International Monetary Fund

Union of the Comoros and the IMF

Press Release:
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December 16, 2008

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Union of the Comoros: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 26, 2008

UNION OF THE COMOROS: LETTER OF INTENT

November 26, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington D.C. 20431
U.S.A.

Dear Mr. Strauss-Kahn:

1. Our long and difficult process of national reconciliation is now getting back on track, following the most recent political crisis in the island of Anjouan. Economic and social conditions have worsened in the post-conflict period; the country's administrative capacity was severely weakened. The fiscal situation has tightened and relations with the international community have suffered. A new island President for the island of Anjouan was elected last June and his administration is fully functioning as an integral part of the Union of Comoros. The Union together with the three island governments has taken early steps to restore inter-island cooperation and reactivate the revenue sharing agreement. There are already encouraging signs of an improvement in national cohesiveness, and donor support is expected to resume.

2. In order to build on these recent gains, the government has agreed on a program of economic and financial policies that begins to address the immediate post-conflict challenges of stabilizing the fiscal position, building capacity for policy implementation, and normalizing relations with the donor community. The program also includes structural measures that lay the ground work for meeting the country's medium-term objectives of reviving growth, reducing poverty, and achieving fiscal and external sustainability. Many donors have already indicated they will provide critical financial and technical support for program management. In order to facilitate implementation of planned measures under the program, address our balance of payments needs and restore confidence in economic management, the government is requesting SDR 1.1125 million (12.5 percent of quota) under the Fund's Emergency Post-Conflict Assistance (EPCA) and SDR 2.225 million (25 percent of quota) under the Rapid-Access Component of the Exogenous Shocks Facility (ESF).

3. A critical factor underlying our program is the firm commitment by the Union and the three island governments to implement the agreed inter-island revenue sharing agreement. The details of the program are included in the attached Memorandum on Economic and Financial Policies (MEFP). The government believes that the policies and measures set forth in the MEFP are adequate for achieving the objectives of the program, but we will take any

further measures that may become appropriate for that purpose. In such cases, as well as before implementing policies that could adversely affect the program, we will consult the Fund.

4. To assist the Fund in assessing progress on the program, we will provide information on a regular basis as detailed in the attached Technical Memorandum of Understanding. Moreover, we invite the staff of the Fund to review performance under the program quarterly, on the basis of quantitative and structural indicators (Tables 1 and 2 of the MEFP) as well as on overall implementation of the program. We consent to the publication of both the staff report and memorandum on economic and financial policies pertaining to the discussions under the 2008 Article IV consultation and EPCA- and ESF-supported program discussions.

5. Going forward, we plan to deepen our reform agenda after the EPCA-supported program is completed. In this context, we intend to seek in due course IMF assistance under the Poverty Reduction and Growth Facility.

Sincerely yours,

/s/	/s/
Mohamed Ali Soilihi	Ahamadi Abdoulbastoi
Minister of Finance and Budget	Governor of the BCC

ATTACHMENT I

UNION OF THE COMOROS: MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2008–09

I. INTRODUCTION

1. Comoros is slowly recovering from the most recent political crisis. Decades of political instability have taken a significant toll: per capita real GDP has declined; basic social services have suffered and administrative capacity has weakened considerably. Almost half of the population lives below the poverty line, and there is limited access to clean water and electricity, and to services such as education and health care. The situation worsened over the last year due to internal strife and lack of donor assistance.

2. Major efforts since March of this year have helped to reunify the country, restart political reconciliation and begin the process of restoring institutions. The forced removal of the former Anjouan island rebel leader, Colonel Bakar, followed by the election of a new island president in June set the stage for bringing Anjouan back into the fold of the Union, resuming inter-island cooperation, and gradually rebuilding economic and social management institutions at the national level, including the revenue-sharing agreement initially put in place in 2005[1]. The government intends to further advance the national reconciliation process by effectively implementing laws devolving to the island administrations significant authority for domestic security, the judiciary, health, and education, and oversight of public sector enterprises.

3. The Union government, firmly backed by its island partners, is determined to pursue prudent economic and financial policies to begin putting the economy on a path of strong and sustainable growth for more effective poverty alleviation. With IMF assistance, an economic reform program has been prepared for the six-month period October 2008 to March 2009, aimed at strengthening institutions and governance, beginning to restore macroeconomic stability, and improving the investment climate. In support of these reforms, the government has requested IMF Emergency Post Conflict Assistance (EPCA), a bridge to a possible support under the Poverty Reduction and Growth Facility (PRGF) and debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI).

