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

January 13, 2006

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

Bangui, January 13, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, DC, 20431
USA

Dear Sir:

1. After a long period of political and military disturbances which took a heavy toll on the economy of the Central African Republic, the political change of March 15, 2003, marked the start of a transition toward constitutional order and democracy and culminated in the presidential and legislative elections in March and May of 2005. With the support of international and regional partners, the elections were the most peaceful, democratic and inclusive the country has seen in years. The democratically elected government has shifted the country's policy priorities from political transition issues that dominated the previous 18 months to rehabilitation, economic recovery, and reconstruction issues while continuing to further strengthen security.
2. The approval in July 2004 by the IMF's Executive Board of a drawing under the emergency post-conflict assistance (EPCA) policy marked the resumption of Fund financial support after an absence of several years. With its focus on key governance and public finance issues, including capacity building, the EPCA provided an important impetus for the economic reform program during the transition period. It also helped catalyze much needed support from the international community, which increased in 2004.
3. Considerable progress has been made under the program in improving governance, fiscal management, and security. Nevertheless, the authorities recognize that the road to recovery remains long given the country's deep rooted economic problems, and the government's continuing difficulties in honoring its domestic and foreign obligations. Economic activity continues to be stagnant, fiscal performance has lagged, and the climate for an export rebound—including security and transportation—remains unfavorable. In these conditions, the government has reiterated its determination to pursue sound policies aimed at improving the overall environment necessary to underpin a sustainable and equitable economic recovery.
4. The attached memorandum sets out the authorities' updated economic and financial program for 2006. The program continues to address the country's immediate needs: (i) security and humanitarian aid; (ii) the restoration of macroeconomic stability; (iii) improved governance; and (iv) rehabilitation of basic infrastructure and the social sectors. The program rests on two pillars: (a) fiscal consolidation, through concrete measures

to strengthen revenues and maintain better control of expenditures, including the wage bill; and (b) improving governance and fighting corruption, in particular through greater transparency by making more information public and disseminating it more widely. Improving relations with foreign creditors also remains a key objective. The government is convinced that the policies and measures laid out in the memorandum will make it possible to achieve the program's objectives. Nevertheless, in consultation with the IMF, it will take any additional measures that may be required to this end.

5. In support of this program, the government of the Central African Republic hereby requests a second drawing from the IMF under the emergency post-conflict assistance policy in the amount of SDR 6,962,500 (equivalent to 12.5 percent of quota). The government strongly hopes that, as with the first drawing, it will benefit from an interest subsidy on the purchase. In addition, the government of the Central African Republic hereby commits to set aside—following Executive Board approval of this request—SDR 3,042,734 (equivalent to 5.463 percent of quota) out of the amount requested in its account with the IMF to cover obligations falling due during the remainder of the 2006 calendar year. Successful implementation of the program should bring the government closer to undertaking a medium-term program aimed at more comprehensively addressing the acute poverty situation in the country and promoting sustainable growth. To receive support under the Poverty Reduction and Growth Facility (PRGF), we expect by that point to have built our economic policy planning and implementation capacities sufficiently for such a program.

6. The government of the Central African Republic will provide the IMF with any information it may request on the implementation of the program.

Very truly yours,

Théodore Dabanga
Minister of Finance and Budget

Attachments: Memorandum on Economic and Financial Policies for 2006
Technical Memorandum of Understanding

Memorandum on Economic and Financial Policies for 2006

January 13, 2006

I. INTRODUCTION

1. From the mid-1990s to 2003, a series of political and military conflicts in the Central African Republic (C.A.R.) resulted in substantial loss of human life, destruction of basic infrastructure, and a severe erosion of administrative capacity as well as of the nation's economic fabric. Social conditions in the country deteriorated steadily, particularly in recent years when the conflict escalated, as the weak security conditions in rural areas prevented the delivery of basic services to the population.

2. The transitional government that followed the political change of March 2003 worked closely with regional and international partners, who provided significant technical and financial support, including support from the IMF in 2004 under its emergency post-conflict assistance (EPCA) policy. Domestically, a consensus-building approach, particularly through the National Dialogue, helped restore peace, democracy, and constitutional order. These efforts were very successful and resulted in the holding of presidential and parliamentary elections in March and May 2005. The broad acceptance of the election process and its outcome augurs well for solidifying peace and security and should therefore contribute to macroeconomic stabilization.

3. The newly-elected C.A.R. government is committed to continuing the reform process. It is well aware of the many challenges it faces, particularly with regard to the country's weak institutional and administrative capacity. With this in mind, the C.A.R. authorities request additional assistance from the IMF and all development partners to support its reform program, including further emergency post-conflict assistance from the IMF.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE FIRST EPCA PROGRAM

4. Since the recent conflict, economic recovery has been modest. After the significant contraction in economic activity in 2002-2003, real GDP growth reached approximately 1 percent in 2004 and is estimated at about 2 percent in 2005. This modest growth has been supported by a rebound in the diamond sector and, in 2005, by a strengthening of industrial activity. In the agricultural sector, food crop production increased in 2004 before stagnating in 2005. In addition, the lack of security in the countryside and along certain roads continued to undermine a recovery in coffee and cotton production. Production in the forestry sector declined during this period as a result of heavy rains in 2004 and problems affecting a few companies in 2005. Moreover, private investors maintained a wait-and-see attitude, particularly during the early part of 2005, because of the elections. With regard to inflation, the increase in agricultural production along with the decline in transport costs led to a

2.2 percent decline in the average price level in 2004, following a relatively sizable increase in 2003. In 2005, inflation increased moderately as agricultural production stagnated.

5. The external current account deficit improved modestly in 2005. Gains in the services account offset the worsening of the trade deficit during the period, which was largely due to a decline in timber exports and the increase in oil prices in 2005.

6. On the monetary front, after a strong increase in credit to the economy in December 2004, the money supply remained stable during 2005. The liquidity situation in the banking sector improved modestly due in part to the strengthening of the export receipts repatriation requirement and the inflow of resources from regional peacekeeping organizations.

