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

June 5, 2010

The following item is a Letter of Intent of the government of Union of the Comoros, which describes the policies that Union of the Comoros intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Union of the Comoros, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
June 5, 2010

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

Dear Mr. Strauss-Kahn:

1. Over the last two years the Union of the Comoros has advanced along the path to political normalization. Amendments to the constitution in 2009 allow a more coherent management of the economy at the national level. At the same time, on the political front a promising start toward consolidation has been made since the most recent legislative elections. Moreover, the ongoing reform of the electoral cycle is expected to bring the number of democratic consultations to a level more compatible with the country’s limited resources.

2. In this new context, the government’s priority is to accelerate ongoing reforms with a view to boosting growth and more effectively combating poverty. We intend to achieve this working in close cooperation with the IMF and our other development partners. To sharpen the focus of our reform effort, in September 2009 the government adopted a final Poverty Reduction and Growth Strategy Paper (PRGSP), prepared through a participatory process involving the nation’s civil society representatives. This poverty reduction strategy is the basis of a three-year program of reforms supported by the IMF under the Enhanced Credit Facility (ECF) in the amount of SDR 13.57 million, or 152.5 percent of our quota. Consistent with PRGSP, the ECF-supported program notably aims to further economic stabilization and lay the foundations for sustained and equitable growth by strengthening public finance and improving infrastructure provision. Accordingly, the program will seek to create fiscal space for higher spending in priority and growth-supporting sectors. Also, to strengthen overall economic competitiveness and foster stronger growth and faster poverty alleviation, the ECF program is pursuing an ambitious restructuring of the public utilities. This will help deliver cost-effective and reliable energy and telecommunications services to the economy.

3. Since the launch of our ECF-supported program in July 2009, the government has sought to keep the program on track. Our discussions with Fund staff for the first review confirmed that only two of fifteen quantitative and structural indicators for the second half of 2009 were not met. The primary fiscal balance recorded a substantial overrun, in particular because of higher-than-anticipated wage outlays; and the reform strategies for the two State-owned companies engaged in telecommunications and imports of petroleum products were
not adopted by the initial end-September deadline under the program. In the first quarter of 2010, three of ten quantitative and structural performance indicators have not been met. In particular, the domestic revenue target was missed by a small margin.

4. The government has taken steps to substantially improve program performance. To this end, new measures aimed at strengthening domestic resource mobilization and strengthening control over expenditure, especially personnel expenses, have been taken. The government also plans to improve the preparation of requests for the disbursement of assistance expected from donors; and has taken steps to improve the institutional framework for program monitoring. To that end, the Economic and Financial Reforms Unit (CREF) has been expanded to include a representative of the Office of the President of the Union. The above initiatives are expected to bring about a significant improvement in the monitoring of program execution and facilitate the attainment of program objectives in the future. In view of the corrective measures being implemented, the government is requesting completion of the first review and disbursement of the related ECF resources. Completion of the first review will enable the Union of the Comoros to reach the enhanced HIPC Initiative decision point.

5. Economic activity in the Comoros remains sluggish. The rate of real GDP growth was only 1.8 percent in 2009, up slightly from 2008 but still below the rate of population growth. It continues to be dependent on subsistence farming, externally financed public investments, and private sector construction, which benefits from relatively sustained remittances from Comorians living abroad. The easing of pressures on food and energy prices since 2008 has helped slow inflation and narrow the external current account deficit. In an environment of gradual recovery of the world economy, improvement in the business climate and in domestic political conditions, as well as the resumption of financial support from development partners, growth is expected to accelerate to an average of at least 2.5 percent in 2010–12. To achieve this, the government reaffirms its determination to continue implementing a prudent fiscal policy and to expedite implementation of structural reforms necessary to enhance the competitiveness of the economy. In this regard, IMF technical and financial support remains essential. The government remains determined to take any other appropriate measures that may prove necessary to achieve the program objectives. It would then consult with the Fund before revising any of the policies contained in the attached MEFP, in accordance with the Fund’s policy on such consultation.

