

## International Monetary Fund

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## LETTER OF INTENT

November 29, 2007

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
700 19<sup>th</sup> Street N.W.  
Washington DC 20431  
USA

Dear Mr. Strauss-Kahn:

The attached Memorandum of Economic and Financial Policies, reviews implementation to date of the Cape Verde government's macroeconomic and structural program under the country's three-year Policy Support Instrument (PSI), approved by the IMF Executive Board in July 2006. Details of this program are set out in the initial Memorandum of Economic and Financial Policies (MEFP) of July 2006, which was updated in January 2007 and May 2007 in conjunction with the first and second reviews of the program. The attached MEFP builds on the initial memorandum, with particular attention to policy developments and prospects for 2008. The fourth and fifth reviews of the PSI are scheduled to be completed by end-April 2008 and end-October 2008, respectively.

The government believes that this program will provide firm support for macroeconomic stability and the exchange rate peg, and create the fiscal space needed to adjust to possible declines in concessional external financing following the country's expected graduation from Least-Developed-Country status in 2008.

Under the PSI, the government will keep the IMF regularly updated on economic and policy developments and will provide the data needed for adequate monitoring of the program, including in the context of the twice-yearly reviews. During the period of the PSI, Cape Verde will consult with the IMF on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the IMF requests such a consultation.

We authorize the IMF to publish this letter, the attached MEFP, and the related staff report.

Sincerely yours

/s/

Cristina Duarte  
Minister of Finance and Public Administration.

## MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

### I. INTRODUCTION AND BACKGROUND

1. **Cape Verde's economic performance remains strong.** The outlook for growth and inflation is favorable, and fiscal and monetary policies are consistent with program goals. In particular, public debt is coming down as a share of GDP and international reserves are building rapidly. Important progress is also being made toward the structural objectives of the program namely public sector management, especially fiscal accounting, budget execution and control, and arrears prevention; strengthening of the financial sector and improving energy sector regulation.

2. **Reflecting this solid performance, Cape Verde is on the verge of graduation from the UN least-developed-country (LDC) status in early 2008.** While this graduation has its benefits, the government recognizes that this will also entail challenges. In particular, while the government of Cape Verde will continue to seek concessional support, we need to prepare to become less dependent on aid in the future. Further improvements in the business environment are needed to attract private capital. At the same time, to support macroeconomic stability and the exchange rate peg, we intend to reduce government's domestic debt ratio, increase foreign reserves and create fiscal space to accommodate possible declines in concessional external financing as the country graduates from LDC status.

3. **In this vein, the government's policies will continue to focus on four areas to enhance macroeconomic stability and implement structural reforms that remove barriers to productivity growth and encourage private-sector led development.**

Specifically we will aim to:

- *Consolidate macroeconomic stability*, notably by reducing public debt and increasing official foreign exchange reserves;
- *Improve public sector financial management*, including by strengthening macroeconomic coordination and planning, stopping arrears, broadening the tax base, and improving internal and external audit processes;
- *Reduce fiscal risks*, including those that could arise from operations of state-owned enterprises; and
- *Strengthen regulation and supervision of the financial sector* to enhance the efficiency of the financial system, particularly in the growing offshore financial center.

## II. THE CURRENT ECONOMIC SETTING

4. **Cape Verde's recent economic indicators point to high growth, falling unemployment and modest inflation.** According to new data from the National Statistical Institute (INE), growth in 2006 appears to have been much stronger than earlier estimated—reaching 10 <sup>3</sup>/<sub>4</sub> percent. Growth was particularly strong in tourism, telecommunications, financial services, and construction. In line with this, growth for 2007 is projected to be around 7 percent. “Headline” consumer price inflation has largely come down as expected since 2006, but is now being pushed up temporarily due to poor rainfall and recent adjustments in petroleum prices. Consumer price inflation (annual average) is now projected to reach about 5 percent for 2007.
5. **The June 2007 program quantitative targets were observed by wide margins.**
- **International reserves continue to accumulate rapidly,** significantly exceeding the program target at end-June. Cape Verde has continued to attract official assistance, and tourism and foreign direct investment (FDI) flows are both surging.
  - **Domestic borrowing was significantly below its ceiling.** The government has already unwound the CVEsc 2.3 billion higher-than-targeted borrowing that arose in 2006, and the end-2007 domestic borrowing ceiling has been lowered by the same amount. Tax revenues are growing higher than projected, and receipts from privatization and land sales have already surpassed the amounts budgeted for 2007. Expenditure commitments are being closely monitored and controlled, with expenditures evolving in line with budget ceilings. The government is further strengthening budget management to ensure that this strong performance continues (see below). Because of these measures and stronger growth prospects, domestic debt is expected to decline to below 23 percent of GDP by end-2007, significantly below the target set at the beginning of the PSI program.
6. **Significant progress has been made on the reform front.** In the area of public sector financial management, the government has taken firm measures to prevent a recurrence of central government payment arrears, and there has been no accumulation of such arrears in 2007. There has also been significant reduction in the accumulation of arrears by municipalities (with most of them being current). We are also strengthening budget execution and monitoring practices, including improved control of end-year spending commitments. The Bank of Cape Verde (BCV) is moving ahead with plans to strengthen banking supervision, to upgrade legislation concerning anti-money laundering and combating the financing of terrorism (AML/CFT), and to establish a financial intelligence unit. As part of its broader strategy to improve efficiency and capacity in the energy sector, the government will introduce more transparent approaches for pricing energy products, which will help to ensure that no further contingent fiscal liabilities are borne by the budget.

