Union of the Comoros
and the IMF

Press Release:
IMF Executive Board Approves US$21.5 Million PRGF Arrangement for the Union of the Comoros
September 21, 2009

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

August 11, 2009

LETTER OF INTENT

UNION DES COMORES

August 11, 2009

Mr. Dominique Strauss Khan
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss Khan,

1. The Union of the Comoros views the support of its international partners as crucial to the success of its economic and social policies that underpin the resumption of growth and its strategy for reducing poverty. With the long process of national reconciliation now reaching an end, following the constitutional referendum in May which restored cohesion to the functioning of our institutions, the time has arrived to redouble our efforts to rehabilitate the economic environment, revitalize the economy, and reduce poverty.

2. Our strategy is aimed at promoting strong, sustainable, private-sector led economic growth that creates employment and income, as well as strengthening public finances, institutions, and governance within the context of a stable macroeconomic environment. To achieve this and meet the aspirations of all Comorians for peace and prosperity, the government intends to work with the IMF and the rest of the international community. The policies implemented under the Emergency Post-Conflict Assistance (EPCA) and those envisaged in our new three-year program (2009-12) outlined in the attached Memorandum of Economic and Financial Policies (MEFP) should help us achieve this goal. These courageous policies provide a sound basis for our request for support from the IMF under the Poverty Reduction and Growth Facility (PRGF).

3. We view a PRGF arrangement as crucial for anchoring our medium-term economic reform agenda, ensuring responsible management of public finances, and catalyzing donor support, which should allow the Comoros to access the benefits of the enhanced Heavily Indebted Poor Counties (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). To ensure the smooth implementation of the program supported by the PRGF, including coverage of our related balances of payments needs, the government of the Union of the Comoros requests assistance from the IMF under the PRGF arrangement in the amount of SDR 13.57 million or 152.5 percent of quota, to be disbursed over three years.

4. A critical factor underlying the reform agenda is our firm commitment at the Union and islands levels to fully implement the national revenue sharing agreement. We believe that strict adherence to this agreement and rigorous implementation of the policies set forth in the

MEFP will allow us to achieve the objectives of our program. The government will, nonetheless, take any further measures that may be necessary to meet the program objectives. We will consult with the Fund in advance on the adoption of these measures, and before any revision to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. In addition, we will supply such information as the IMF requests on policy implementation and achievement of program objectives.

5. In line with our commitment to transparency in government operations, we agree to the publication of the PRGF related documents, subsequent to endorsement of the proposed program by the IMF Executive Board.

Sincerely yours,

/s/
Ilkililou Dhoinine
Vice-President in charge of the
Ministry of Finance, Budget, and
Promotion of Women Entrepreneurship

/s/
Ahamadi Abdoulbastoi
Governor of the BCC

ATTACHMENT 1

UNION OF THE COMOROS

Memorandum of Economic and Financial Policies for 2009-10

I. INTRODUCTION

1. After the resolution of the Anjouan crisis last year and the recent amendment of the constitution that brings needed cohesion to government operations, the Union of the Comoros has finally emerged from over 10 years of chronic political instability, and can now focus on the challenges of its economic development. The country has limited natural resources, a small and fragmented domestic market, weak institutional capacity and a narrow export base, which make it particularly vulnerable to shocks. Almost half of the population lives below the poverty line, and there is limited access to clean water and electricity, and to essential services such as education and health care.

2. To put the economy back on the road to strong and sustainable growth and to reduce poverty more effectively, the government is determined to pursue sound economic and financial policies. With the assistance of IMF and World Bank staff, it has prepared a medium-term economic program for 2009–12 aimed at consolidating macroeconomic stability, strengthening institutions and governance, and improving the investment climate. The effective implementation of this program, which is based on the country's interim Poverty Reduction Strategy Paper (I-PRSP), will be supported by Fund resources under the Poverty Reduction and Growth Facility (PRGF), and it will enable the Comoros to benefit from debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI).

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE STAFF-MONITORED PROGRAM

A. Recent Economic Developments

3. Economic activity in the Comoros remains subdued. Over the past two years, it has been dominated by disturbances related to the crisis in Anjouan and the difficult international economic situation. The economy also suffered from a serious energy crisis and from limited private sector access to bank credit during the first half of 2008. These constraints caused a decline in activity in the main productive sectors, in particular the vanilla, transportation, and trade sectors. However, the decline was compensated for by strong production of foodstuffs stimulated by favorable rainfall and rising global food prices. The weakness of the economy was also mitigated by the relatively dynamic performance of the construction and public works sector, backed by donor support, financial inflows from migrants, and some foreign

investments in the tourism sector. As a result, real GDP growth is estimated at an average 1 percent in 2008/09, an increase of one-half percentage point over 2007. Inflation rose to 7.4 percent year-on-year in 2008, owing to the high cost of fuel and transportation, but it has fallen sharply and should drop to 2.3 percent in 2009, reflecting reduced pressures on oil and food prices.