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[1] Under the revenue sharing agreement, the customs and tax authorities transfer revenues designated for distribution to a single special account at the central bank. Under the 2006 framework fixed percentages are set aside for external debt service (20.1 percent), and pension payments (5.5 percent). The remainder is shared as follows: Union (37.5 percent), Ngazidja (27.4 percent), Anjouan (25.7 percent) and Moheli (9.4 percent). However, beginning with the 2007 budget, provisions for external debt service are based on obligations actually falling due.

II. Economic Developments in 2007

4. Real GDP growth was a mere 0.5 percent in 2007, mainly reflecting the political crisis in Anjouan and the curtailment of domestic credit by the sole commercial bank following a disputed lawsuit. Both events have hampered business activities and reduced the volume of imports by 19 percent. The agricultural sector has been sustained only by a relatively good food harvest. Inflation stood at 4.6 percent ay year-end, driven by higher food prices and by the impact of rising oil prices. Broad money increased modestly by 1.1 percent, with declining domestic credit offsetting gains in net foreign assets.

5. Against a background of a destabilizing political crisis and economic decline, fiscal performance deteriorated. The 2007 budget targets were missed with the domestic primary deficit increasing to 2.2 percent of GDP against a budgeted surplus of 1.5 percent. Revenues were down by 3.9 percent of GDP against budget, reflecting poor economic activity in general, as well as weaknesses in fiscal administration in the face of political instability and the breakdown in the inter-island revenue sharing mechanism. The wage bill was well above the budgeted ceiling, mainly due to staffing increases in the run up to last year's presidential elections on the islands of Moheli and Ngazidja. Additional budget financing was secured from the central bank, donors, and short-term non-bank sources; nevertheless domestic arrears increased to 1.8 percent of GDP.

6. In 2007, the external current account deficit narrowed by 2.2 percentage-points of GDP, reflecting deterioration in the terms of trade and a surge in energy and food import values, despite strong inflows of remittances and a quite reasonable export performance. End-year official reserves amounted to over 7 months of import cover. Understandings on arrears clearance were reached with key multilateral creditors, in particular BADEA, IFAD, and the Arab Monetary Fund. The government also started debt discussions with the European Investment Bank (EIB), the Islamic Development Bank (IsDB) and OPEC. The African Development Bank (AfDB) approved an arrears clearance operation in December 2007, canceling $34.5 million in external debt arrears. However, Comoros' external debt burden remains unsustainable. The NPV of debt to exports ratio is estimated at over 249 percent in 2007, above the HIPC threshold. Remaining current on obligations stemming from recent external arrears clearance agreements represents a substantial drain on public finances, particularly in the absence of debt relief under the HIPC and MDRI initiatives. As a result, new arrears were accumulated at the end of 2007 amounting to 0.4 percent of GDP, of which 0.2 percent of GDP was owed to BADEA, EIB and IsDB.

7. Progress on structural reforms was held back by the political crisis. Nevertheless, a new investment code has been adopted, and some progress made toward liberalizing the telecommunication sector. Amendments to strengthen the central bank charter have been approved by both the French and Comoros finance ministries, and are awaiting parliamentary approval in both countries; at the same time progress has been made on implementing the

recommendations of the IMF's Safeguards Assessment and on strengthening supervision of microfinance institutions.

III. Outlook, Objectives and Economic Policies for 2008 And the Medium Term

A. Macroeconomic Framework for 2008

8. Economic developments in the first half of 2008 were dominated by a serious energy crisis and restrictions on credit to the private sector, at a time of particularly high seasonal economic activity driven by the visiting diaspora.

9. Despite a significant increase in international oil prices, the freeze on retail prices of petroleum products since 2005 and on electricity tariffs for the past 20 years was still in effect at end-June 2008. Moreover, a permanent government contract for importing petroleum products, which expired in April, was not been renewed, as a result of which the state-owned oil and gas (SCH) and electric (MAMWE) companies are beset by ever-increasing operating losses. Widespread power outages were suffered in mid-year and only 20 percent of annual oil imports are expected to be effected in the second half of 2008. Aware of the negative repercussions of this situation for economic activity, the government has started upwardly adjusting petroleum products prices, consistent with developments in underlying cost parameters. To that end, prices of key petroleum products were increased by 18 percent on average in August. Going forward, these prices will be revised on a quarterly basis, beginning in November 2008, to take account of changes in relevant cost parameters. In the financial sector, the Comoros' single commercial bank (Banque de l'Industrie et du Commerce) resumed normal activities in late September, following resolution of a lawsuit by a private sector economic operator. This should ease access to credit for the private sector, further facilitated by the recent opening of a new commercial credit institution (EXIMBANK of Tanzania).

10. Against this backdrop, the objectives of the government's economic program are based on a real GDP growth rate of 0.5 percent for 2008, underpinned mainly by activity in the agricultural sector; end-year inflation of 9.6 percent; and a current account deficit (including grants) of 8.7 percent of GDP. International reserves would be maintained around 6 months of imports of goods and nonfactor services.