7. Performance under the first post-conflict program and during the first nine months of 2005 was characterized by some delays in implementation due in part to the political environment, notably the electoral process. Although most of the quantitative objectives were not achieved—particularly in regard to the fiscal balance on a commitment basis, changes in domestic arrears, the wage bill, and the government's net position vis-à-vis the banking system—the progress made has been generally encouraging, largely as a result of the corrective measures implemented since the last quarter of 2004.

8. One of the key elements of the authorities' strategy to improve government finances was the strengthening of expenditure and cash flow management. To that end, the authorities closed a number of bank accounts held by the central government and government agencies, consolidated government debt held by local commercial banks, and integrated virtually all the special earmarked accounts into the Treasury by appointing Treasury officials to manage these accounts (*régies de recettes*). The Treasury will no longer pay any public expenditure without a prior payment order, with certain specified exceptions.¹ Moreover, spending under exceptional procedures must be regularized before the end of the 2005 budgetary exercise. An improved monthly cash-flow plan has been adopted and approved by the Minister of Finance. It should make it possible for spending to be better monitored throughout the fiscal year, and will be published regularly. Although expenditure oversight is still not adequate, there has been notable improvement in the tracking of expenditures at the level of payment orders.

9. Regarding the public sector wage bill, the government's total payroll continued to grow despite the pay cuts instituted in 2004, and reached CFAF 3.5 billion a month, an amount that considerably exceeds the budget appropriation and the government's capacity to pay it. Consequently, significant arrears once again accumulated. This increase was due to a number of factors, including a lack of controls on the files of the civil service and those of

¹ The exceptions are wages and salaries, pensions, legal expenses, embassies, medical evacuations, contributions to international organizations, official travel of the President of the Republic and members of the government, and certain unforeseeable, urgent expenditures, not exceeding 10 percent of overall monthly expenditure.

the Payroll Office. In addition, the very slow implementation of the consolidated civil service database (FURCA) delayed the cleaning up of these records. However, the government has started to tackle the problem on several fronts with the aim of realizing savings of approximately CFAF 600 million a month. The pace of retirements increased, and over 1,400 public officials and government employees were removed from civil service rolls in 2005. These officials will not be replaced in the foreseeable future. In addition, a civil service census and payment exercise has been conducted in order to identify irregularities in the payroll management: it turned up over 2,300 cases of irregularities and identified more than 1,600 government employees who no longer occupy their positions, out of a total of about 26,000 total employees. It is also worth noting that family allowances are now limited to a maximum of five children per employee and bonuses and allowances have been cut by CFAF 100 million a month. Also, with a view to reducing the government's total wage bill and ensuring that further slippages do not arise, other steps have been taken such as a freeze on hiring new public officials and government employees, the transfer of the management of contractual staff to the Payroll Office, and the transfer of civil service payroll data processing from the National Information Technology Office (ONI) to the Payroll Office.

10. With regard to revenue, several measures have been taken to improve tax administration. In particular, the government has consolidated the various units responsible for auditing and collecting taxes from large taxpayers. Use of the single taxpayer identification number (NIF) has been extended, and any economic agent failing to use it is subject to penalties. On the audit side, the number of inspections has been increased (21 desk audits were performed in 2005 to detect businesses incorrectly subject to the small enterprise flat tax (*impôt libérateur*)), and the number of audit teams was enlarged to 10, with two auditors in each team.

11. In the area of customs reform, some progress has been made, albeit after significant delays. Customs border posts are now required to record on bills of lading a detailed and accurate description of merchandise not cleared through customs. Moreover, in order to better combat fraud, the government has expanded the list of imported products for which CEMAC origin is questionable, and will communicate it to the customs offices; for goods on this list, a deposit equivalent to the amount of the applicable duties must be paid. In addition, any transit agent who has not paid the CFAF 50 million bond is no longer authorized to operate on Central African territory. Also, suspended clearance procedures and the practice of using fictional warehouses have been sharply curtailed, and application of the reduced tariff rate on imports for investments has been suspended (except for businesses that already meet the eligibility criteria) in order to eliminate abuse of this mechanism. In the future, all requests for preferential tariff treatment in this regard will be submitted to a review committee consisting of the Ministry of Trade and Commerce, the customs department, the tax department, and the import inspection agency BIVAC. Other new measures that have been put in place to increase customs revenues include, in particular: the elimination of provisional customs clearance release for imports of used vehicles, and the setting up of a bonded warehouse at the highway terminal customs collection office, which would serve to process bulk merchandise and systematically measure the respective quantities. Lastly, a transit management unit (CELGETRANS) has been established within the customs

department to back up the activity of the Central African customs post in Douala with regard to the transit of forest products between Bangui and Douala for export.

12. Despite all these reforms, fiscal performance has fallen short of expectations. Some factors, such as the wait-and-see attitude of economic agents during the electoral period as well as the delays in the implementation of some measures,² partially explain the low revenue levels. It should also be emphasized that weaknesses in the public administration and a lack of effective mechanisms to combat corruption have adversely affected the collection of government revenues. As well, expenditure controls and cash-flow management continue to be inadequate.

13. With regard to external debt, contrary to the quantitative indicator on nonconcessional external borrowing, the authorities took out in July 2005 a loan for CFAF 4 billion on nonconcessional terms from a subregional financial group (based in Cameroon).

14. On governance, the focus has been on improving transparency and strengthening government institutions so that they are better able to detect and prevent corruption. To that end, a new organizational structure for the Ministry of Justice was introduced, albeit with delays, including a specialized financial unit to better investigate financial crimes and a state legal officer to strengthen the government's ability to defend its interests. The authorities have published a code of ethics and conduct based on a model provided by the World Customs Organization for customs personnel and explained it to them.

III. OBJECTIVES AND STRATEGIES OF THE 2006 POST-CONFLICT PROGRAM

15. The government's post-conflict program for 2006 is built on the reform progress to date, with a view to strengthening the economic recovery and improving living standards in the country. The main objectives are to restore macroeconomic stability through fiscal consolidation and to improve governance and transparency. These efforts are set in the context of a broader program that aims at strengthening security and improving basic infrastructure and the social sectors. The government is counting on its international and regional partners for their support in all these areas and is committed to improving its relations with external creditors.