4. In the fiscal area, government revenues have witnessed an upturn, reaching the equivalent of 13.5 percent of GDP as an annual average since 2008. At the same time personnel expenditures have been relatively better controlled, although they continue to weigh heavily on the government budget. In general, the preliminary results obtained with respect to fiscal consolidation reflect the impact of the gradual implementation of measures to strengthen revenue collection and improve expenditure management, including the establishment of a cash flow committee. Thus the deficit on the domestic primary budget balance should fall to 1.6 percent of GDP in 2009, compared to 2.7 percent in 2008. Government expenditures nonetheless remain well above the capacity for revenue collection, thus justifying the accumulation of new payment arrears through the first half of 2009.

5. In the external sector, the upturn in exports remains uncertain given the continued low world prices, although there has been a timely increase in vanilla exports in 2009. On the other hand, imports, including materials for the construction sector and used vehicles, supported by increased transfers of funds from emigrants (equivalent to 25 percent of GDP in 2008), remain robust and the oil bill is still high. Because of these developments, the external current account deficit (including budgetary support grants) climbs to the equivalent of 9.7 percent of GDP in 2008-09, compared to 6.7 percent of GDP in 2007. New external payment arrears have accumulated and government debt, expected to reach 230 percent of the net present value of goods exports at end-2009 according to forecasts, remains unsustainable. However, the government was able to reach agreements to defer settlement of external arrears amounting to $13.95 million until the HIPC decision point (mid 2010) as well as amounts due to creditors, except major multilateral, for servicing the external debt ($1.8 million) corresponding to the 2009 budget, while awaiting the comprehensive resolution of its external debt situation under the enhanced HIPC initiative.

6. Credit to the economy, including the microfinance sector loans, should increase by 10 percent in 2009, following a 27 percent increase last year. It is essentially allocated to the trade sector. Under these conditions, and in the context of an expanding national banking system, the money supply increased by 7.7 percent on average in 2008 and 2009, in parallel with a decline in net external assets. Foreign exchange reserves stand at the equivalent of 5-6 months of imports of non-factor goods and services.

B. Performance under the EPCA Program

7. Out of a total of 11 quantitative and structural indicators for program monitoring, seven had been met at end-2008. In particular, the quantitative indicator related to the minimum level of revenue collection was met. However, because of pressures on expenditures for goods and services related to the military operation in Anjouan and the subsidies granted to the National Water and Electricity Company (MA-MWE) in response to the energy crisis, the program indicators related to external payment arrears, net present credit to the government, and the primary fiscal deficit as at December 31, 2008 could not be met. Three of the four structural indicators were met and the fourth was partially met. The computerization of the payroll was begun only by the executives of the Union, Anjouan, and Mohéli, while it was yet to be started in Ngazidja as at end-2008 (paragraph 8 below).

8. The results of the EPCA program were more satisfactory as at end-March 2009, reflecting the impact of efforts to enhance fiscal management that have been under way for several months. All seven quantitative performance indicators for this date were met, despite the still difficult economic situation. Implementation of the structural reforms was also satisfactory overall: only one of the program benchmarks for end-March was not fully met, owing to continued delays in the computerization of payroll operations, although work has begun to accomplish this on the Island of Ngazidja.

III. Medium-Term Macroeconomic Framework for Poverty Reduction

9. Reducing poverty and achieving the MDGs are among the government’s key objectives. To this end, the government intends to implement the I-PRSP action plan for the medium term, focusing on five strategic areas: laying the ground for sustainable economic development; stimulating private sector activities; developing the agricultural sector; strengthening governance, the justice system, and security; and enhancing human capital. It has launched the consultation process that will lead to the elaboration of the full PSRP by end-2009. Pending the finalization of the PRSP, the economic program will build on the objectives of the I-PRSP, which focus on increasing budget allocations to the priority sectors, so as to boost sustainable renewed growth and improve the MDGS indicators.

10. The government’s program for the next three years aims to restore macroeconomic stability, strengthening institutions and governance and improving the investment climate. Real GDP growth is projected to rise to about 3-4 percent per year by end-2012, underpinned by a pick-up in public and private investment, as both donor support rises and the investment climate improves. Tourism, agriculture, fishing, finance, infrastructure, and communication are expected to contribute positively to growth. Inflation will be contained at 3 percent in the context of our pegged exchange regime and a prudent wage policy. Exports of goods and services and private remittances should remain somewhat restrained because of the difficult international circumstances. However, increased support from partners will stimulate the growth of imports, the external current account deficit is projected to stabilize at around 10 percent of GDP by 2012, and international reserves levels will remain at slightly under 5 months of imports of goods and services.