B. Fiscal Policy

11. In the fiscal area, the program will focus on restoring inter-island cooperation and initiating fiscal consolidation. To that end, the 2008 budget of the Union, which was initially approved by parliament in February of 2008, has been amended and approved by the National Assembly last November to include Anjouan and to consolidate the framework of the revenue sharing mechanism. The budget anticipates a domestic primary deficit of 2.7 percent of GDP, and a nearly balanced overall budget position (on a cash basis, including grants). This takes account of delayed payments for wages (9 tenths of one month) and for debt service to selected external creditors, owing to the government's tight budgetary situation. The government has initiated discussions with concerned domestic and external creditors, including France, aimed at developing agreed modalities for an early settlement of the overdue payments; it is committed to remaining current on debt service to the World Bank and African Development Bank. On the basis of the above, the fiscal financing requirements for 2008 are estimated at CF 7.1 billion ($21.2 million or 3.9 percent of GDP). In addition to IMF support under the EPCA and ESF, external assistance under the program comprises budget support earmarked for wage and wage arrears payments—from the EU and France, food aid from the AfDB, and general budget support from Kuwait. Should additional external budget assistance become available, the government will consult with the Fund on its use and issue a further supplementary budget outlining how the resources are to be spent.

12. Strict implementation of the inter-island revenue-sharing agreement and better expenditure management should result in a more predictable cash flow that will facilitate the timely payment of domestic obligations, and help avoid the accumulation of new domestic arrears. In this context the government will curtail its use of the three-month bridge financing arrangement with the National Financial and Postal Services Company (SNPSF) to ensure timely payment of civil service salaries. It also intends to start repayment of the advances received from the SNPSF (CF 833 million at end-July 2008), the total of which is to be reduced by CF 238 million in net terms in 2008.

13. Domestic revenues are projected at CF 22,301 billion (12.4 percent of GDP), 5 percent higher than the revenue collected in 2007. This largely reflects efficiency gains in tax and customs administration and other recent measures to improve revenue collection. The customs department (i) implemented the ASYCUDA++ system in the islands of Ngazidja and Anjouan and intends to extend it to all customs agencies nationwide; (ii) established an exemptions control commission tasked with reducing exemptions by 40 percent from their 2007 level, in strict observance of the pertinent Vienna Convention; and (iii) took steps to remove the presumptive tax on containers from October 1, 2008, under the 2008 supplementary budget. In addition, a single taxpayer identification number system (NIF) was established and, after taking a census of large taxpayers, the General Directorate of Taxes (DGI) has refocused the activities of the Corporate Tax Unit to the exclusive monitoring the large taxpayers' fiscal obligations. The government plans to increase the unit's operating

budget, while the DGI works to complete implementation of the SYSIT system (aimed at enhancing tax compliance and collection). Finally, a customs-tax mixed commission was created to ensure better collaboration between the two administrations.

14. Total expenditures are estimated at CF 38,978 billion or 21.7 percent of GDP. The authorities are determined to slow the rapid growth in primary spending experienced in recent years to a level compatible with available resources. Accordingly, the government has (i) placed a freeze on new hiring in the civil service starting August 8, 2008; (ii) reduced the number of Union and island ministerial portfolios from 35 to 26 by end-November 2008; and (iii) launched the computerization of wage payments. Consequently, current primary expenditure will be limited to 14.4 percent of GDP, including 9 percent of GDP in wage payments, and capital spending financed with domestic resources will be contained at 0.7 percent of GDP. To ensure greater control of spending on goods and services, the government has decreed a freeze on non essential overseas missions.

15. Faced with a difficult budgetary situation, the government has taken only very limited fiscal measures to cushion the impact on consumers of higher food and oil prices. Customs tariffs on flour imports have been temporarily reduced and the government has made petroleum products available to the national electric company (MAMWE) at reduced prices. The fiscal cost of these measures is estimated at CF 249.3 million (0.14 percent of GDP) in the 2008 budget. The government recognizes that measures to protect the poor must be well targeted and relative price distortions avoided. In the medium term, adjustment requires price increases as needed to continue the recent trend towards revival of agricultural production.

16. In 2009, the government intends to intensify the revenue efforts and expenditure control measures initiated in 2008. As a result, the domestic primary budget deficit is projected to decline to 1.6 percent of GDP (2.7 percent in 2008). However, in view of greater debt service obligations falling due, the fiscal financing requirements for 2009 are expected to rise to the equivalent of US$25.1 million (4.8 percent of GDP). The government plans to organize a donors conference in the coming months to seek financing assurances to cover a residual gap currently estimated at the equivalent of $11.5 million (2.2 percent of GDP).