6. While the underlying objectives of the program remain unchanged, we would like to request modifications to some performance criteria for end-June 2010 to reflect the fiscal and macroeconomic repercussions from substantial external assistance received in late April. It is expected that the second review of the ECF-supported program will be completed by end-November 2010, and that the third review will be completed by mid-March 2011.
7. In line with our commitment to transparency in government operations, we agree to the publication of documents pertaining to our discussions with IMF staff under the first review of our ECF-supported program.

Sincerely yours,

/s/

Ahmed Abdallah Mohamed Sambi
President of Union of the Comoros

/s/           /s/

Mohamed Bacar Dossar  Ahamadi Abdoulbastoi
Minister of Finance, Budget, and Governor of the BCC
Investment

Attachments: MEFP and TMU
I. Introduction

1. Since the adoption of its medium-term economic reform program supported by the International Monetary Fund under the Enhanced Credit Facility (ECF), the government has taken steps to progressively lay the foundation for sustained strong growth. The actions taken are aimed at improving fiscal sustainability, building institutional and governance capacity, and rehabilitating social and economic infrastructure, particularly public utilities through the reform of public enterprises operating in that sector. Successful implementation of these reforms should also enable the Comoros to obtain debt relief under the HIPC Initiative and gradually stabilize the macroeconomic environment, enhance the competitiveness of the economy, and give new impetus to growth.

2. This memorandum summarizes progress since the adoption of the ECF-supported program, and sets out the measures and policies that the government plans to implement in 2010 to attain the objectives it has set in the program.

II. Economic Developments and Program Performance

A. Recent economic developments and outlook for end-2010

3. Despite a number of encouraging signs, economic activity remained modest in 2009. Bank credit to the private sector continued to grow, vanilla exports performed relatively well, and imports of petroleum products and cement, potentially supporting growth, remained steady. However, very few new investments were made outside the banking sector, and growth is far from shedding the effects of a long period of political instability and, more recently, a difficult international economic environment. The rate of real GDP growth is estimated at 1.8 percent in 2009, up nearly 1 percentage point from 2008. Benefiting from the easing of world food and energy prices, inflation was contained overall, remaining below 3 percent in 2009.

4. Fiscal performance was not as good as expected. Government revenue reached the equivalent of 13.9 percent of GDP, slightly exceeding the program target. However, this was only possible because of exceptional revenues from the economic citizenship program, because tax revenue, particularly direct and indirect domestic taxes, fell short of program expectations. Apart from the impact of a difficult economic situation, fiscal performance reflected weaknesses in tax and customs administration, which the government plans to
tackle as quickly as possible. The fiscal 2009 budget outturn was also negatively affected by (i) increasing difficulties in managing personnel expenses, which caused the wage bill to exceed projections by 0.3 percent of GDP; (ii) the assumption of obligations resulting from the crash of Yemenia Airways flight 626; and (iii) the cost of linking the Comoros to the regional fiber-optic communications cable. As a result of these developments, the domestic primary fiscal deficit amounted to 2.6 percent of GDP, close to the level recorded in 2008 and far from the program target of 1.6 percent of GDP.

5. **A sharp rise in the terms of trade and external grants helped reduce the external current account deficit in 2009.** Exports grew significantly, owing to the rundown of stocks built up in recent years. Supported by a continued high level of remittances from Comorians living abroad, the volume of imports, particularly in the construction, used vehicle, and petroleum sectors expanded appreciably, even though imports increased only slightly in value terms. With a sizable increase in budget grants received from abroad, these developments narrowed the external current account deficit (including budget support grants) to the equivalent of 7.9 percent of GDP (11.1 percent of GDP in 2008), close to the program projection of 8 percent. International reserves increased to the equivalent of 7.1 months of imports of goods and nonfactor services, reflecting in particular the SDR allocations from the IMF.

6. **The external debt of the Comoros remains unsustainable.** It rose to the equivalent of 343 percent of exports of goods and services (in net present value terms) at end-2009. In November, the government concluded an arrangement to restructure its debt to Paris Club creditors, securing an 80-percent reduction of service due during 2009–12, which could be increased to 90 percent when the country reaches the HIPC Initiative decision point. The Union of the Comoros obtained the agreement of non-Paris Club creditors to defer the settlement of external arrears equivalent to US$43.9 million at end-2009 and debt service of US$0.24 million in 2010, pending full resolution of the country’s external debt situation under the enhanced HIPC Initiative and on terms comparable to those agreed with Paris Club creditors.