11. The program aims to reduce by half the primary fiscal deficit by 2012, from a projected 1.6 percent of GDP in 2009, in order to provide more resources to meet debt service obligations; support higher social spending and investments, and to allow a gradual reduction in domestic payment arrears. In this framework, public investment and social outlays should increase by about 1.7 percentage points of GDP, financed through a gradual increase in domestic revenue, a modest reduction in the wage bill, and higher external assistance. To this end, the government will ensure that domestic revenue will increase to at least 14 percent of GDP in 2012, driven mainly by higher tax revenue, which is projected to average 12½ percent of GDP. On the expenditure side, the government's policy will aim to contain the wage bill through reform of the civil service and effective personnel management; it will also limit discretionary spending to the strict minimum in order to free the resources for spending on priority sectors that support growth.

12. We hope that support of the program under the IMF's PRGF will allow us to secure debt relief under the enhanced HIPC initiative and MDRI, which is critical for restoring debt sustainability. The medium-term program currently assumes that, following clearance of external payment arrears and rescheduling on concessional terms in 2010, the HIPC decision point can be reached by the second quarter of the same year, and that both the HIPC completion point and MDRI are secured by end-2012.

IV. Economic and Financial Policies for 2009-10

13. The objectives of our 2009-10 program are: to secure average real GDP growth of 1.5 percent, with a strong contribution from agriculture the public works construction sector as projects financed by external resources and migrants' remittances are implemented; an inflation rate of 3 percent; containing the current account deficit (including grants) to about 9½ percent of GDP, and maintain international reserves around 5-6 months of imports of goods and nonfactor services.

A. Government Finance

14. The government's economic program is aimed at reducing the domestic primary fiscal balance deficit from 2.7 percent of GDP in 2008 to 1.5 percent of GDP on average in 2009 and 2010. The overall budget deficit (cash basis, grants included) is expected to reach 2.3 percent and 2.7 percent of GDP in 2009 and 2010 respectively, compared to 2.3 percent of GDP in 2008. External debt service will amount to CF 8.002 billion (4.5 percent of GDP) in 2009, including CF 5.084 billion in arrears to be rescheduled under the enhanced HIPC initiative. In 2010, it is expected to fall to CF 2.307 billion (1.5 percent of GDP, excluding rescheduled arrears from 2009), covering obligations to the main multilateral creditors.

15. The budgetary framework of the program for fiscal year 2009 is reflected in a supplementary budget introduced by the government before IMF Board consideration of Comoros' PRGF request. It is fully financed with: (i) budgetary support from external

partners, and deferment of outstanding external arrears and of 2009 debt service due to creditors except major multilaterals; and (ii) net domestic financing (including reimbursement of credits from the central bank and the SNPSF). In addition to the IMF, external budget financing is expected particularly from partners in the Gulf region, the European Union, the World Bank, the African Development Bank, and France. If the government obtains external budget support beyond the programmed amounts, it will consult with the IMF on how to use it and will establish a new supplementary budget indicating how these resources will be allocated, giving priority to the settling of arrears to government suppliers and public service career agents. The fiscal financing requirements for 2010 are estimated at 6.7 percent of GDP, including 2.9 percent of GDP in external arrears to be rescheduled under the HIPC process. They are expected to be covered by development partners, including with interim HIPC assistance if the country reaches the HIPC decision point.

16. Sound 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 strengthen the consolidated tracking mechanisms for government financial operations and will ensure that meetings of the budget and cash flow committees are held on a regular basis.

17. Domestic revenues are expected to reach CF 25.975 billion (13.8 percent of GDP) in 2009 and CF 27.103 billion (13.6 percent of GDP) in 2010, compared to CF 23.379 billion (13.1 percent of GDP) in 2008. The 2009 figures show the effect of relatively weak economic activity in 2009, before the slow beginning of recovery in 2010. They also take into account exceptional revenues from the economic citizenship program (0.8 percent of GDP) and sales of the new biometric passports (0.3 percent of GDP), as well as the impact of the measures already taken to enhance revenue collection (paragraphs 24-26 below).

18. Total expenditures are expected to reach CF 42.018 billion or 22.3 percent of GDP in 2009 and CF 43.987 billion (22.1 percent of GDP) in 2010. The authorities are determined to limit primary spending to a level commensurate with available resources, in order to strengthen the fiscal position sufficiently to restore macroeconomic stability and redirect expenditures toward the priority sectors. Accordingly, domestic primary expenditure will be limited to 14.6 percent and 14.1 percent of GDP in 2009 and 2010, respectively. To this end, there will be a freeze on new hiring, the computerization of the civil service payment roster will be finalized, and organic frameworks for the Union and islands will be adopted. Moreover, thanks to improved supervision, largely resulting from the refocusing of the national political institutions after the constitutional referendum of May 17, 2009 and the establishment of a central database for public service personnel, the wage bill is expected to be better managed and limited to the equivalent of 8.7 percent and 8.4 percent of GDP in 2009 and 2010, respectively. Expenditure on goods and services will be more closely monitored, thanks to more rigorous cash management by the government. Nonessential

overseas missions will be frozen. In view of the tight fiscal constraints, while awaiting the implementation of infrastructure projects linked to the special economic citizenship program, domestically-financed investment expenditure will amount to 0.8 percent and 1 percent of GDP in 2009 and 2010, respectively.