17. The government will complete an audit of domestic payment arrears, including an arrears clearance strategy, with donor assistance by end-June 2009. To that end, it began discussions with the World Bank last October 2008 and will hire the services of a consultant by January 31, 2009. In addition to government debt to private enterprises, the audit will cover cross-financial obligations between the Treasury and public enterprises.

C. Monetary Policy and Financial Sector Reforms

18. Broad money is projected to increase by 7.1 percent, with credit to the private sector remaining stagnant. Monetary policy will continue to be circumscribed by the Comoros' participation in the franc zone, which has enabled the government to contain inflation, and maintain a stable exchange rate and an adequate level of foreign reserves despite major fiscal imbalances.

19. The government is determined to ensure the independence of the central bank in monetary and credit policy. This is necessary to ensure macroeconomic stability and support the exchange rate regime in a more competitive banking environment seeking to achieve market-based interest rates.

20. The central bank will continue efforts to enhance the effectiveness of the financial system and to strengthen bank supervision. To encourage competition, it has granted licenses for the opening of two new foreign commercial banks specializing in financing the productive sectors. The BCC will endeavor to contain the potential risks that could arise with the operation of these new foreign banks by strengthening the modalities of cooperation with the banks' home country supervisors. A memorandum of understanding with these home country supervisors will be finalized by end-December 2008. In keeping with the decree of July 2004 authorizing BCC supervision of microfinance institutions (MFIs), the central bank will reinforce the supervision program for these institutions, which have experienced rapid growth in recent years.[2] The National Financial and Postal Services Company (SNPSF) will take steps to limit credit risks notably pertaining to its lending to public enterprises and to the Treasury; it will endeavor to extend the new postal checking service to a larger public.

21. To combat money laundering and the financing of terrorism, a law was adopted in 2004 to implement the rules derived from the United Nations conventions and resolutions and the 40 FATF recommendations. Updated consistent with new FATF recommendations, the legislation is under review, and awaits approval, by the government. The government intends to involve the autonomous islands in its implementation. The government, in consultation with the central bank and the autonomous islands, will endeavor to terminate the operations of the offshore banking centers.

22. To provide reasonable assurance that the central bank's legal structure, its control, accounting, reporting and auditing systems are adequate to manage resources, including IMF disbursements, the government has accepted key recommendations of the Safeguards

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[2] By the end of their first year of operations in 1997, the two MFI networks had created 39 funds on the different islands, collected more than CF 360 million in savings, and distributed CF 320 million in loans. By end-2005, they had reached a membership base of 54,480 and a network of 83 units on the three islands, and currently they have a market share of 31 percent of deposits and credit.

Assessment undertaken by the IMF Finance Department in 2007. The priority recommendations of this assessment are being implemented in line with the timeframe proposed in the assessment. In that connection, an audit committee was established and audited the 2007 accounts of the BCC. The government is also aware of the need to conduct an update safeguards assessment of the BCC in connection with EPCA and will provide all necessary support and information to facilitate completion of the update assessment prior to the IMF Executive Board consideration of a subsequent financial arrangement.

D. Structural Reform Agenda

Strengthening institutions and public expenditure management

23. As underscored above, the objectives of the fiscal program can only be achieved through strict adherence to the revenue-sharing mechanism. To this end, the governments of the Union and the autonomous islands have fully restored inter-island cooperation and strengthened accountability in public financial management. To improve efficiency, the parties have also agreed to centralize certain government functions, including revenue administration, monitoring of budget execution, and compilation of economic statistics. Implementation of the revenue-sharing mechanism will be monitored by the operation of inter-government committees and administrative units charged with data compilation and dissemination, as well as policy coordination. A unit has been established to consolidate fiscal data from the Union and island governments. In this context, the monthly meetings of the Budgetary Committee, made up of representatives from the Union and the three islands, will be strictly adhered to. Budget execution reports will also be prepared on a monthly basis and disseminated to the executive branches of the Union and the three island governments.

Civil service reform

24. The government is determined to significantly improve management of the wage bill. Reform of the public administration (initiated under the *Appui Pour une Administration Publique Performante*—APP—project funded by UNDP) is critical to that effect. It will notably consist of efforts to computerize the civil service payment roster and implement a computer-based and integrated system of payroll management. Other critical elements of the civil service reform include the adoption of organic frameworks which will help set the appropriate structure and optimal level of staffing for the civil service. A unit responsible for monitoring wage payments has been set up and its director appointed.

25. Implementation of the civil service reform program is being coordinated by the High Authority for Public Administration (HA-PA), which started operations in early 2007. HA-PA's responsibilities include preparation of the institutional and legal framework for the reforms within the public administration, coordination of all public entities, and effective surveillance of the Union-wide application of administrative and financial management

procedures. During 2008, the authority will propose for adoption by the Union and Island parliaments the envisaged organic frameworks for all ministries, which establish their structure and staffing levels. Such frameworks will be used in the preparation of the consolidated budgetary framework for the 2008 and subsequent budget laws.