7. **Against the background of the expansion of the banking system, credit to the economy was sustained.** Two new banking institutions have been established, opening up new financing possibilities for the private sector. Thus, including microfinance sector lending, credit to the economy increased 44.1 percent in 2009, following growth of 27 percent in 2008. The bulk of bank credit benefited the trade sector. Money supply grew by 13.5 percent, outpacing the growth of nominal GDP, in parallel with a 9.7 percent increase in net foreign assets of the banking system—corresponding to a rise of 7.7 percent relative to beginning-of-the-period money supply.
B. Implementation of the program

8. **Domestic primary expenditure swelled to 16.5 percent of GDP (15.4 percent in the program).** This was due to pressure from the wage bill, the cost of the regional fiber-optic communications project, and expenses related to the crash of the Yemenia Airlines aircraft, which made numerous Comorian casualties. The spending overrun was not offset by modest excess revenue achieved (0.1 percent of GDP above the program target). Consequently, the domestic primary fiscal balance remained at the high level of 2008 (2.6 percent of GDP), compared to the program target of 1.6 percent of GDP. However, overall, only two of the fifteen quantitative and structural indicators of the program for end-December 2009 were not met. The second unmet program indicator for the period concerns the adoption of reform strategies for the State-owned telecommunications (Comores Télécoms) and petroleum products-importing (Société comorienne des hydrocarbures) companies.

9. **In the first quarter of 2010, seven of ten performance indicators were met.** The domestic revenue target was only narrowly missed and, thanks to improved monitoring of current expenditure, the domestic primary fiscal balance was kept within the program limits. However, net credit to the government exceeded program projections, because the settlement of wage arrears exceeded budgetary assistance earmarked for that purpose. In all, six of the eight quantitative performance indicators were met. In the area of structural reforms, one of the two program benchmarks for end-March was met, but with some delay. The second benchmark concerning the computerization of payroll operations was only partially met.

III. Economic and Financial Policies for 2010

A. Macroeconomic Framework

10. **The government intends to give new impetus to the economic reform agenda.** It is determined to strengthen fiscal discipline to maintain macroeconomic stability, and to ensure the prompt execution of its structural reform agenda.

11. **In line with this, the rate of real GDP growth is expected to begin recovering gradually and reach 2.1 percent in 2010.** In addition to subsistence farming and private construction sustained by the remittances of Comorians living abroad, economic activity is expected to rebound as a result of the rehabilitation of economic infrastructures, especially in the energy sector, financed by development partners, and the revival of financial services thanks to increased financial intermediation. The tourism sector could also receive a boost, benefiting from the greater involvement of Gulf region private partners following the March 2010 Doha Conference on development and investment in the Comoros. Inflation is expected to slightly pick-up, fueled in part by stronger aggregate demand following large repayments of civil service wage arrears. Reflecting the weakness of exports and sustained import demand, the external accounts are not expected to improve in 2010. The external
current account deficit is projected at 8.9 percent of GDP, compared to about 8 percent in 2009.

B. Fiscal Policy

12. The government recognizes the need to curb the fiscal slippages recorded in 2009 as quickly as possible, in order to protect the fiscal consolidation objectives of its three-year reform program supported by the IMF under the ECF. To achieve this, corrective measures are intended to strengthen the mobilization of government revenue and significantly improve the control of expenditure, particularly wage expenses. In 2010 these measures should make it possible to narrow the domestic primary fiscal balance to the equivalent of 1.5 percent of GDP, compared to 2.6 percent of GDP in 2008–09, consistent with our revised budget. The government’s net fiscal financing needs for 2010 are estimated at 3.3 percent of GDP; they will be covered entirely by budget support from the European Union, the World Bank, the African Development Bank, Gulf region partners, and the IMF. If the government receives external budget support in excess of programmed amounts, it will consult with the IMF concerning its use and will establish a new supplementary budget outlining how these resources will be allocated to the settlement of domestic payments arrears and to other priority sectors. The amended 2010 fiscal program will be submitted for the approval of the National Assembly in the form of a supplementary budget by June 30, 2010.