19. The government is fully committed to finding a sustainable way to clear domestic arrears. With the assistance of the European Union, it is currently carrying out an audit of these arrears, including debt owed to private enterprises. On this basis, the government intends to approve by end-October 2009 a strategy for the orderly clearance of these domestic financial obligations. The recommendations of the strategy will be taken into account in the government budget beginning in fiscal year 2010. Efforts will be made in this context to mobilize external financing for clearing the arrears of civil servants' wages accumulated through June 30, 2009, ensuring equal treatment for the three islands and the Union. In the meanwhile, measures have been taken to: (i) settle two months of salary arrears for December 2008 and January 2009 if assistance from Gulf development partners amounts to the equivalent of at least US$10 million, and (ii) ensure henceforth that salaries are paid on a regular basis to avoid any accumulation of new salary arrears. Finally, the government plans to offset the cross-debts between the government and public enterprises by end-June 2010 and to clear the balance in 2011.

B. Strengthening Institutions and Public Expenditure Management

20. Our fiscal program can only be achieved through strict adherence to the revenue-sharing mechanism. To this end, the government intends to continue strengthening inter-entity cooperation and enhance the accountability of public financial management. It will henceforth ensure that the account statements from the Treasury to the BCC concerning the revenue-sharing mechanism are forwarded on monthly basis to the governors of the islands. In addition, to improve efficiency, we intend to centralize certain government functions, including revenue administration of large taxpayers, monitoring of budget execution, and economic statistics, in accordance with the revenue-sharing mechanism. This will be monitored by inter-government committees and administrative units charged with information compilation and dissemination and policy coordination. The Economic and Financial Reform Unit (Cellule des Reformes Economiques et Financières, CREF), charged with consolidating fiscal data from the Union and island governments, and the Budgetary Committee, made up of representatives from the Union and the three island executives, will continue to play a key role in monitoring the execution of the government budget. These two entities will work in close collaboration with the Cash Flow Committee established last June.

21. Further, the government has taken measures to ensure that all ministries meet their quarterly targets on spending commitments. These will be revised downward if actual revenue collections fall short of the initial projections. Measures have also been taken to ensure effective controls on amounts liquidated (*liquidation)*. Over time, the Budgetary Committee—including the Minister of Finance and representatives of the respective budget

directorates and treasuries of each entity—will monitor through detailed monthly status reports the expenditure chain from commitment (*engagement*) through the payment phase (*paiement*), and the outstanding balances (*restes a payer*). The outstanding balances will be monitored closely by including a breakdown by month showing the amounts falling due (staring in July 2009 for salaries, and by end-March 2010 for other spending categories). The treasury will give priority to those amounts that are first in the payment queue.

22. With the support of the development partners, including the World Bank, the IMF, and the European Union, the government conducted a preliminary evaluation of public expenditure management systems in 2009. The main recommendations stemming from the assessment are incorporated into the three-year program, particularly those concerning: (i) establishing a weekly cash flow committee; (ii) approving by end-October 2009 a strategy for clearing domestic payment arrears, following an audit; (iii) restoring in 2010 the normal expenditure process, in accordance with the Framework Law of 2005. With the assistance of the IMF, the World Bank, and the African Development Bank, the government will complete by end-December 2009 a strategy for reforming the public expenditure management systems and will ensure that it is implemented at the earliest possible date. The recommended measures are aimed at strengthening budget and accounting procedures, (computerization and training), internal and external controls, and government procurement rules and practices. Their implementation will help enhance the transparency of government actions and improve the investment climate.

23. Pursuant to the new law on the government's financial operations, the government will submit to the National Assembly, as an annex to the budget law, a performance report on outcomes and prospects. This law gives the parliament an opportunity to reinforce its control over budget execution.

C. Tax Reforms

24. To achieve its revenue collection targets, within the framework of the country's joining the COMESA free trade area, the government intends to work towards modernizing and improving the tax and customs administrations. It plans to: (i) enlarge the tax base using the database from the most recent taxpayer census, by imposing a real tax regime on persons formerly subject to the single professional tax (TPU) and opening local tax centers; (ii) simplify the tax and customs systems; (iii) consolidate tax audits through rigorous management of the single tax identification number; and (iv) limit tax and customs exemptions to those stipulated in the investment code. The government will conduct a comprehensive inventory and by end-September 2009 will eliminate ad hoc discriminatory tax advantages previously granted. It will also enhance its communication with taxpayers to foster taxpayer compliance and fiscal discipline. Other structural and organizational reforms include a revision of the customs code and use of the SYDONIA ++ system in all the main customs posts, under a project supported by the UNDP in partnership with COMESA.