Strengthening the investment climate

26. The government is determined to take steps to rehabilitate management of public enterprises—Société Comorienne des Hydrocarbures (SCH), the electricity (MAMWE) and telecommunication (Comores Telecom) companies. These must provide reliable service in order to attract investors, which is a critical condition for revitalizing economic activity. The liabilities of these units are a potential burden for the government budget. The government plans to engage the services of the International Finance Corporation (IFC) to assist in developing a coherent reform strategy for these enterprises. The government also plans to allow private sector participation in the importation of rice. The government also commits not to interfere in the price setting and marketing mechanisms for export crops: vanilla, cloves and ylang-ylang.

27. The government is determined to resolve the energy crisis, which threatens sustainable economic recovery. With technical assistance from donors, the government plans to introduce a permanent flexible mechanism for setting petroleum product prices, which would be reviewed on a quarterly basis, starting in November 2008, to reflect changes in international prices for oil products. In the meantime, as indicated above, it has already applied initial price increases for petroleum products and electricity rates, in an effort to begin reducing the operating losses of the concerned public utilities. This is critical for guaranteeing the steady availability of energy products and ensuring that needed adjustments are effected in the face increasing international energy costs. Lastly, the government will ensure that an agreement is signed with a firm of international repute to guarantee continuing availability of petroleum products.

28. Improvements in the investment climate will be needed to attract foreign investment and encourage a shift in the use of large remittances from consumption to growth-oriented investment. To support this, a draft Investment Code was approved by the parliament in 2007. The government will introduce a one-stop shop for investors and set up the National Investment Promotion Agency (ANPI) by end-December 2008.

29. The government is committed to trade liberalization. High specific import duties on key commodities have been converted into domestic excise taxes, and ad valorem tariff rates reduced to a new maximum of 20 percent. The government intends to pursue efforts aimed at simplifying and further reducing import duties in the context of the Comoros' adherence to the regional free trade area (COMESA). These efforts will focus on eliminating exemptions and the presumptive regime for imported multiple cargo containers. The recently concluded diagnostic trade integration study (DTIS) under the Integrated Framework Initiative has

assessed the overall competitiveness of the economy, identified sectors for greatest export potential and outlined constraints to trade development. The DTIS recommendations will be used to guide further reforms beyond our program horizon. By end-December 2008, the government will request IMF assistance in evaluating the effectiveness of its tax system, with a view to preparing a program of simplification and reform that would provide an incentive to private investment.

30. The government is committed to an extensive program to promote good governance, including civil service reform, judicial reform and increased transparency. The government will review and reform its public procurement procedures with a view to making them fully transparent and open to competition. Following the adoption by the National Assembly of the organic laws on the justice system, the Supreme Court, and the status of magistrates, the government will launch, starting in 2009, extensive reforms of the judiciary, and strengthen the powers of the courts. The government has requested the support of its development partners, including France and the UNDP, to help in the implementation of the action plan for justice aimed at improving the quality of the judicial system.

E. External Debt Relief and Management

31. The government is committed to regularizing its external debt situation and improving external debt management. In 2007, it signed agreements on the treatment of arrears owed to its multilateral and bilateral creditors. It is committed to closely working with concerned creditors in developing mutually agreed modalities for dealing with related debt service obligations as they fall due, pending implementation of a comprehensive IMF-supported program and Comoros' subsequent eligibility for debt relief under the enhanced HIPC Initiative.

32. The government will pursue a prudent debt management policy**.** Any government or government-guaranteed external borrowing will be subject to prior approval by the Finance Minister of the Union, and the autonomous island governments may under no circumstances contract or guarantee external loans. Moreover, for the full duration of the program, the government will not contract or guarantee any nonconcessional or short-term external debt, as defined in the Technical Memorandum of Understanding (TMU). The government is committed to avoiding any accumulation of new external arrears in 2009; it will consult closely with the IMF staff regarding any external debt contracted or guaranteed on concessional terms in excess of US$20 million.

F. Statistics

33. The Comoros' socio-demographic and macroeconomic data bases remain weak. With technical and financial support from the World Bank, the government has developed a National Strategy for the Development of Statistics (SNDS), which was approved in

December 2007. The strategy aims to develop and adopt a legal and regulatory framework (statistical law) for managing the country's socio-demographic statistics. The government aims in particular to enhance its human capacity in this area by providing training to senior and middle-level executives in charge of the development of an integrated national account data system with the installation of ERETES software, with a view to ensuring an adequate monitoring of household living conditions and of the incidence of poverty in the country. The government also intends to work on improving governance and the coordination of the national statistics system, the production of agriculture, demographic and social statistics. It evaluates the cost of the country's statistical program for the period 2008–12 at CF 4.903 million. The government will soon submit a request for technical and financial assistance to donors for the implementation of the program. Some development partners have already expressed interest in supporting the initiative.