13. Domestic revenue is expected to reach CF 28.838 billion (14.3 percent of GDP) in 2010, 6.4 percent above the initial program target. Revenue mobilization in 2010 will focus on enhancing the effectiveness of tax and customs administration, with technical support from development partners, including the IMF Fiscal Affairs Department, the AfDB, and France.

14. The growth in Directorate General of Taxes (DGI) revenues will reflect the effects of agreed measures in the Directorate’s performance contract. Under the contract, tax centers will soon be opened in the island entities and placed under the direct authority of the Director General, and management of taxpayers monitored by the Large Taxpayer Unit (LTU) will be improved, based on the recommendations of the IMF Fiscal Affairs Department. In this context, the practice of “reclassifying” taxpayers has been eliminated; tax returns filed by large enterprises are now more closely monitored with a view to increasing the rate of filing to 95 percent; and the government has appointed a new manager for the LTU. In addition, a comprehensive inventory will be conducted of the Treasury’s balance of outstanding tax claims, and the findings will be communicated to IMF staff before the first review of the program by the IMF Executive Board. Based on this report, a more systematic recovery of the tax liabilities in question will be undertaken. Finally, the offices of the DGI will be increasingly provided with qualified personnel and equipment, especially IT hardware.
15. **To achieve its domestic revenue mobilization goal, the government has also adopted new tax measures.** These include: (i) an increase of 5 percent in the tax on petroleum products; (ii) reinstatement of the tax on diesel and other motor vehicles, as well as the business license tax; and (iii) an increase of 5 percent in the rates of the excises on tobacco and alcohol. Moreover, the government is introducing royalties on management licenses and use of radio frequencies. The revenue yield from these measures is estimated at least CF 886 million.

16. **Measures at the Directorate General of Customs (DGD) to streamline goods clearance procedures will be stepped up and the ad valorem taxation on imports completed.** Several management changes have been introduced at the directorate general of customs. A central office responsible for the valuation, type, and origin of imported goods has begun operations, and the flat tax per container is being eliminated.

17. **As regards expenditure, nonpriority payments will be strictly monitored to protect the government’s fiscal objectives.** Cuts will be made to certain expenditure items to compensate for shortfalls in revenue collection. In 2010, total expenditure is expected to be capped at CF 46.567 billion, or 23.2 percent GDP. In line with this, domestic primary expenditure will amount to CF 31.788 billion, equivalent to 15.8 percent of GDP, including a budgetary contribution to capital expenditure of CF 2.60 billion (1 percent of GDP, up 66 percent from last year). In support of the government’s poverty alleviation efforts under the PRSP, education and health spending financed with own resources will be closely monitored by the reform-monitoring committee (CREF, paras. 28 and 29) and is expected to reach CF 11,870 billion (5.9 percent of GDP) in 2010, from 5.2 percent of GDP in 2009.

18. **The wage bill, projected at CF 17.864 billion (8.9 percent of GDP), fully reflects the government’s current obligations to its employees.** Steps have been taken to keep it within that envelope. In particular, any new recruitment, solely in priority sectors, can be considered only in within the limit permitted by the number of departures. In August 2010 the government will roll out its new computerized payroll management system, which it has already fully tested. Finally, the government will conduct a comprehensive census of government employees and officials by end-2010. Further efforts are discussed in paragraph 26.

19. **Domestic payments arrears, including wage arrears, will be settled consistent with the broader objectives of the fiscal program.** With earmarked budget support from Qatar, the government will reduce domestic arrears by CF 10.784 billion in 2010, including several months of wage arrears and arrears to government private suppliers.

20. **More generally, the monitoring of government expenditure will be improved through more regular meetings of the Cash Flow Committee.** Complete minutes of the committee’s deliberations will be kept and sent monthly to IMF staff. Expenditure without a prior commitment, particularly through Treasury payment orders, will be executed only in
exceptional cases of extreme urgency and will not exceed the ceiling of CF 150 million, beginning July 1, 2010.