16. With the return of democracy, the gradual reestablishment of security in the country, and the implementation of deeper reforms, economic growth should gradually strengthen to slightly above 3 percent in 2006. This assumes an increase in private sector activity as well as in donor support. Inflation is expected to return to its historical range of 2 to 3 percent, in line with the CEMAC trend. Over the medium term, stronger economic growth is projected as improved security takes hold, the fiscal position strengthens, and significant donor

² These measures include the collection of a bond at the revenue collection office at the destination point to cover customs charges for merchandise not cleared at the border, and the effective implementation of the procedure to combat fraudulent CEMAC certificates of origin.

assistance resumes, allowing for the rehabilitation of long-neglected or destroyed infrastructure.

A. Strengthening Security

17. The security situation has been steadily improving since March 2003, with the support of CEMAC peacekeepers and assistance from France. Outside the main cities, however, banditry remains a serious problem and lawless elements continue to harass the rural population, particularly in the north and northwest of the country. The government is committed to addressing this problem on two fronts. First, it is implementing the Special Project for the Reinsertion of Former Combatants and Community Support. The reinsertion process which is underway is scheduled to be completed by mid 2007. Second, with the support of France, the government is continuing to build up the country's armed forces. The government is strengthening military cooperation with its neighbors in order to be able to undertake joint operations against armed bands operating in border areas.

B. Improvement of the Economic and Financial Situation

Fiscal policy

18. The government is committed to fiscal consolidation, and has set an objective for the overall deficit on a commitment basis (including grants) in 2006 of 1.3 percent of GDP, which represents an improvement of about 1 percent over the result expected for 2005. This reflects a revenue increase of 0.5 percent of GDP in 2006 and strict control of the wage bill and outlays on goods and services. In addition, the government is committed to spending more on education, health, and basic infrastructure, provided that donor financing materializes.

19. On the revenue side, new tax provisions are now in force aimed at broadening the tax base. They are contained either in the 2005 Supplementary Budget or in the 2006 Budget Law. Among the key provisions are the following:

- increasing the VAT rate from 18 percent to 19 percent;
- establishing a withholding requirement that a 10 percent deposit on income tax or corporate tax owed by individuals or companies be paid at the time of import and/or purchase from domestic suppliers;
- introducing a licensing requirement for operators of motorcycle taxis;
- establishing a commercial rent tax, applicable to any business that pays rent;
- establishing a special tax on gambling;
- establishing a requirement that any sale of goods or services be recorded on an invoice.

20. The government emphasized strengthening the fiscal agencies to make them more effective. In the area of tax administration, the government will implement the following measures:

- Management of large taxpayers will be strengthened by systematically following up on delinquent taxpayers, and, in particular, ensuring effective tracking of taxpayers who have been sent a reminder and applying deterrent penalties to non-filers.
- Tax audits will be intensified, and more ambitious goals will be established as to the quantity and quality of audits. For 2006, a target has been set of at least 40 full audits and 200 ad hoc inspections (of which half are to be done by June 2006).
- Management of small and medium-sized businesses will be strengthened by updating tracking records in order to verify more effectively that these businesses have complied with all tax obligations, including VAT, and by bolstering the recovery procedure, while focusing on those businesses most likely to yield substantial tax revenues.
- Examination of returns will be enhanced to identify businesses to which the small enterprise flat tax (*impôt libérateur*) has been wrongly applied, by maintaining the target of at least 20 off-site examinations a year.
- The reliability and usefulness of the central taxpayer database will be improved by updating it, in particular by systematically retrieving “inactive” files in order to facilitate the automatic identification of noncompliant taxpayers and provide other financial agencies with a database that is updated regularly.

21. In the customs area, the government is committed to speeding up the pace of reforms, particularly those that were planned for 2004-05 but have still not been fully implemented. Additional efforts by the customs department in 2006 will include the following:

- continuing to strengthen the Douala office, particularly by providing a computer link with the Cameroonian one-stop window, by conducting ad hoc inspections in collaboration with Cameroonian customs, and by ensuring good communication between the Douala office and the transit management unit (CELGETRANS);
- migrating from the SYDONIA customs computer software to the SYDONIA++ software, in accordance with UNCTAD recommendations;
- building customs clearance zones at border posts, for clearing goods imported overland; and
- strengthening provisions related to the customs clearance of used vehicles to improve the collection of taxes on these imports.

22. Rising world oil prices have cut deeply into government revenues, since they have been absorbed entirely by the government’s budget. Because this could compromise

government finance objectives for 2006, including the regular payment of civil service wages and salaries, as well as priority spending, the authorities have raised prices at the pump with a view to increasing revenues by some CFAF 2 billion. The government will make every effort to reduce consumption of oil products by the public administration. The authorities are aware of the importance of mitigating the consequences of these price increases on the most vulnerable segments of the population, and to this end are committed to increasing social spending in a targeted fashion. As well, the increase in the price of kerosene, an important item for the poor, has been limited to 10 percent. The government is looking to introduce a system whereby prices at the pump will vary in line with world prices, which will help accustom economic agents to fluctuations in oil prices.

23. On the spending side, the focus is on improving public expenditure monitoring and controls. To that end, the government will further limit spending effected outside the normal expenditure process. Given the excessively cumbersome expenditure commitment procedures, the authorities will make every effort to streamline them and enhance their transparency and efficiency. This will include the following measures:

- The issuance of Treasury promissory notes against deposit accounts of suppliers at the Treasury will be limited and made secure, notes in circulation will be tracked, and the prohibition on certain expenses not allocated to line items will be monitored closely.
- All payments of expenses by means of automatic debits from Treasury accounts held with banks not initiated by the Treasury will be prohibited, except for repayments of bank debt of the government.
- The final accounting for the 2004 fiscal year will be completed; and, more generally, the Treasury budget accounts for each year are to be closed not later than February of the following year, with all expenses not authorized during the fiscal year being regularized.
- Mobile telephone operators will be instructed to freeze all government cell phone services except those of the Head of State and members of the government, and to reactivate them on a case-by-case basis. A system of prepaid meters will be put in place to ration the public administration's use of electricity and telephone services.
- Simplified expenditure procedures will be introduced.