### III. MACROECONOMIC OBJECTIVES AND POLICIES FOR 2008

#### A. Macroeconomic Objectives

7. **We expect growth to be about 7¾ percent in 2008**, underpinned by further growth in tourism investment and other services, and by public infrastructure investment. Inflation is expected to return to trend value of about 2 percent consistent with the peg. Gross reserves are targeted to increase by 0.1 month of imports. The specific program objectives for the remainder of 2007 and for 2008 are set out in Table 1 (attached).

#### B. Fiscal policy

8. **Continued fiscal consolidation remains key to our macroeconomic program and the 2008 budget aims at a further sizable reduction of the domestic debt-to-GDP ratio.** This budget is based on prudent projections for revenues and expenditures, with tax revenues and the wage bill budgeted to grow by less than nominal GDP. The goods and services budget is sufficient to ensure timely payment of recurrent bills, notably electricity, water, and fuel. To provide more flexibility in managing debt, the budget's ceiling for domestic borrowing will be on a net basis (rather than on a gross basis as in the past), and the Treasury will seek to clear arrears more rapidly if extraordinary revenues materialize. There will be no additional net domestic borrowing by the budget in 2008. Consequently, the net domestic debt-to-GDP ratio is projected to decline to below 20 percent by end-2008, one year ahead of the original target set under the PSI.

#### C. Monetary Management

9. **Monetary management remains fully consistent with the program goal of building up foreign exchange reserves to support the exchange rate peg to the Euro.** Within the framework of the exchange rate peg, the BCV will continue to more actively manage liquidity and interest rate differentials with the Euro area. Liquidity management will continue to be implemented through the issuance of 14-day and 6-month central bank bills and the interest rate offered on the 14-day bill constitutes the BCV's official policy rate. More generally, the BCV will continue to monitor the liquidity situation closely and its implications for domestic interest rates and credit growth, and adjust policy operations as appropriate.

#### D. Structural Reform Issues

##### *Public sector financial management:*

10. **The government is moving ahead with its program of strengthening public sector financial management.** In particular, the Ministry of Finance is:

- Closely monitoring spending commitments, payments, and accounts payable through the SIGOF (Integrated Online Budget Management) system, which will be expanded to include all semi-autonomous institutes and most municipalities by the end of this year. In addition a new procedures manual will be drafted with Millennium Challenge Corporation (MCC) funding to support the ongoing decentralization of budget execution and the upcoming implementation of the new budget framework law and new chart of public accounts, and to ensure that all spending units will use SIGOF consistently;
- Instituting as of 2007 an earlier (November 30) deadline for granting new spending commitments to reduce end of year payment pressures. Spending commitments after November 30 will be authorized only on an exceptional basis;
- Introducing a formal mid-year review of fiscal developments: this will assess revenue, expenditure, and financing developments halfway through the fiscal year, compare these with budget forecasts, and take corrective actions if necessary.
- A new chart of government accounts (PNCP) has been approved by Parliament and will be implemented in 2008.
- Preparing a new treasury management system;
- Moving ahead with the development of a medium-term expenditure framework.