IV. PROGRAM MONITORING

34. The program is to cover the period October 2008–March 2009, and would be monitored through quarterly quantitative and structural indicators (Tables 1 and 2). IMF Executive Board consideration of the government's EPCA assistance request would be conditioned on the implementation of the following prior actions: (i) approval by parliament of the revised budget for 2008; (ii) signing by the finance ministers of the Union and the three island entities of a memorandum of understanding on the reactivation of the revenue sharing mechanism; and (iii) a joint decree by the finance ministers of the union and the islands requiring the monthly transmission to the Reform Monitoring Committee (CREF) of data on budget execution by the Union and the islands, as well as the holding of monthly meetings of the expanded CREF, including the budget directors of the Union and the autonomous entities. The definitions of the quantitative indicators are provided in the attached TMU.

35. To secure the full collaboration of the four territorial entities in program implementation, a four-party Budgetary Committee has been created to monitor the program. The committee is made up of finance ministers from the three islands and the Union or their deputies. At the technical level, the Treasurers-Paymasters General of the Union and their colleagues in the entities will prepare the meetings of the Budgetary Committee, which will monitor the operations of the special account (payments and appropriations) and ensure transparent management and mutual agreement with respect to the redistribution of government resources among the entities.

36. The government will report the data necessary for program monitoring to the IMF in accordance with the relevant Technical Memorandum of Understanding. During the program period, the government will not (i) introduce restrictions on payments and transfers on current international transactions or intensify any such restrictions without first consulting the Fund, (ii) introduce or modify multiple currency practices, (iii) conclude bilateral payments agreements not compatible with the provisions of Article VIII of the IMF's Articles of Agreement, or (iv) introduce restrictions on imports for balance of payments purposes.

Table 1 MEFP. Prior Actions and Structural Indicators under the 2008–09 EPCA

Prior Actions

Full restoration of the Revenue Sharing Agreement (RSA) on the basis of the joint decree (*procès verbal)* signed by the four Ministers of Finance.

Adoption by the parliament of the supplementary budget law for 2008 in compliance with the budgetary program and with the macroeconomic framework agreed with the Fund.

Issuance of a joint order of the Ministers of Finance of the Union and the islands requiring the monthly transmission to the macroeconomic and accounting unit (CREEF) of the data on the budgetary execution of the Union and the islands, as well as the holding of the monthly meetings of the CREEF with the participation of the Directors of the Budget of the Union and the island administrations.

Structural Indicators

Submission of consolidated accounts to all Ministries of Finance and to Fund staff on a quarterly basis. (January 1st, 2009).

Holding of monthly meetings of the Budgetary Committee. (Continuous)

Maintaining the automatic fuel price adjustment mechanism. (Continuous)

Computerization of civil servant payment roster and staffing of the unit responsible for monitoring and controlling wage payments. (December 1st, 2008).

Table 2 MEFP. Comoros: Quantitative Indicators Under the proposed EPCA[1]
December 2008–June 2009
(Millions of Comorian Francs)

	2008	2009	
	December [2]	March [2]	June
	Prog.	Prog.	Proj.
Indicators			
1. Ceiling on net credit to government (NCG) [3]	1,546	-171	-250
2. Ceiling on the net accumulation of domestic arrears	304	0	0
3. Ceiling on new nonconcessional external debt contracted or guaranteed by the state [4]	0	0	0
4. Ceiling on new short-term external debt contracted or guaranteed by the state [4]	0	0	0
5. Ceiling on accumulation of external debt service arrears	572	0	0
6. Floor on the domestic primary balance	-4,803	1,062	-1,922
7. Floor on total domestic revenues	22,301	6,441	10,803

[1] Definitions of quantitative indicators and adjusters are provided in the Technical Memorandum of Understanding (TMU).
[2] Cumulative from January 1, 2008 for end-December 2008, and from January 1, 2009 for end-March 2009.
[3] NCG is based on end-December of previous year in the monetary survey, and includes IMF assistance.
[4] Excluding trade credits.

ATTACHMENT II

UNION OF THE COMOROS: TECHNICAL MEMORANDUM OF UNDERSTANDING

November 26, 2008

1. This technical memorandum of understanding (TMU) defines the quantitative indicators and structural benchmarks to monitor the implementation of the program supported under the Emergency Post-Conflict Assistance (EPCA) in accordance with the understandings reached between the authorities of Comoros and the staff of the IMF. It also specifies the reporting requirements and deadlines for transmission of data to the staff of the IMF for program monitoring purposes.