24. To promote the concept of a unified Treasury, the government will continue to close government bank accounts that are deemed unnecessary and will provide justification for those that are kept open. The balances of the closed accounts will be deposited in a Treasury account opened at the central bank, which will facilitate monitoring, ensure good governance, and better safeguard resources.

25. Containing the wage bill is central to the authorities' fiscal consolidation strategy. The measures mentioned in paragraph 12 should result in the total wage bill being reduced by an amount equal to approximately 1 percent of GDP, which would bring it down to a level consistent with the government's available resources. The government is committed to

implementing reforms aimed at maintaining better control of the wage bill, particularly regarding the cleaning up of civil service records. The census findings will be verified, with UNDP support, to identify other potential anomalies. By March 2006, civil servants' academic credentials will also be verified, to help identify instances in which civil servants may have been assigned improper grades. As far as retired staff are concerned, a census is under way to identify by March 2006 errors in pension benefits. The resulting savings in pension payments should help offset the increase in the total pension bill following the retirement of 1,400 government employees in 2005.

26. With regard to the management of the Payroll Office and civil service records, an assessment has been carried out of the work already done on the FURCA. The differences found between the FURCA database and the ONI database were not insignificant. Therefore—with the support of donors, chiefly the UNDP and the World Bank, and making use of the findings of the recent census—the authorities, working on the basis of an international consultant's recommendations, will undertake the necessary measures to clean up and secure the records. The authorities are asking donors urgently to continue their technical assistance so that this work can be done. In the meantime, the authorities will ensure that data processing for these files will be carried out by the Payroll Office, and no longer by the ONI. The authorities will maintain the hiring freeze through 2006.

27. The government is committed to finding a lasting solution to the problem of its domestic arrears, particularly those owed to the civil service and the private sector. A committee has been formed to verify the stock of arrears and its composition. With the assistance of an international consultant financed by the World Bank, progress has been made in determining which claims on the government are legitimate and which are unfounded. By June 2006, the authorities will submit the results of this verification to an internationally recognized auditing firm for validation; and in the middle of 2006, following dialogue with the various social partners, the government will aim to take a decision on an explicit strategy for clearing these arrears. In the meantime, the government will strive to honor its current obligations and avoid the accumulation of new arrears in 2006.

Monetary and Financial Policies

28. The government has agreed with the Bank of Central African States (BEAC) on postponing until January 2006 the first repayment of the exceptional advance granted in 2004 with the guarantee of other member countries of the CEMAC. In order to avoid increasing the net credit of government to the banking system and augmenting the government's debt burden, the government will endeavor to ensure that any new support from member states of the BEAC will be in the form of a grant. Should it be in the form of a loan, however, support from donors should be used in part to reimburse the amount of the loan.

29. The authorities are closely monitoring the situation of the banks, especially their observance of the prudential ratios established by the Central African Banking Commission (COBAC). More specifically, one local bank has significant weaknesses in its balance sheet and is in compliance with only one prudential ratio. The authorities will ensure that this bank

is recapitalized by existing and new shareholders, and is brought into compliance with prudential standards Overall, the government commits itself to improving the legal environment so that banks can recover loans. Weaknesses in the banking system also affect the microfinance sector, which is dominated by the credit cooperative CMCA (Crédit Mutuel de la Centrafrique). To minimize the risk associated with CMCA deposits, the monetary authorities will consider mechanisms to allow the CMCA to open an account with the central bank. Efforts are under way, with UNDP support, to rehabilitate other microfinance structures with a view to developing the sector, particularly outside the main cities.

External Sector and Debt

30. The Central African Republic continues to face serious financial constraints and is not servicing its external debt, with the result that external arrears continue to accumulate, including to multilateral creditors. The government is holding discussions with its creditors with the aim of consolidating its debt and finding a global solution to the arrears problem. Efforts with creditors are continuing to reconcile data on the stock of debt outstanding and arrears, and significant progress has been made to date. The government will no longer contract or guarantee any nonconcessional debt and is aware of the need to obtain financial assistance in the form of grants. It is determined to improve its debt management capacity and in this connection is seeking donor assistance for new debt management software, as the program it is currently using has become obsolete.

31. The government is committed to removing obstacles to international trade. In this regard, it will ensure compliance with all CEMAC trade regulations, in particular those relating to the regional Common External Tariff (CET). The government will enforce strict compliance with the tariff classification for imported goods according to the four categories of the CET. Recognizing the importance of further trade liberalization, particularly for a land-locked country, the government will take up the issue of the reduction of external tariffs at the regional level.

32. The government recognizes the considerable obstacles faced by exporters in accessing seaports in neighboring countries. Transport costs are amplified by the deterioration of infrastructure, banditry, and illegal roadblocks set up by military personnel on the main highways. The government intends to eliminate the roadblocks, restore the rule of law on the roads, and rehabilitate the transportation infrastructure, with financial backing from donors and, in the case of regional highways, in cooperation with other CEMAC countries.

C. Governance, Transparency, and Structural Reforms

33. The government is committed to tackling corruption and promoting good economic governance in order to create a more favorable business climate for the private sector and lay the necessary foundations for economic recovery. One of the pillars of this strategy will be assuring greater transparency in the government's activities.

Public Administration

34. The government intends to equip the recently established State Legal Agent and the special section (financial unit) in the Ministry of Justice with the necessary resources to accelerate the prosecution of corruption cases. A full list of the corruption cases now underway has already been published. The government will strengthen the administrative penalties imposed on government employees who are implicated in cases of misconduct and corruption. In the spirit of increasing transparency, the government will, by March 2006, set up a website on which it will regularly publish budget execution data under the cash-flow plan, indicators of activity in the forestry and diamond sectors, information on the awarding of public contracts, and information on progress made in the fight against corruption. In addition, Transparency International and the UNDP recently conducted a survey on the perception of corruption in the country. The findings have been made public and show that corruption is widespread and most entrenched in the police force and gendarmerie, the customs administration, and the judiciary.