25. Other measures to enhance revenue collection focus on restructuring the tax and customs authorities, which includes strengthening the hierarchical cohesion among the central and island authorities, in order to improve the efficiency of administration. The budget laws also aim at various modifications of tax policy, particularly expanding the tax base and replacing certain import duties with indirect taxes by extending the scope of application of excise duties, following the recommendation of various IMF technical assistance missions, in order to ensure the stability of the tax base after the Comoros joins COMESA. A program to enhance infrastructure and human capacities of the island tax and customs jurisdictions has been launched, which should help increase revenue collection, particularly from patents and local businesses.

26. Finally, to reinforce the effectiveness of tax administration, the government will enhance the instruments of the large taxpayer unit (LTU) which has become fully operational and in charge of management, audits, and collections for all big business taxes in the Union of the Comoros. It intends to: (i) establish in each island a regional branch of the LTU placed under the direct authority of the national LTU; (ii) strengthen relations between the LTU and the customs administration; and (iii) complete the computerization of the LTU and begin application of the AGIR software to secure revenue, by replacing the current software for managing cash operations. The government will request the assistance of its development partners to appoint a resident expert to support its efforts to modernize the tax and customs administrations.

D. Civil Service Reform

27. Reform of the public administration (initiated under the *Appui Pour une Administration Publique Performante* (APP) project funded by UNDP) is aimed primarily at enhancing control of the public sector wage bill and ensuring its budgetary viability. It includes: (i) completion of the computerization of the civil service payment roster by end-March 2010; (ii) adoption of organic frameworks which will help set the appropriate structure and optimal level of staffing for the civil service (iii) implementation of a computer-based and integrated payroll management system. To ensure the proper implementation of these reforms, the government established the High Authority for the Public Administration (HAPA), which began operations in 2007, and appointed its director. The authority's responsibilities include preparation of the institutional and legal framework for civil service reform, coordination of all public entities, and effective surveillance of the Union-wide application of the procedures for administrative and financial management of government personnel. The government will shortly submit for adoption by Parliament the organic frameworks for all the ministries, established on the basis of executive structures resulting from the last constitutional referendum. These organic frameworks are to be annexed to the budget law beginning with fiscal year 2010. The implementation will make it possible to reduce the civil service staffing level to about 9,000 agents, compared to the current level of about 10,600. With the support of its development partners, the government intends to

develop and implement the reinsertion and/or redeployment of laid-off personnel, and plans to seek from donors the financial means necessary for the success of this program.

E. Financial Sector and Monetary Policies

28. Monetary policy will be pursued within the framework of the Comoros' participation in the franc zone, an arrangement that has enabled the country to contain inflation and maintain a stable exchange rate and an adequate level of foreign reserves despite major fiscal imbalances. The government recognizes that the excess liquidity on the banking system and the relative weakness of demand for credit limit its monetary policy operations. Within these constraints, the central bank will continue to rely on the reserve requirement ratio as its main instrument for managing liquidity. This ratio has not changed since 2008, when it was reduced from 35 percent to 25 percent. To enhance the independence of the central bank (BCC) and allow it to better play its role in consolidating macroeconomic stability and effectively support the exchange rate regime, its statutes have been amended to bring them into line with international standards as recommended by the IMF. Over the medium term, the BCC intends to liberalize interest rates completely in an increasingly competitive environment.

29. The central bank will continue its efforts to enhance the effectiveness of the financial system and to strengthen bank supervision. To encourage competition, two new foreign commercial banks specializing in financing the productive sectors have opened their doors during the past two years (EMIX Bank of Tanzania and Banque Fédérale de Commerce). The BCC will endeavor to contain the potential risks that could arise with the entry of these new foreign banks by strengthening the modalities of cooperation with the banks' home country supervisors. A memorandum of understanding with home country supervisors of newly licenses foreign banks has been finalized. In keeping with the decree of July 2004 authorizing the BCC supervision of microfinance institutions (MFIs), it has reinforced the supervision program for these institutions, which have experienced a rapid growth in recent years.[1] By end-March 2010, the government intends to complete preparation of a strategy for refocusing the activities of the National Financial and Postal Services Company (SNPSF). The strategy is aimed primarily at limiting its activities to saving deposit taking and money transfers, as well as extending the new postal checking service to a larger public.

30. 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 resolution and the 40 FATF recommendations. The government has updated the legislation and secured its

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[1] By the end of their first year of operations in 1997, the two MFIs networks had created 39 funds on the three islands, collected more than CF 360 million in deposits, and distributed CF 320 million in credits. At end-2008, deposits collected had increased to CF 10.4 billion, and distributed credits had reached CF 4.2 billion (22 percent of total credit to the private sector).

approval by Parliament. In addition, the government has terminated the operation of illegal offshore banking centers.