I. DEFINITION

2. Unless otherwise specified below, "the governments" is meant to include the government of the Union of the Comoros and the governments of the three autonomous islands. Local Governments, the central bank, or any government-owned entity with separate legal personality are excluded from the definition of government. The units covered under this definition of government are consolidated for the needs of the program.

II. QUANTITATIVE INDICATORS

3. Quantitative indicators are the following: (i) ceiling on net domestic credit to the government (NCG); (ii) ceiling on net accumulation of domestic arrears; (iii) ceiling on new non-concessional external debt contracted or guaranteed by state; (iv) ceiling on new short-term external debt contracted or guaranteed by state; (v) ceiling on accumulation of external debt service arrears; (vi) floor on the domestic primary deficit; and (vii) floor on total domestic revenues.

A. Ceiling on Net Domestic Credit to the Government

4. Net domestic credit to the government is defined as overall net credit extended to the government from domestic bank and non-bank sources. Net bank credit to the government reflects the net credit position of the government vis-à-vis the central bank, commercial banks and the national savings bank. It is the difference between the government's gross indebtedness to the banking system and its claims on the banking system. Government claims include all deposits at the central bank and commercial banks, as well as treasury cash holdings. The government's debt to the banking system includes central bank credit (statutory advances as well as any long-term credit, and IMF net credit) and commercial bank credit, and deposits at the national savings bank. Domestic non-bank financing includes changes in the stock of treasury bills placed in the domestic market, and privatization receipts, as well as

any other domestic financial debt held outside the banking sector, other than arrears, that may arise. Table 1 below provides the details.

Table 1 TMU. Net Domestic Financing, 2007–09
(Millions of Comorian Francs)

	2007	2008 Dec. Prog	2009 Mar. Prog.
Net Domestic Financing	6,118	7,664	7,493
(flow, cumulative from end December of previous year)	...	1,546	-171
Central Bank (net)	5,642	7,426	7,314
(flow, cumulative from end December of previous year)	...	1,783	-111
Advances	5,587	5,609	5,497
Of which: long term	1,313	1,163	1,163
IMF credit	395	2,157	2,157
Government deposits [1]	340	340	340
Commercial Bank net credit to Treasury	0	0	0
Non-Bank financing [2]	476	238	179

Sources: Monetary Survey and government financial operations data.
[1] Net of earmarked Saudi grant and of deposits of other government entities in the Central Bank.
[2] Postal savings bank (SNPSF) advances for salary payment, backed by government deposits at the Central Bank.

5. The change in net domestic credit to the government as of the date for the quantitative indicator or benchmark is defined as the difference between the stock on the date indicated and the stock on December 31, 2007 for the 2008 indicators, and the stock at December 31, 2008 for the 2009 indicators.

6. The BCC will report the provisional data on the net bank credit to the government to Fund staff on a monthly basis, with a lag of no more than 45 days after the end of each observation period. Final data will be reported with a maximum lag of two months. The Ministry of Finance will report on a monthly basis, any financing from non-bank sources.

B. Ceiling on Net Accumulation of Domestic Arrears

7. New domestic payments arrears of the government are defined as any of the following: (i) Any bill that has been received by the spending ministry from a supplier of goods and services, delivered and verified and for which, payment has not been made within 90 days after the date the payment order (*ordonnancement*) was cleared; (ii) in the case of specific contracts between the suppliers and the government, any bill received and not paid on the due date stipulated in the contracts; (iii) tax credits confirmed by the proper authorities after review, and not paid within 60 days from the date when the payment order was issued; (iv) wages and salaries and any payment to a government employee that were due to be paid in a given month but remained unpaid on the 15th day of the following month.

8. Under the program, the government of the union and the autonomous island governments will not accumulate any new net domestic payments arrears, except as indicated in Table 2 of the MEFP. This quantitative indicator will be monitored on a quarterly basis

Reporting requirements

9. The authorities will report to Fund staff any accumulation of domestic payments arrears as defined above as well as the status of outstanding balances (*restes à payer*) of the Treasury.

C. Ceiling on External Debt Payments Arrears

10. External payments arrears are defined as the sum of payments due but unpaid on outstanding external debt (for a definition of external debt, (see above ¶16) that has been contracted or guaranteed by the government, with the exception of external payments arrears arising from government debt being renegotiated with creditors including Paris Club creditors.

11. Under the program, the government will not accumulate any external payments arrears, except as indicated in Table 2 of the MEFP. This quantitative indicator will be monitored on a continuous basis.

Reporting requirements

12. The government will report to Fund staff any accumulation of external payments arrears as soon as the due date has been missed. It will provide each month with a maximum lag of 15 days, a table showing external debt service due (after rescheduling) and paid.