35. The government is committed to reforming the legal system and correcting its severe weaknesses. The priority is to improve the business climate for the formal private sector, including in the financial system where problems in enforcing contracts have contributed the prevailing high rate of nonperforming loans. The government will make every effort to ensure that the legal system is better able to guarantee the respect and the application of contracts.

36. To develop the private sector and attract investment, the authorities realize that it is essential to have a stable regulatory framework in place, particularly for business activity in the formal sector. The government is committed to consulting with economic agents before amending regulations, and not to cancel licenses granted to operators except in cases where the terms of the license have not been fulfilled (notably concerning the telecommunications sector). In addition, the authorities intend to revise the Labor Code to modernize it and make it more flexible.

37. The government has undertaken a review of the rules governing public procurement, which suffer from serious deficiencies, engender poor governance, and risk undermining investor confidence. In consultation with donors, the authorities are updating the Procurement Code, and will ensure that it fosters transparency and predictability and is in line with international best practices, while reducing the government's discretionary power. In the meantime, the government is committed to awarding all public contracts in conformity with current procurement procedures. In addition, the authorities will by April 2006 undertake an assessment of the work done by the firm responsible for the security of C.A.R. port revenue at Douala, and if the findings are unsatisfactory, will issue a call for tenders so that a new contract for doing this work can be awarded.

Sectoral Policies

38. Improving the management of the country's natural resources is a priority for the government. In the forestry sector, a new inspection company with an expanded mandate to secure government receipts commenced its work in May 2005. In an effort to better monitor revenue from the sector, the government has implemented a system of automatic issuance of revenue collection orders. The government has also begun the systematic application of penalties to companies that fail to submit their monthly report on production and export volumes by the due date specified in the Forestry Code.

39. In the mining sector, the government has awarded more than 50 exploration licenses in 2005, which should improve the prospects for the sector in the medium term. The government will continue to consider ways to reform the Mining Code to encourage potential investors in this sector. Recognizing that the significant undervaluation of diamond production and undeclared diamond exports are problems that have an impact on Treasury receipts, the government is determined to combat fraud while safeguarding competition in this sector. The authorities will suspend the minimum export levels applied to purchasing offices if, after three months, exports by the formal sector and tax receipts show a decline. The government is also committed to strengthening the practices of the Office of Diamond and Gold Valuation and Control (BECDOR), including the obtaining of information on the volume and value of C.A.R. diamonds traded in Antwerp. A revision of the valuation mechanism for diamonds is envisaged for early 2006. With regard to the Kimberley Process, the government is committed to strengthening its capacity in order to transfer the verification process to the public sector as soon as possible.

40. The government will continue to enhance transparency in the forestry and diamond sectors. It is committed to publishing monthly data on all companies doing business in these sectors, indicating the volumes produced and exported and the public receipts generated. Information will continue to be published on the awarding and cancellation of licenses.

41. The agricultural sectors suffered greatly during the conflict years and because of unfavorable developments in the world market. In light of their importance for economic growth, employment, and poverty reduction, the government intends to step up its support for these sectors. This support will focus on integrated rural development, in partnership with donors, without aiming to benefit any particular sector.

42. The authorities will endeavor to rehabilitate public enterprises whose financial and operational position has seriously deteriorated. To that end, they plan, by early 2006, to issue a call for bids for awarding the commercial management of the water authority SODECA to a private operator; a similar operation is planned for the electric power authority ENERCA by June 2006.

D. Social Sectors and Poverty Reduction Strategy

43. The health, education, and basic infrastructure sectors have been in dire straits for many years. As a result of support from nongovernmental organizations, the government has

initiated the resumption of services in rural areas by rehabilitating health clinics and schools and promoting the return of qualified social personnel. The government recognizes that much more is needed to achieve tangible improvement in social indicators. The participation of all donors is essential to mobilize the necessary resources in this regard.

44. The government has made significant progress in the preparation of the poverty reduction strategy paper (PRSP), notably since March 2004. With the support of the World Bank and other partners, the government will move forward on the work of consolidating the initial draft PRSP, which identified the high-priority sectors. A macroeconomic framework for the strategy, as well as details on participation and on monitoring and evaluation, still need to be worked out. The authorities believe that the PRSP must be a clear document with a limited number of programs, whose costs have been assessed and whose objectives have been fixed, in order to focus the attention of the government and donors on the country's priorities. The authorities are determined to finalize the PRSP in 2006.

IV. TECHNICAL ASSISTANCE

45. The technical assistance needs of the Central African Republic are enormous. The government will continue to work closely with its multilateral and bilateral partners to improve its administrative capacity in priority sectors, which include strengthening the tax and customs administrations, expenditure management and government accounting, and the verification of domestic arrears. Assistance will be urgently needed to better control and monitor the public sector wage bill. Given the weaknesses of the statistical apparatus in the C.A.R., the government will seek technical assistance in this area. For their part, the authorities have begun to redeploy staff internally in the Department of Economic and Social Statistics and Research to the units responsible for the national accounts, economic and social indicators, and government finances. In the social sectors, the government will need assistance to support the work of finalizing the PRSP.

V. PROGRAM FINANCING AND MONITORING

46. Under the program projections, the financing gap for 2006 corresponds to the level of external debt obligations. The government is in close contact with its creditors to reach an arrears clearance agreement: in the meantime, external arrears continue to accumulate, with the exception of payments to the IMF which the government is firmly committed to honoring. However, in order to support the rehabilitation and economic recovery efforts, the authorities are asking the donor community—particularly the World Bank, the African Development Bank, United Nations agencies, the European Union, France, the United States, the People's Republic of China, and others—to finance investment projects in the infrastructure and social sectors, as well as to provide technical assistance. Given the dire situation in the country, the government has also requested budgetary support for priority spending in the social sectors to help restore public services. These expenditures have not been included in the budget and will only be effected if the requested assistance materializes, particularly from the European Union and France, as well as the resources available in the context of the IMF's emergency post-conflict assistance.