31. 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 is participating in a Safeguards Assessment undertaken by the IMF. Considerable progress has been made by the BCC in implementing the principal recommendations of the 2007 Safeguards Assessment. A new evaluation is under way and should be completed before the first review in the first half of 2010 under the requested PRGF arrangement.

F. External Debt Relief and Management

32. The government is committed to enhance its efforts to regularize its relations with its external creditors. It intends to discharge is external debt service obligations within the deadlines and considerably improve its debt management capacity and organization. We have reached understandings with our creditors, except major multilaterals, on the arrears situation concerning the external debt as at end-December 2008, and have obtained an extension on the debt corresponding to fiscal year 2009 due to our creditors other than the main multilateral donors. Pending approval of our country's eligibility for debt relief at the decision point under the enhanced HIPC initiative, we are committed to honor in a timely manner all the obligations due to these creditors.

33. The government is very much aware of the need for prudent debt management. 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 three year 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 will also consult closely with the IMF staff for any external debt contracted or guaranteed on concessional terms in excess of US$20 million.

G. Enhancing the Investment Climate

34. With the support of the World Bank Group, the African Development Bank, and other donors, the government has resumed the program for restructuring and possible divestment of public enterprises. In this context, the boards of directors of these entities will be established by end-December 2009. After having introduced the regulatory framework to allow private participation in the telecommunications sector with the advice of the International Telecommunications Union, the government passed a law dismantling the state monopoly. To carry out the reform of public enterprises, it requested and obtained the assistance of the International Finance Corporation (IFC), which is slated by end-September to complete preparation of the reform strategies, including possible privatization and the

introduction of competition for the Comoros Hydrocarbons Corporation and the telecommunications company (Comores Telecom). The implementation of these strategies is begin on January 1, 2010. The government also requested technical support from the African Development Bank to prepare a similar strategy for the electricity utility, MAMWE. This strategy will be finalized by the end of 2009 and implementation will begin in the first quarter of 2010. The government also plans to allow private sector participation in the importation of rice. Finally, it reaffirms its commitment not to interfere in the price-setting and marketing mechanisms for export crops: vanilla, cloves and ylang-ylang. In general, the government will refrain from pursuing and pricing policies liable to hinder the production and supply of market goods and services.

35. Improvements in the investment climate is one of the main priorities of government action. It makes it possible to attract foreign investment and encourage a shift in the use of large remittances from consumption to growth-oriented investment. To support this, the government has passed a new Investment Code and developed a one-stop shop for investors. It has also defined the legal procedures facilitating recourse to the courts when necessary.

36. The government has begun an extensive program of external 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. Pursuing efforts aimed at simplifying and further reducing import duties, the government has fully subscribed to the commitments resulting from the Comoros' joining the regional free trade area (COMESA). These include eliminating exemptions and the forfeit regime for multiple cargo imported containers. Based on a diagnostic trade integration study, the government identified the sectors for greatest export potential and outlined constraints to trade development. The reforms needed to remove these obstacles constitute an essential component of our three-year program.

37. The government is committed to an extensive program to promote good governance, including public service reform, judicial reform and increased transparency. With technical assistance from the EU, it will review and reform, by end-June 2010, 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 2010, extensive reforms of the judiciary, and strengthen the powers of the courts as part of the interim PRSP action plan. The government has requested the support of its development partners, including from France and the UNDP, to help in the implementation of the action plan for justice aimed at improving the quality of the judicial system. With the support of the World Bank, the ADB, France, the EU, and several UN agencies, it also intends to develop a program to improve governance, which should be finalized by end-March 2010.

H. Statistics

38. The government is determined to continue its efforts to improve its database of socio-demographic and macroeconomic data needed to design and monitor is development policy . The government plans to submit a request to donors by end-March 2010 for technical assistance for a comprehensive review of the statistical apparatus, most notably for fiscal and balance of payment statistics. This review will serve as a basis for setting up a medium-term action and reform plan for the sector. With support from the World Bank the government will undertake to strengthen its statistical capacity, taking into account the governments decentralization. Efforts will be directed at the development of framework**s** for compiling, collecting, and disseminating data from the islands, regular data dissemination, and the training of statistical officers.