11. **The government intends to update and strengthen the tax framework.** Drafts of the revised General Tax Code, a new Code on Judicial Processes, a Forced Tax Collection code, and bills covering individual and corporate income taxes (IRC and IRS) have been prepared, and these will be submitted to the National Assembly before end-December 2007. In addition, to further reduce and streamline the granting of tax incentives and exemptions, the government has commenced preparation of a unified law on tax benefits that will revoke all tax benefits not specifically mentioned in the new law. In support of this effort, the government requests further IMF technical assistance to meet its policy goals in this area and drafting of the associated legislation. The government intends to submit this legislation to the National Assembly in 2008. Pending the completion of this work, a moratorium has been put in place on the granting of new tax exemptions.

12. **To further improve tax administration, the government is strengthening the structure, functioning, and management of the General Directorate of Taxes (DGCI).** These reforms, which draw on the recommendations of recent technical assistance from the IMF, include refocused tax collection and control towards major tax payers. To deter tax evasion, the DGCI will cross-check, using computer tools, taxpayer information in databases in the Ministry of Labor, Social Security Institute and Customs. With the hiring of new tax inspectors, taxpayers will be audited more frequently. The DGCI is also preparing to

implement the Forced Tax Collection Code as soon as possible after its approval. The recovery of tax liabilities of large amounts and close to expiry will be given priority. Recovery processes will be opened more quickly, and assets seized in these processes will be auctioned with minimal delay.

**13. The Ministry of Finance has introduced firm measures to prevent accumulation of public sector arrears.** In particular, the Ministry is:

- carefully monitoring the payment arrears of central government entities, including semi-autonomous agencies;
- working with these entities to strengthen their budget execution and payment practices; and
- applying procedures to make the required payments on behalf of these entities if they incur arrears and deduct those amounts from government transfers to them.

**14. Furthermore, municipalities have agreed in principle to pay electricity bills on time,** and are working with Electra to ensure that the amounts billed correctly reflect their responsibilities in this regard. The government is preparing a tax on consumer electricity bills to meet the costs of public lighting, which has been a persistent area of dispute between municipalities and Electra.

**15. The government is strengthening external and internal audit processes.** A new draft law concerning the Court of Auditors (TdC) has been submitted to the National Assembly. In addition, a new customs audit court has been set up and the Tax Inspectorate will be strengthened and modernized. As for internal audit, a new budget framework law will create the positions of financial controllers in 2008 to strengthen internal audit.

**16. The government is also preparing to implement a number of civil service reforms.** The draft Civil Service Framework Law is expected to be sent to the National Assembly and come into force in 2008. The key objectives of this law were described in the LOI for the second review of the PSI.

***Financial Sector Issues:***

**17. The BCV is strengthening regulation and supervision of the financial sector.** In particular:

- New bank regulations on capital ratios, provisioning and loan classification; credit risk assessment, and credit concentration have been approved and will soon be published;

- New banking accounting rules based on international accounting standards will be implemented from 2008;
- Procedures for bank licensing and supervision are being strengthened, supported by technical assistance from the IMF;
- The BCV is finalizing information sharing agreements with the home country supervisor of most of the current offshore financial institutions, and seeking similar agreements with other countries;
- Following the recent AML/CFT assessment by the Fund, the BCV is preparing to implement the recommendations arising from this assessment in the first half of 2008 (a new structural benchmark under the program);
- Also drawing on the AML/CFT recommendations, legislation to set up a Financial Intelligence Unit is being prepared and will be presented to the National Assembly by end-March 2008 (a structural benchmark).

18. **The above measures to strengthen the financial sector will support the BCV's strategy of further opening the capital account.** This move will largely validate the current de facto situation regarding inward and outward capital flows. Measured liberalization will support the ongoing economic and financial development of Cape Verde, including access to international financial markets. A revised decree law to further liberalize the capital account has been drafted and should soon be submitted to the Government for approval.

### **Energy Sector Reform**

19. **The government is putting in place a comprehensive strategy to ensure that the energy sector is able to support the growth and development of Cape Verde, and is not a source of fiscal risk.** Working with public and private participants in the sector, the government's strategy emphasizes:

- Investment to increase capacity and efficiency, including improvements in electricity generation and transmission, higher water production capacities, and development of alternative energy sources;
- Increased private sector participation in the sector's management and investment activities;
- Formation of a joint logistics company to handle importation, storage and inter-island distribution of oil products;
- Improvement in billing and collection practices, including use of pre-paid meters for electricity and reduction in illegal connections.