D. Ceiling on the Contracting or Guaranteeing of New Non Concessional External Debt and Short-Term Debt by the Government

13. This Quantitative Indicator applies not only to debt as defined in Point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Executive Board Decision No. 6230–(79/140), last amended by Executive Board Decision No. 12274–(00/85), adopted August 24, 2000, but also to commitments contracted or guaranteed by the government for which value has not been received.

14. Short-term debt refers to external debt with a contractual maturity of less than one year.

15. The definition of debt—as specified in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt—reads as follows: " (a) For the purposes of this guideline, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the

contract. Debts can take a number of forms, including: (i) loans, i.e., 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, i.e., 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, i.e., arrangements under which property is provided which 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. (b) Under the definition of debt set out in point 9(a), 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."

16. Any external debt of which the present value, calculated with the reference interest rates mentioned hereafter, is superior to 50 percent of the nominal value (grant element of less than 50 percent) is considered nonconcessional, with the exception of IMF lending under the Poverty Reduction and Growth Facility, which is considered concessional even if it does not meet the 35 percent grant element threshold. For debt with a maturity of more than 15 years, the ten-year reference market interest rate, published by the OECD, is used to calculate the grant element. The six-month reference market rate is used for debt with shorter maturities.

17. For the purposes of this Quantitative Indicator, government is understood to include the government (as defined in ¶2 above), as well as local administrations, public institutions of an industrial and commercial nature (EPIC), public administrative institutions (EPA), public enterprises, and government-owned or controlled independent companies (i.e. public enterprises with financial autonomy of which the government holds at least 50 percent of the capital).

18. The government as defined in ¶2 will not contract or guarantee nonconcessional or short-term external debt as defined above. These performance criteria are monitored on a continuous basis. They do not apply to: debt rescheduling and restructuring operations. In addition, import-related credit and pre-export financing secured on export contracts of less than one year maturity, are excluded from the performance criteria on short-term debt.

Reporting requirements

19. The government will report any new external borrowing and its terms to Fund staff as soon as external debt is contracted or guaranteed by the government.

E. Floor on the Domestic Primary Balance

20. The consolidated domestic primary fiscal balance (payments order basis) is calculated as total government revenue (defined below), excluding foreign grants, less expenditure, excluding interest payments, and foreign-financed technical assistance and investment expenditure.

21. The indicative targets for the domestic primary fiscal balance are floors set at CF 4,803 million for December 31, 2008 and CF 1,062 million for Mach 31, 2009.

Reporting requirements

22. During the program period, data on the domestic primary fiscal balance (payment order basis) will be forwarded monthly by the Ministry of Finance and the Budget of the Union within 30 days following the end of each month.

F. Floor on Total Domestic Revenues

23. Total domestic revenue is defined as reported in the consolidated government financial operations table (TOFE), and includes all tax and non-tax receipts and excludes external grants**.**

24. The floors on total domestic revenue, cumulative from the beginning of the 2008 calendar year, is set at CF 22,301 million for December 31, 2008 and CF6,441 million for March 31, 2009.

Reporting requirements

25. The Ministry of Finance and Budget will report to Fund staff preliminary revenue data on a monthly basis, with a lag of no more than one month, on the basis of actual collections as recorded in treasury accounts. Final data will be provided once the final treasury accounts are available, but not later than two months after the reporting of preliminary data.

III. Additional Information for Program Monitoring

26. The authorities will report to Fund staff the following information and data according to the schedule provided, either directly (e-mail or facsimile) or by airmail. Barring any agreement to the contrary, the data will take the form mutually agreed by the authorities and the IMF. The fiscal data, monetary data, external debt data, the consumer price index, and

any information on important legislative and/or other developments will be provided not later than one month after the date to which they pertain.

Monthly

The monetary survey and the monthly balance sheets of the BCC and the commercial bank;

Classification of commercial bank loans by economic sector;

Interest rates;

TOFE data on a cash and payments order basis, the related detailed tables on revenue and a table showing the link between the payments order and cash basis for expenditures;

External public debt operations (debt contracted and publicly guaranteed, settlement of external payments arrears, and debt service paid, broken down between interest and principal);

Consumer price index; and

Imports and exports, production of electricity, tourist arrivals, and any other indicators of economic activity that may be available on a monthly basis.

Quarterly

Production of major products (vanilla, cloves, ylang-ylang)

Annually

- National accounts
- Balance of payments

  Moreover, information on important measures adopted by the government in the economic and social areas that would have an impact on program developments, changes in legislation, and any other pertinent legislation will be reported to Fund staff on a timely basis.

27. Moreover, the authorities will promptly communicate to IMF staff all information and data pertaining to policy measures adopted by the government in the economic and social areas, which are likely to have an impact on program performance, amendments to existing laws and to any other relevant legislation.