I. Program Monitoring

39. The first year of the program covers the twelve months from July 1, 2009 to June 30, 2010. It will be monitored using the quarterly quantitative benchmarks and structural benchmarks, as well as the semi-annual quantitative performance criteria presented in Tables 1 and 2. The latter also includes the prior actions for seeking approval for the PRGF arrangement. The definitions of quantitative performance criteria and benchmarks are provided in the attached TMU. We expect the first review to be completed by mid-March 2010 and the second review to be completed by mid-September 2010.To secure the participation of the Union and the three territorial entities in program implementation, the government will enhance the instruments of the four-party Budgetary Committee created to monitor the program, and will ensure that the it functions properly. The committee is made up of the Commissioners from the three islands and the Union or their deputies. On a technical level, the Treasurers-Paymasters General of each entity will take part in monitoring the operations of the special account (payments and appropriations), to ensure transparent management and mutual agreement with respect to redistribution among the entities.

Table 1. The Comoros: Quantitative Performance Criteria, Benchmarks and Indicative Targets Under the proposed PRGF [1]
July - June 2010
(In millions of Comorian francs, cumulative since end-December 2009, unless otherwise specified)

	2009 [2]			2010 [2]	
	Jun. Proj.	Sep. Indicative Target	Dec. PC	Mar. Indicative Target	Jun. PC
Performance Criteria					
1. Ceiling on net credit to government (NCG) [3]	-1,103	588	1,142	-391	753
2. Ceiling on the net accumulation of domestic payments arrears	-8	-780	-1,300	-159	-319
3. Ceiling on new nonconcessional external debt contracted or guaranteed by the government [4]	0	0	0	0	0
4. Ceiling on new short-term external debt contracted or guaranteed by the government [4]	0	0	0	0	0
5. Ceiling on accumulation of external debt service arrears	-1,018	0	0	0	0
Quantitative Benchmarks					
6. Floor on the domestic primary balance	1,555	-2,143	-2,970	-1,421	-2,035
7. Floor on total domestic revenues	12,715	18,124	25,975	5,232	11,801
8. Ceiling on expenditures by cash advances [5]		300	500	100	150

[1] Definitions of targets and adjusters are provided in the Technical Memorandum of Understanding (TMU).
[2] 2009 cumulative from January 1, 2009. 2010 cumulative from January 1, 2010.
[3] NCG target is based on end-December 2008; unlike in the monetary survey it includes net PRGF purchases.
[4] Excluding trade credits.
[5] Cumulative from July 1, 2009 (for September and December 2009) and from January 1, 2010 (for March and June 2010).

Table 2. Comoros: Proposed Prior Actions, and Structural Benchmarks
Under the PRGF Arrangement, 2009–10

Measures	Macro-criticality justification	Date
Prior actions		
Agreements with relevant creditors on rescheduling of external payments arrears and deferment of 2009 debt payment to non-IMF/World Bank/AfDB creditors		
Formal government request for African Development Bank assistance in the reform of the electricity parastatal (MA-MWE)		
Structural benchmarks		
Maintaining a flexible petroleum price-fixing mechanism	Allowing reliable supply of petroleum products and limit subsidy pressures	Continuous
Completion of IFC-approved reform strategies for Comores Telecom and Societe Comorienne des Hydrocarbures	Improve provision of growth-supporting public utilities	September 30, 2009
Appointing the Permanent Secretary for the reform-monitoring committee (CREF)	Strengthen macroeconomic reform coordination	September 30, 2009
Government approval of a strategy for clearance of domestic payments arrears	Orderly clearance of past domestic obligations	October 31, 2009
Government approval of a comprehensive medium-term PEM reform strategy	Enhance expenditure allocation and productivity	December 31, 2009
Government approval of a medium-term strategy to improve revenue mobilization	Promote fiscal consolidation through stronger revenue mobilization	December 31, 2009
Government approval of the final PRSP		December 31, 2009
Full computerization of civil servant payment roster and adequate staffing of the unit monitoring wage payments.	Support fiscal consolidation by improving control of the wage bill	March 31, 2010
Submitting a draft law to parliament that sets the organic frameworks for the island ministries in line with the recommendations of the High Authority for the Public Administration (Haute Autorité de La Fonction Publique).	Rightsizing the civil service to achieve medium-term budget viability	March 31, 2010

ATTACHMENT 2

UNION OF THE COMOROS

Technical Memorandum of Understanding

Moroni, August 11, 2009

1. This technical memorandum of understanding (TMU) defines the quantitative and structural performance criteria and benchmarks to monitor the implementation of the program supported by the three-year arrangement under the Poverty Reduction and Growth Facility. It also describes the reporting requirements under that program.

I. DEFINITION

2. Unless otherwise specified below, "the government" 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 PERFORMANCE CRITERIA

3. Quantitative performance criteria are proposed for December 31, 2009 and June 30, 2010 with respect to change in net domestic credit to the government (NCG) and net accumulation of domestic payment arrears of government; with benchmarks for September 30, 2009 and March 31, 2010. The following performance criteria are proposed for monitoring on a continuous basis: (i) the external debt service payments arrears of the government; (ii) the contracting or guaranteeing of new non concessional external debt by the government; and (iii) the contracting or guaranteeing of new short-term external debt.