20. **To support the above developments, the government remains committed to improving the regulatory frameworks for the energy sector.** With the administrative council of ARE (economic regulatory agency) again at full strength, the government is determined to ensure that domestic fuel prices are adjusted in line with international prices. In this respect, retail gasoline and diesel prices were increased by 15 and 11 percent respectively on October 24 which will clear the contingent fiscal liabilities that had built up over the period while prices were unchanged. Furthermore, the government has directed ARE to ensure, through regular fuel price adjustments, that no further fiscal liabilities accrue. To support the regular and transparent alignment of domestic fuel prices with international prices, ARE intends to have a new adjustment mechanism in place no later than end-March 2008. This mechanism will be based on international benchmark prices and applied with minimal delay after each shipment of oil imports. Publication and implementation of this mechanism will be a new structural benchmark under the PSI program.

21. **An adjustment in electricity and water tariffs is not required at present.** A commission charged by the oil companies on earlier fuel supplies to Electra (the electricity and water utility) should not have been charged. The resulting balance now owed to the Treasury will be drawn on to cover the difference between the (notional) revised fuel oil and the actual price Electra will be charged for the rest of 2007. After that the market price will be charged (with consequent adjustments in electricity and water prices).

22. **Implementation of the mechanism for setting base electricity tariffs is also planned for the first quarter of 2008.** This mechanism had originally been expected to be ready by June 2007, but has been delayed by the need to confirm two new members of the ARE administrative council. Its implementation by March 2008 (which will be an assessment criterion for the fourth review under the PSI) will enable base electricity tariffs to begin to reflect the broader structural reform strategy noted above that will improve efficiency in the energy sector.

Table 1. Cape Verde: Quantitative Assessment Criteria and Benchmarks for 2007-08 Under the PSI<sup>1, 2</sup>

	2006 Dec. Level Actual	2007								Cumulative Flows from End-December, 2007 2008			
		March		June		Sep. Indicative target	Dec. Assessment Criteria	March Indicative Target	June Assessment Criteria	Sep. Indicative Target	Dec. Indicative Target		
		Indicative target	Indicative target w/ adjusters	Actual	Assessment Criteria w/ adjusters							Actual	Actual
<b>Quantitative targets</b>													
Ceiling on net domestic borrowing of the central government <sup>3</sup>	...	-0.8	-0.2	-2.3	-1.5	-0.3	-4.0	-2.9	-3.9 <sup>9</sup>	-0.4 <sup>10</sup>	-0.8 <sup>10</sup>	-1.3 <sup>10</sup>	-1.7 <sup>10</sup>
Ceiling on net domestic assets of the central bank <sup>4</sup>	1.5	-0.7	-0.2	-0.4	-1.5	-0.2	-4.7	-2.3	-3.0	-0.7	-1.3	-2.0	-2.6
Ceiling on the accumulation of new domestic payment arrears by the central government	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0 <sup>5</sup>	0.0	0.0	0.0	0.0
(Millions of U.S. dollars)													
Ceiling on the accumulation of new external payment arrears by the central government <sup>5</sup>	...	...	...	0.0	0.0	0.0	0.0	0.0	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 <sup>6</sup>	...	5.0	5.0	0.0	21.0	21.0	0.0	28.0	35.0	5.0	21.0	28.0	35.0
Ceiling on the outstanding stock of nonconcessional external debt with a maturity of less than one year by the central government <sup>5,7</sup>	...	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(Millions of euros)													
Floor on net international reserves of the Bank of Cape Verde (BCV) <sup>8</sup>	183.3	10.3	9.7	8.2	20.6	19.3	53.0	30.0	41.2	13.3	26.6	38.7	53.2
(Billions of Cape Verde escudos)													
<b>Memorandum item:</b>													
<b>Program assumptions</b>													
Nonproject external financial assistance, including credit line (program assumption)	...	0.7	0.7	0.0	1.5	...	0.0	2.2	3.0	0.6	1.2	1.8	2.4
External debt service	...	0.7	0.7	0.5	1.3	...	1.1	2.0	2.6	0.7	1.3	2.0	2.6
Land sales	...	...	...	...	...	...	...	...	2.0	...	...	...	...
Clearance of end-2006 stock of domestic arrears	...	0.3	0.3	0.1	0.5	...	0.2	0.8	1.0	0.4	0.8	1.1	1.5

<sup>1</sup> Quantitative assessment criteria and benchmarks are described in the technical memorandum of understanding.

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

<sup>3</sup> Excluding borrowing for clearance of arrears and net late payments. 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) deviation in nonproject external financial assistance relative to program assumptions.

<sup>4</sup> 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) deviation in nonproject external financial assistance relative to program assumptions.

<sup>5</sup> This assessment criterion is on a continuous basis.