47. The quantitative objectives set for 2006 are summarized in Table 1, and the monitoring of fiscal, governance, and structural reforms will be carried out on the basis of Table 2. The quantitative indicators are defined in the attached Technical Memorandum of Understanding. The government will provide all necessary data to monitor the program, as indicated in the Memorandum. An IMF mission could visit Bangui, if necessary, in the first half of 2006 to assess progress under the program. If performance under the program during the first half of 2006 is satisfactory, the government will ask IMF staff to return in the third quarter of the year to begin negotiations on a successor program.

Table 1. Central African Republic: Authorities' Indicative Targets,
March 1– December 31, 2006
(In billions of CFA francs; cumulative from January 1, 2006; ceilings, unless otherwise indicated)

	End-March	End-June	End-September	End-December
	Objective			
Floor on total government revenue 1/	16.6	33.7	50.5	67.3
Wages and salaries 2/	8.8	17.5	26.3	35.0
Floor on narrow primary balance (cash) 3/	1.2	2.5	3.5	4.0
Net change in domestic arrears on wages and on goods and services 4/	0.0	0.0	0.0	0.0
Change in net claims of the banking system on the government	0.0	0.0	0.0	0.0
New nonconcessional external debt 5/	0.0	0.0	0.0	0.0
Memorandum items				
Customs receipts (cash basis)	5.9	12.2	18.9	25.8
Floor on narrow primary balance (payment order) 6/	1.2	2.5	3.5	4.0
Net change in domestic arrears 7/	0.0	0.0	0.0	0.0

1/ Including withholding taxes on government salaries, earmarked revenue, and taxes and duties on project-related imports.

2/ Including withholding taxes on government salaries.

3/ The narrow primary balance compares revenue on a cash basis (that is, excluding withholding taxes on government salaries, earmarked revenue, and taxes and duties on project-related imports) with total expenditure on a **cash** basis, excluding interest payments and foreign-financed investment and including treasury operations. Targets will be adjusted downward if external grants allocated to priority spending are above the projected amounts.

4/ Wage arrears (including unpaid pensions and bonuses) and arrears on goods and services excluding arrears on utility consumption. Arrears on goods and services include unpaid spending commitments vis-à-vis suppliers as well as deposit accounts of enterprises at the Treasury.

5/ Contracted or guaranteed by the government.

6/ The narrow primary balance compares revenue on a cash basis (that is, excluding withholding taxes on government salaries, earmarked revenue, and taxes and duties on project-related imports) with total expenditure on a **payment order** basis, excluding interest payments and foreign-financed investment and including treasury operations. Targets will be adjusted downward if external grants allocated to priority spending are above the projected amounts.

7/ Arrears on spending measured on a commitment basis.

Table 2. Structural Measures for 2006

Measure	Date
Revenue	
Strengthen the management of large taxpayers by systematically following up on delinquent taxpayers, and, in particular, ensuring effective tracking of taxpayers who have been sent a reminder and applying deterrent penalties to non-filers.	March 2006
Step up tax audits by setting more ambitious goals as to the quantity and quality of audits, to cover the taxpayer base more thoroughly. For June 2006, a target has been set of at least 20 full audits and 100 ad hoc inspections.	June 2006
Continue to strengthen the Douala office, particularly by providing a computer link with the Cameroonian one-stop window and by conducting ad hoc inspections in collaboration with Cameroonian customs.	June 2006
Install a copy of the SYDONIA++ customs computer software on a pilot basis, in preparation for a full migration from the SYDONIA software to the SYDONIA++ software.	June 2006
Strengthen the examination of returns to identify businesses to which the flat tax (<i>impôt libérateur</i>) has been wrongly applied, by maintaining the target of at least 20 off-site examinations a year.	December 2006
Cash-flow management	
Limit and secure the issuance of Treasury checks against deposit accounts.	March 2006
Close government bank accounts that are deemed unnecessary and provide justification for those that are kept open.	April 2006
Expenditure	
Identify any false academic qualifications presented by civil servants; detect any instances in which civil servants may have been assigned improper grades; and finalize the census of retired staff and adjust the payments database on the basis of the findings from the census.	March 2006
Fully implement the unified civil service database (FURCA), so that both the Ministry of the Civil Service and the Payroll Office are using the same database.	June 2006
Simplify the expenditure process including greater use of computerization.	June 2006

Measure	Date
Governance and transparency	
Publish monthly data, with a time lag of not more than six weeks, on (i) the volume and value of forestry sector output produced, exported, and sold locally, together with the corresponding government revenue, and (ii) all licenses awarded or cancelled, the volume and value of diamonds produced and exported, and the corresponding government revenue.	Beginning in February 2006
Set up a website for publishing, on a regular basis, the government cash-flow plan, activity indicators in the forestry and diamond sectors, progress in the fight against corruption, and information on the awarding of procurement contracts based on the template agreed with the staff.	March 2006
Assess the work done by the firm responsible for the security of transit revenues at the port of Douala, and if the findings are unsatisfactory, issue a call for tenders so that a new contract can be awarded for doing this work.	April 2006
Submit the results of the verification of domestic arrears to an internationally recognized auditing firm for validation.	June 2006

CENTRAL AFRICAN REPUBLIC

Technical Memorandum of Understanding

January 12, 2006

48. This memorandum describes the quantitative and structural indicators for the program supported by the Fund's emergency post-conflict assistance policy. It also specifies the periodicity and deadlines for transmission of data to the staff of the International Monetary Fund (IMF) for program monitoring purposes.

I. Quantitative Indicators and Adjusters

Quantitative indicators

49. The quantitative indicators are the following:

- a. cumulative floors on total government revenue, including taxes on wages, earmarked revenues, and duties and taxes on projects;
- b. cumulative ceilings on the government wage bill, including withholding taxes;
- c. cumulative floors on the narrow primary fiscal balance (cash basis);
- d. cumulative ceilings on the net change in government domestic payment arrears on wages and goods and services;
- e. cumulative ceilings set on the change in net banking system claims on the government, excluding the counterpart of the use of Fund resources; and
- f. cumulative ceilings set on new nonconcessional external debt contracted or guaranteed by the government.