A. Change in Net Domestic Credit to the Government

Definitions

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 debit position of the government vis-à-vis the central bank, commercial banks and the National Postal and Financial Services Company (SNPSF), as well as microfinance institutions. It is the difference between the government's gross indebtedness to the banking system and its claims on the banking system. These 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, as well as net deposits at

the SNPSF. Domestic non-bank credit to the government includes changes in the stock of Treasury bills placed in the domestic market, and privatization receipts, as well as any other domestic financial debt of the government held outside the banking sector, other than arrears, that may arise.

5. The change in net domestic credit to the government as of the date for the quantitative performance criterion or benchmark is defined as the difference between the stock on the date indicated and the stock on December 31, 2008 for 2009, and for 2010 the difference between the stock on the date indicated and the stock on December 31, 2009.

Performance criteria

6. The amounts set in Table 1 of the MEFP on Net Credit to Government for December 31, 2009 and June 30, 2010 are ceilings and constitute performance criteria. The amounts set in the above table for September 30, 2009 and March 31, 2010 are ceilings and constitute indicative targets.

Reporting requirements

7. 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. Domestic Payment Arrears

Definition

8. 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.

Performance criteria

9. Under the program, the government will not accumulate any new net domestic payments arrears. The amounts set in Table 1 of the MEFP on Net Accumulation of Domestic Arrears for December 31, 2009 and June 30, 2010 are ceilings and constitute

performance criteria. The amounts set in the above table for September 30, 2009 and March 31, 2010 are ceilings and constitute quantitative benchmarks.

Adjuster

10. If external budget support is less that expected, the floor on the reduction of domestic payment arrears will be lowered by the full amount of the shortfall. In the case of surplus in external budget support, the floor on the net reduction of domestic arrears will be raised by the full amount of the surplus. Cumulative from July 1, 2009, the program assumes external budget support of CF 4,6 billion by end-September 2009, CF 6 billion by end-December 2009, CF 1.4 billion by end-March 2010 and CF 2 billion by end-June 2010.

Reporting requirements

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

C. External Payments Arrears

Definition

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

Performance criterion

13. Under the program, the government will not accumulate any external payments arrears with respect to public debt, except for payments related to renegotiations with creditors, including the Paris Club. This performance criterion will be monitored on a continuous basis.

Reporting requirements

14. 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

Definition

15. These performance criteria apply 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.

16. Short-term debt refers to external debt with a contractual maturity of less than one year. The external debt refers to debt owed to non-resident.

17. 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."

18. 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.

19. For the purposes of this performance criterion, 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).

Performance criterion

20. The government as defined in ¶19 will not contract or guarantee nonconcessional nor short-term external debt as defined above. These performance criteria are monitored on a continuous basis. It does 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

21. 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.

III. Quantitative Benchmarks

A. Domestic Primary Balance

Definition

22. 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.

Quantitative Benchmarks

23. The benchmarks for the floor on the domestic primary fiscal balance, cumulative from the beginning of the 2009 calendar year, are set at CF -2,14 billion for September 30, 2009, CF -2.97 billion for December 31, 2009. Cumulative from the beginning of the 2010 calendar year, they are set at CF -1.42 billion for March 31, 2010, and CF - 2.04 billion for June 30, 2010.

Reporting requirements

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 government within 30 days following the end of each month.

B. Government Revenue

Definition

24. Government 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.

Quantitative Benchmarks

25. The floor on government revenue, cumulative from the beginning of the 2009 calendar year, is set at CF 18.12 billion for September 30, 2009 and CF 25.98 billion for December 31, 2009. Cumulative from the beginning of the 2010 calendar year, it is set at CF 5.23 billion for March 31, 2010 and CF 11.80 billion for June 30, 2010. These amounts are considered benchmarks under the program, for the respective dates.

Reporting requirements

26. The Ministry of Finance will report to Fund staff preliminary revenue data monthly, with a lag of no more than 45 days, 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.

C. Expenditures Made by Cash Advances

Definition

27. Expenditures made by cash advances include all expenditures paid without prior commitment order.

Quantitative Benchmarks

28. Responsibility for achieving the ceiling on expenditures outside of normal procedures rests with both the Union government and island authorities. The ceiling on expenditures made outside of normal procedures, cumulative from July 1, 2009 is set at CF 300 million at September 30, 2009; CF 500 million at December 31, 2009; and cumulative from January 1, 2010 is set at CF 100 million at end-March 2010; and CF 150 million at end-June 2010.

Reporting requirements

29. Data on expenditures made outside of normal procedures will be forwarded monthly by the Ministry of Finance of the Union government within 30 days following the end of each month.

IV. Additional Information for Program Monitoring

30. 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 45 days after the date to which they pertain.

Monthly

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

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 data
• Balance of payments

31. 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.