<sup>6</sup> This assessment 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 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.

<sup>7</sup> 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.

<sup>8</sup> The floor on net international reserves of the Bank of Cape Verde 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.

<sup>9</sup> The end-2007 ceiling will be adjusted upward by the downward deviation in revenue from contracted land sales relative to program assumption.

<sup>10</sup> The 2008 ceilings will be adjusted downward by the downward deviation in revenue from contracted land sales in 2007 relative to the 2007 program assumption.

**Table 2. Cape Verde: Structural Assessment Criteria and Benchmarks for 2007–08**

Objectives	Conditionality	Timing	Status
<b>Structural Assessment Criteria</b>			
Reduce fiscal risks.	Fully implement the automatic utility tariff adjustment mechanism.	End-March 2007	Met
Reduce fiscal risks.	Finalize and publish the mechanism for setting base utility tariffs	End-June 2007	Not met
Reduce fiscal risks.	Fully apply mechanisms for setting and adjusting electricity, water, and fuel prices	Continuous as of July 1, 2007	Not met
<b>Structural Benchmarks</b>			
Strengthen financial supervision.	Sign formal information-sharing agreements with home country supervisors of subsidiaries and branches operating in Cape Verde.	End-December 2006	In progress
Improve budget prioritization	Implement the MTEF.	End-June 2007	In progress
Strengthen financial regulation.	Implement recommendations of the task force on financial sector reform.	End-June 2007	In progress
Strengthen fiscal control.	Implement laws to strengthen the Court of Auditors (TdC) and the National Chart of Public Accounts.	End-June 2007	In preparation
Strengthen the tax base.	Large taxpayers unit to be fully operational	End-June 2007	Met
Strengthen tax administration.	Finalize reform strategy for DGCI	End-December 2007	
Strengthen the tax base.	Submit the new General Tax Code to the National Assembly.	End-December 2007	
Strengthen the tax base.	Submit the new Code on Judicial Processes to the National Assembly.	End-December 2007	
Strengthen the tax base.	Submit the draft individual and corporate income taxes bills to the National Assembly.	End-December 2007	

**Table 2. Cape Verde: Structural Assessment Criteria and Benchmarks for 2007–08, concluded<sup>1</sup>**

Objectives	Conditionality	Timing	Status
<b>Proposed New Measures</b>			
<b>Structural Assessment Criteria</b>			
Improve fiscal policy execution	Complete a formal mid-year review of revenue and expenditure developments that allows for taking corrective actions if necessary.	End-August 2008	
Reduce fiscal risks.	Finalize and publish the mechanism for setting base utility tariffs	End-March 2008	
<b>Structural Benchmarks</b>			
Reduce fiscal risks.	Finalize and publish a revised mechanism for adjusting petroleum prices.	End-March 2008	
Improve budget control	Instituting November 30 as deadline for granting new spending commitments to reduce end year payment pressure.	End-October 2007	
Strengthen financial supervision.	Submit to the National Assembly legislation to establish a Financial Intelligence Unit.	End-March 2008	
Strengthen financial regulation.	Submit to the National Assembly legislation to criminalize financing of terrorism and facilitate the combating of financing of terrorism.	End-March 2008	
Strengthen financial regulation.	Submit to the National Assembly legislation to strengthen the framework for combating money laundering.	End-March 2008	

<sup>1</sup> Measures added in the third program review.

## TECHNICAL MEMORANDUM OF UNDERSTANDING<sup>1</sup>

1. This memorandum sets out the understandings between the Cape Verdean authorities and the IMF staff regarding the definition of assessment criteria and indicative targets and reporting requirements under the first annual program supported by the Policy Support Instrument.

### I. QUANTITATIVE ASSESSMENT CRITERIA AND INDICATIVE TARGETS

#### A. Net Domestic Borrowing Excluding for Clearance of Arrears and Net Late Payments

2. **Net domestic borrowing excluding for clearance of arrears and net late payments** is defined as the cumulative change since the start of the calendar year of the net credit to the central government from the banking and nonbanking sectors less (1) the cumulative clearance during the calendar year of the stock of arrears as of the end of the previous year and (2) the cumulative payments during the first three months of the calendar year of expenses authorized by the previous year's budget, and plus the expenses accrued during the current year that will be paid during the first three months of the next calendar year as provisioned for in the budget law (late payments or *atrasados*). 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. Also, the end-2007 ceiling will be adjusted upward by the downward deviation in revenue from contracted land sales relative to program assumption, and the 2008 ceilings will correspondingly be adjusted downward by the downward deviation in revenue from contracted land sales in 2007 relative to the 2007 program assumption.