Memorandum items

- g. cumulative floor on customs receipts (cash basis);
- h. cumulative floors on the narrow primary fiscal balance (payment order basis);
and
- i. cumulative ceilings on the net change in government domestic payments arrears.

Definitions and computation

50. Unless otherwise indicated, the government is defined as the central government of the Central African Republic and does not include local governments, the central bank, or any public entity with autonomous legal personality not covered by the government consolidated financial operations table (*tableau des operations financiers de l'État*—TOFE).

51. Government revenue is valued on a cash basis and includes offsetting operations in current revenue and expenditure. Revenue is shown in the TOFE and includes earmarked revenue, checks for project-related customs duties, and withholdings from civil service wages and salaries actually paid. Revenue for 2004 was estimated at CFAF 55.8 billion, broken down as follows:

Fiscal revenue (TOFE basis, in billions of CFA francs)	55.8
Cash receipts, including offsets (customs, tax, and treasury directorates)	47.4
Other revenue	8.4
Earmarked revenue (road fund, contributions to the Central African Economic and Monetary Community (CEMAC), hospitals, and livestock fund (FIDE))	2.5
Withholding taxes on government salaries and wages	4.4
Customs duties on projects (treasury checks)	1.5

52. The government wage bill is valued on a commitment basis for all staff (permanent and temporary) of the civil service and the armed forces, including withholdings on behalf of the tax general directorate. The wage bill covers wages, salaries, and bonuses for the current period, even when pay advices for the period are not issued by the payroll directorate, owing to the payment lag. The 2004 wage bill was estimated at CFAF 38.9 billion.

53. The narrow primary fiscal balance on a cash basis is calculated as the difference between government revenue valued on a cash basis (excluding earmarked revenue, withholding taxes on government salaries and wages, and project-related customs duties) and primary government expenditure, which is total government expenditure excluding interest payments and externally financed investment, and including treasury operations, valued on a cash basis.

54. The net change in government domestic payments arrears on wages and purchases of goods and services corresponds to unpaid salaries, wages, pensions, and bonuses of civil servants and other government employees and to unpaid payment orders to suppliers of goods and services during the period. This change corresponds to a net reduction of arrears when the amount is negative and a net accumulation of arrears when the amount is positive.

The net change in government domestic payments arrears on purchases of goods and services includes the deposit accounts of enterprises at the treasury resulting from unpaid expenses on goods and services supplied, and excludes unpaid government's utility consumption.

55. The end-of-period stock of net claims of the banking system on the government, excluding the counterpart of the use of Fund resources, is valued in accordance with the accounting framework currently used by the Bank of Central African States (BEAC). As of December 31, 2004, these claims amounted to CFAF 41.670 billion, broken down as follows:

Net banking system claims on the government, excluding the counterpart of the use of Fund resources (in billions of CFA francs)	41.670
Statutory advances from the BEAC	15.540
Extraordinary advances from the BEAC	9.574
Consolidated debt owed to the BEAC	14.552
Minus: deposits held with the BEAC	2.171
Debt owed to commercial banks	5.009
Minus: deposits with commercial banks	0.834

The change in net claims of the banking system on the government as of the date for the quantitative indicator is defined as the difference between the stock at the date indicated and the stock on December 31, 2005. The coverage implies a definition of government that is broader than the definition given in paragraph 3 and includes public institutions.

56. The indicators for external debt are cumulative ceilings on new nonconcessional external debt contracted or guaranteed by the government.

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

a. This indicator applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, adopted by the Executive Board of the IMF on August 24, 2000 (Decision No. 12274-00/85) but also to commitments contracted or guaranteed for which value has not been received. For purposes of these guidelines, the term "debt" is understood to mean a current, that is, not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans, under which the obligor is required to repay

the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, that is, arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

b. Loan concessionality is assessed on the basis of the commercial interest reference rates (CIRRs) established by the OECD. A loan is said to be on concessional terms if, on the initial date of disbursement, the ratio of the present value of the loan, calculated on the basis of the reference interest rates, to its nominal value is less than 50 percent (that is, a grant element of at least 50 percent). For debts with a maturity exceeding 15 years, the ten-year reference interest rate published by the OECD is used to calculate the grant element. For shorter maturities, the six-month market reference rate is used. Purchases from the IMF are excluded from this limit.

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

59. Customs receipts are defined as revenue collected by the customs general directorate on a cash basis, and including offsetting operations in current revenue and expenditure, but excluding earmarked revenue, and customs checks for project-related customs duties.

60. The narrow primary fiscal balance on a payment order basis is calculated as the difference between government revenue valued on a cash basis (excluding earmarked revenue, withholding taxes on government salaries and wages, and project-related customs duties) and primary government expenditure, which is total government expenditure excluding interest payments and externally financed investment, and including treasury operations, valued on a payment order basis. Government expenditure on a payment order basis includes all expenditure for which payment orders have been issued by the budget general directorate in the Ministry of Finance and Budget; automatic expenditure (such as wages and salaries, pensions, utilities, and other expenditure for which payment is

centralized); expenditure by means of offsetting operations; and budgetary contributions in the form of treasury checks in payment of project-related customs duties. In the absence of appropriate documentation indicating the amount of expenditure for which payment orders have been issued, the amount indicated in the cash-flow plan by way of a projection of payment orders will be used for program assessment. Nonetheless, if the primary expenditure on a cash basis is higher than the amount indicated in the cash-flow plan, the former will be used in the computation of the narrow primary balance. Narrow primary expenditure for 2004 was estimated at CFAF 74.4 billion, broken down as follows:

Narrow primary government expenditure (TOFE basis; in billions of CFA francs)	74.4
Current expenditure	66.7
Wages and salaries	38.9
Goods and services	17.8
Subsidies and transfers	10.0
Domestically financed capital expenditure	7.7

