmitted on a monthly basis, with a maximum delay of five weeks. The definitive version of the monthly balance sheet of the BCV will be provided as soon as available.

D. Ceiling on Nonconcessional External Debt Contracted or Guaranteed by the Central Government

15. Under the program, ceilings on medium- and long-term, as well as on short-term, nonconcessional external debt constitute performance criteria. These performance criteria are on a continuous basis. Nonconcessional external debt is defined as debt contracted or guaranteed by the central government with a grant element of less than 35 percent, calculated using currency-specific commercial interest reference rates (CIRRs) published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD). Debt rescheduling and debt reorganization are excluded from the limits on nonconcessional external debt. The limits on new nonconcessional external debt contracted or guaranteed by the central government (excluding borrowing from the Fund) are specified in Tables 1 and 3 of the memorandum of economic and financial policies. The

definition of short-term nonconcessional external debt excludes normal short-term (less than one year) import-related financing. The Portuguese government's precautionary credit line in support of the exchange rate peg is also excluded from the definition of nonconcessional external debt. In addition, the central government will not guarantee any external debt contracted by state enterprises and will maintain the policy of not guaranteeing private sector external debt. The performance criterion on medium- and long-term nonconcessional external indebtedness applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00) but also to commitments contracted or guaranteed for which value has not been received. With respect to the performance criterion on short-term nonconcessional external indebtedness, the term "debt" has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), 8/24/00).

16. **Reporting requirements.** The government of Cape Verde will consult with Fund staff before assuming any liabilities in circumstances where they are uncertain whether the instrument in question falls under the performance criterion. Details of all new external debt (including government guarantees), indicating terms of debt and creditors, will be provided on a quarterly basis within five weeks of the end of each quarter.

E. Net International Reserves of the Central Bank

17. The floor on the cumulative change, from the beginning of calendar-year 2003, in net international reserves (NIR) of the BCV constitutes a performance criterion under the program. The NIR of the BCV are defined as gross international reserves of the BCV net of its short-term external liabilities, calculated at the program exchange rates described below. Gross reserves of the BCV are those that are readily available (i.e., liquid and marketable and free of any pledges or encumbrances), controlled by the BCV and held for the purposes of meeting balance of payments needs and intervening in foreign exchange markets. They include gold, holdings of SDRs, the reserve position at the IMF, holdings of foreign exchange and traveler's checks, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. External liabilities of the BCV comprise liabilities to nonresidents contracted by the BCV with an original maturity of less than a year, any net off-balance-sheet position of the BCV (futures, forwards, swaps, or options) with either resident or nonresidents, any arrears on principal and interest to external creditors and suppliers, and purchases from the IMF. The program floors for the NIR will be adjusted upward (downward) by the cumulative downward (upward) deviations in external debt service and downward (upward) by the cumulative downward (upward) deviations in nonproject external financial assistance relative to program assumptions. For purposes of calculating the adjusters, these flows will be valued at current exchange rates.

18. **Reporting requirements.** A table on the NIR prepared by the BCV will be transmitted on weekly basis, with a maximum delay of two weeks.

F. Nonaccumulation of New Domestic Payments Arrears

19. As part of the program, the government will not accumulate any new domestic payments arrears. This will be monitored through the monthly execution of the cash-flow plan and the corresponding release of budget appropriations. For programming purposes, a domestic payment obligation to suppliers is deemed to be in arrears if it has not been paid within the normal grace period of 60 days (30 days for government salaries and debt service) or such other period as has been contractually agreed with the supplier after the verified delivery of the concerned goods and services, unless the amount or the timing of the payment is subject to good faith negotiations between the government and the creditor.

20. **Reporting requirements.** The Ministry of Finance and Economic Planning, through the D.G.T., will submit on a quarterly basis a detailed table of the stock of domestic payments arrears, including the accumulation, payment, rescheduling and write-off of domestic payments arrears during the quarter. The data are to be provided within four weeks after the end of the quarter.

G. Nonaccumulation of External Payments Arrears

21. As part of the program, the government will not accumulate any new external payments arrears on a continuous basis. This will be monitored through the monthly execution of the cash-flow plan and the corresponding release of budget appropriations.

22. External arrears are defined as total external debt-service obligations of the government that have not been paid by the time they are due, unless the definition of an arrear has been defined contractually between the government and creditor. External arrears exclude arrears on external debt, pending the conclusion of debt-rescheduling agreements.

23. **Reporting requirements.** Data on (i) debt-service payments; and (ii) external arrears accumulation and payments will be transmitted on a quarterly basis by the Ministry of Finance and Economic Planning, within five weeks of the end of each quarter. In addition, the government will inform the Fund staff immediately of any accumulation of external arrears.

H. Program Exchange Rates and Nonproject Budgetary Support

24. Performance under the program will be assessed based on program exchange rates. Foreign currency amounts will be evaluated at the following program exchange rates:

CVEsc 110.3 = €1; CVEsc 87.3 = USD 1.00; and CVEsc 129.7 = SDR 1.

25. The 2004 program assumes the following nonproject budget support during 2004: (i) €2.5 million from the European Union in the third quarter of 2004 and €3 million in the fourth quarter of 2004; (ii) US\$15 million from the World Bank in the fourth quarter of 2004; (iii) US\$3.0 million from the African Development Bank, in the fourth quarter of 2004; (iv) €3 million from the Netherlands in the second quarter of 2004, as stipulated in the TMU

for the Third Review; and (v) the repayment during the first quarter of 2004 of the outstanding €1 million from the Portuguese credit facility drawn in 2003 and the drawing of €5 million from the Portuguese credit facility in the first quarter of 2004, as stipulated in the TMU for the Third Review; €4 million of the Portuguese credit line drawings will be repaid in the fourth quarter of 2004.

II. OTHER DATA REQUIREMENTS FOR PROGRAM-MONITORING PURPOSES

26. Data on exports and imports, including volume and prices and compiled by the Director of Customs and the BCV, will be transmitted on a quarterly basis within five weeks after the end of each quarter. A preliminary quarterly balance of payments, compiled by the BCV, will be forwarded within five weeks after the end of each quarter.

27. The monthly disaggregated consumer price index for Cape Verde, compiled by the National Institute of Statistics (INE), will be transmitted monthly, within five weeks after the end of each month.

28. Documentation of all measures taken by the government to meet performance criteria or indicative benchmarks under the program will be transmitted to the Fund staff within one week after the day of implementation.