3. **Net credit to the central government from the banking and nonbanking system** is defined as the overall position of the main central government institutions vis-à-vis the banking and nonbanking 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, commercial banks, and nonbank institutions, less all deposits held by the central government with the central bank and with commercial banks. The INPS is not included in central government accounts. Net credit to the central government excludes claims on the Trust Fund (TCMFs).

4. **Reporting requirements.** Data on the implementation of the budget compiled by the Ministry of Finance and Public Administration will be provided on a quarterly basis, to be submitted not later than five weeks after the end of each quarter, including (i) government domestic revenue by category; (ii) external budget support grants; (iii) government

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<sup>1</sup> Unchanged from EBS/07/44, except for last sentence of paragraph 2 that has been added.

expenditure, including primary current expenditure, domestic and external interest payments, and capital expenditure, including domestically and budget support financed capital expenditure and estimates of externally project financed capital expenditure; (iv) the gross payment and gross accumulation of domestic accounts payable (*atrasados*); (v) the gross payment and gross accumulation of domestic payments arrears; (vi) external loan receipts and principal payments; (vii) external arrears payments and accumulation; (viii) bank and nonbank financing; (ix) privatization and land sale receipts; and (x) any other revenue, expenditure, or financing not included above.

5. For the purposes of this memorandum, privatization and land 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 sale of government land and the liquidation of a public company, less restructuring costs.

### **B. Net Domestic Assets of the Central Bank**

6. The ceiling on the cumulative change, from the beginning of calendar-year 2006, in net domestic assets of the BCV constitutes an assessment criterion. Net domestic assets (NDA) of the BCV are defined as reserve money minus net foreign assets of the BCV, evaluated at the current end-of-period exchange rates. 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. Ceiling on Nonconcessional External Debt Contracted or Guaranteed by the Central Government**

8. Under the program, ceilings on medium- and long-term, as well as on short-term, nonconcessional external debt constitute assessment criteria. The ceiling on medium- and long-term nonconcessional external debt is on a quarterly basis while the one on short-term nonconcessional external debt is 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 Table A1 of the Letter of Intent. 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. The assessment 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 assessment 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).

9. **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 assessment 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.

#### **D. Net International Reserves of the Central Bank**

10. The floor on the cumulative change, from the beginning of calendar-year 2006, in net international reserves (NIR) of the BCV constitutes a assessment criterion under the program. The NIR of the BCV are defined as gross international reserves of the BCV net of its external reserve liabilities, calculated at the current exchange rates. 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 and 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.

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

#### **E. Nonaccumulation of New Domestic Payments Arrears**

12. 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 either specified by the budget law or 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.

13. **Reporting requirements.** The Ministry of Finance and Public Administration, 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.

#### **F. Nonaccumulation of External Payments Arrears**

14. 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.

15. External arrears are defined as total external debt-service obligations of the government that have not been paid by the time they are due, except where agreements between the government and creditors explicitly provide for a grace period after such obligations falling due. External arrears exclude arrears on external debt, pending the conclusion of debt-rescheduling agreements.

16. **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 Public Administration, 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.

## **II. STRUCTURAL ASSESSMENT CRITERIA<sup>2</sup>**

### **A. Finalize and publish the mechanism for setting base utility tariffs**

17. The condition for finalizing and publishing the mechanism for setting base electricity and water tariffs will be deemed complete when (i) the technical specifications have been agreed upon between Electra and the autonomous Economic Regulatory Authority (ARE); (ii) the details of the base tariff setting mechanism have been published; and (iii) base tariff levels are brought in line with the agreed mechanism.

### **B. Continuous application of the mechanisms for setting and adjusting electricity, water, and fuel prices**

18. The condition will be deemed met when (i) base utility tariffs are set, and reset with the periodicity, as specified in the agreed base tariff setting mechanism; (ii) between resetting of base tariffs, utility tariffs are adjusted whenever input costs since the last adjustment have changed cumulatively by more than three percent as specified in the published utility tariff adjustment mechanism; and (iii) within one month of each import shipment of petroleum products, retail petroleum product prices are adjusted and brought in line with the specifications in the retail petroleum price adjustment mechanism.

## **III. OTHER DATA REQUIREMENTS FOR PROGRAM-MONITORING PURPOSES**

19. 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.

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<sup>2</sup> See Table A2 of the Letter of Intent of November 29, 2007.