61. As a consequence, the narrow primary fiscal balance for 2004 was CFAF-18.6 billion.

62. The net change in government domestic payments arrears corresponds to the difference during the period between payment orders agreed by the government, excluding external debt operations, and payments made. This change corresponds to a net reduction of arrears when the amount is negative and a net accumulation of arrears when the amount is positive. Government payment orders include all expenditure for which payment orders have been approved by the budget general directorate in the Ministry of Finance, automatic expenditures (such as wages and salaries, pensions, utilities, and other expenditures for which payment is centralized), and payment orders approved by project managers. Government payments include cash payments by the treasury and offsetting operations.³ The net change in government domestic payments arrears is estimated by its components, including the net balance of central government accounts, excluding the treasury accounts; this amount should also ensure a balanced supply and use of funds in the consolidated government flow of funds table (TOFE). For 2004, the net change in arrears was CFAF 2.9 billion (that is, a net increase), broken down as follows:

³ The net change in arrears does not necessarily correspond to arrears in the legal sense. The calculation described here also takes into account temporary operations, such as net flows of cash operations, as well as temporary discrepancies in the data on net banking system claims on the government as reported by the government and by the BEAC.

Net change in domestic payments arrears (in billion of CFA francs)	2.9
On current expenditures	7.1
<i>Of which:</i> wages and salaries	3.8
On domestic debt	-3.7
Treasury operations	-0.5

Adjusters

The following adjusters will be in effect:

63. To the extent that additional (nonprogrammed) external budgetary assistance becomes available, the authorities will use these resources to:

- a. reduce the government’s external payments arrears; and/or
- b. reduce net claims of the banking system on the government, excluding the counterpart of the use of Fund resources; and/or
- c. execute priority public expenditure.

64. The floors on the narrow primary balance (both cash and payment order basis) will be adjusted downward to reflect budgetary support from donors used for executing priority expenditure. The ceiling on the change in net claims of the banking system on the government will be adjusted downward in the event that external budgetary assistance is not used for the amounts specified in paragraph 17.

65. The ceiling on the change in net claims of the banking system on the government will be adjusted downward to reflect borrowing from banks or other financial institutions outside the Central African Republic, or domestic financial institutions that do not appear in net claims of the banking system on the government.

II. Structural Indicators

66. The structural indicators are listed in Table 2 of the memorandum of economic and financial policies. The definition of the terms in the table are as follows:

- Following up on delinquent taxpayers involves sending the appropriate notices and applying and collecting the appropriate penalties according to the relevant regulations.
- Inspection and examination (in relation to the effort to strengthen the Douala office and to strengthen the examination of tax returns) are defined as critical reviews of existing practices in order to identify and correct anomalies.

- Limit and secure the issuance of Treasury checks against deposit accounts refers to i) controlling and tracking the stock of Treasury checks including by prohibiting payment of these checks outside the capital Bangui, and ii) monitoring the deposit accounts to ensure that the balance remains below a ceiling agreed with staff. The issuance of checks against these accounts will stop when the ceiling is broken and until the balance declines under the ceiling.
- Unnecessary government bank accounts are those that are not in place for statutory reasons or because of agreements with external donors.
- Simplifying the expenditure process entails measures to streamline the process by better defining the commitment and payment stages of the process and clearly separating them, and reducing redundancies of controls in each stage.
- Publication is defined as making information available to the public i) via a functional internet site accessible to the press, news agencies, and non-governmental organizations or directly to those entities in the absence of a functional internet site, ii) according to a pre-determined calendar and, iii) using templates agreed with IMF staff. This can include information made available by the General Secretariat of the government.

III. Program Monitoring

67. Monitoring of the quantitative and structural indicators will be the subject of a monthly evaluation report, prepared within six weeks of the end of each month. This document, which will be based on information available within the shortest timeframe as indicated below, will assist with assessing performance in terms of the program's quantitative and structural objectives.

68. The Standing Technical Committee responsible for program monitoring (CTP-PAS) will regularly report the data and other information required for program monitoring to the IMF's African Department by fax or e-mail, including the following information:

- a. a comprehensive monetary survey, central bank survey, and commercial bank accounts (within six weeks);
- b. the net claims of the banking system on the government (within ten days of the end of the month);
- c. table on budgetary cash flow (within four weeks);
- d. table on operational cash flow (within four weeks);
- e. government budget operations (TOFE);
- f. end-of-period stock of domestic arrears (within four weeks);

- g. end-of-period stock of external arrears (within four weeks);
 - h. breakdown of cash outlays for current expenditure and for domestically financed capital expenditure (within six weeks);
 - i. report on government spending in the priority sectors (health, education, social affairs, and rural development) through to cash payments by the treasury (within six weeks);
 - j. monthly table with data on budgetary commitments, payments orders, and cash payments (with a view to reinforcing budget execution and the monitoring of arrears); the first table will start on February 15 with the data for January 2006. Starting from February, the maximum period between the base month and the date at which the table is provided will be four weeks;
 - k. breakdown of revenue office receipts, including the monthly report on the reconciliation of customs payments with data from the import certification agency (within four weeks); and details of any prepaid tax receipts (within six weeks);
 - l. breakdown of external debt-service and external debt arrears, including by interest and principal, and by principal creditor (within four weeks);
 - m. the amount of new nonconcessional external debt contracted or guaranteed by the government (within four weeks);
 - n. actual disbursements of nonproject external financial assistance, and external debt relief granted by external creditors (within four weeks);
 - o. indicators to assess overall economic trends, such as the household consumer price index (within four weeks);
 - p. import and export flows (in volume and value), activity in the forestry sector and industry on a quarterly basis (within six weeks);
 - q. a review of the implementation of structural measures, including explanatory notes and supporting documentation on each of the measures in table 2 (within six weeks); and
 - r. A copy of all information published in line with paragraph 19 (within four weeks).
69. In addition, the Ministry of Finance will provide the IMF's African Department with the following specific information, to be sent not later than 21 days after the end of the respective month:
- a. a monthly report on the structure of petroleum prices; and

- b. a bimonthly report on the implementation of specific measures at the tax, customs, budget, and treasury general directorates, as recommended by technical assistance missions of the IMF.
70. The Ministry of Finance will also provide the IMF's African Department with any information deemed necessary or required by Fund staff for program-monitoring purposes.