21. In view of the foregoing, the overall fiscal deficit (cash basis, grants included) will be CF 5.439 billion (2.7 percent of GDP). Taking into account external financing (including debt relief) and reduction in net bank financing through a buildup of government deposits (CF 2.858 billion), the net financing requirements of the government are estimated at CF 6.640 billion (3.3 percent of GDP). This amount will be covered as follows: (i) World Bank: CF 1.1 billion; (ii) European Union: CF 3.3 billion; (iii) AfDB: CF 0.5 billion; (iv) Gulf region partners: CF 0.1 billion; and (v) IMF: CF 1.7 billion.

C. Money, Credit, and Financial System

22. Monetary policy is conducted within the framework of the Comoros’ membership in the franc zone. It will support a moderate expansion of credit to the economy, aimed at containing inflation and averting capital flight risks. Consistent with this, the government’s indebtedness to the banking system will remain prudent, largely reflecting the domestic pass-through of IMF financial support, including the SDR allocations in 2009. Broad money is expected to grow at a rate of 7.5 percent in 2010, faster than the growth of nominal GDP, compared to 13.5 percent in 2009. The required reserve ratio, set at 25 percent since 2008, will continue to be the main liquidity management tool. In the medium term, the BCC plans to make greater use of liberalized interest rates in an increasingly competitive environment. The BCC has completed a new safeguards assessment and has started implementing the main recommendations. In particular, the Bank’s cash holdings will be audited and certified annually by an external auditor, and the financial statements will be prepared in accordance with international standards, starting in 2011. In addition, the Bank’s comptroller will review the monetary data reported to IMF staff before they are sent. Finally, the BCC plans to complete the expansion of its bank supervision staff as soon as possible, with technical support from the IMF and Banque de France.

23. By end-2010, the government will complete preparations for a strategy to refocus the activities of the National Postal and Financial Services Company (SNPSF). This strategy is aimed, in particular, at limiting the activities of the SNPSF to savings deposits and money transfers, as well as extending the new postal checking service to a broader public.

D. Balance of Payments and External Debt

24. The external current account deficit, private and official grants and transfers included, is expected to widen in 2010 to about 8.9 percent, compared to 7.9 percent of GDP in 2009. This largely reflects the forecasted rebound in world energy and food prices. While seeking a substantial external debt relief within the framework of the enhanced HIPC Initiative and on terms similar to those provided by the Paris Club creditors, the government
reaffirms its commitment to a prudent debt policy, to avoid jeopardizing the sustainability of the country’s external debt.

E. Structural policies

25. **As regards structural reform, the government aims to accelerate implementation of its public enterprise and civil service reform programs.** Prior to the IMF Executive Board’s consideration of the first program review the government will adopt an IFC-approved reform strategy for the state-owned telecommunications company; and while pursuing consultations with the IFC on reform options for the hydro-carbon importing company, it has appointed a new Board of Directors in an effort to begin addressing management inefficiencies in the company. By end-December 2010 the government will also complete a reform strategy for the electric company, MAMWE, developed with the assistance of the AfDB. Implementation of the SCH and Comores Télécoms reforms are to begin in the fourth quarter of 2010, and by end-March 2011 for MAMWE.

26. **In the area of public administration, the government will take important measures aimed at securing medium-term budget viability.** The government recently submitted to Parliament new personnel frameworks for ministries that are compatible with available government financial resources. The government expects to have these frameworks operational by the end of the year and will attach them as annexes to the budget law, beginning in fiscal 2011. This reform will make it possible, in particular, to reduce the level of civil service staffing (including the army) to approximately 10,600 employees, compared to the current total of 12,300. The government is requesting technical and financial support from its development partners for the preparation and implementation of a staff reduction support program.

27. **The government will continue its broad program to promote good governance, including judicial reform and enhanced transparency.** By end-2011, it will complete the revision of procurement procedures to make them fully transparent, and consistent with COMESA standards. The government has also requested the support of technical and financial partners, France and the UNDP in particular, to assist with implementation of the Judiciary Action Plan aimed at improving the quality of the judicial system. With the support of the World Bank, the AfDB, France, and the United Nations System of Organizations, it has developed a program to improve governance, with implementation to begin before end-March 2011.

F. Poverty Reduction Strategy Paper (PRSP)

28. **In September 2009, the government completed the update of its Poverty Reduction Strategy (PRS).** The new PRS assigns priority to the promotion of macroeconomic stability; activity in the productive sectors of agriculture, fisheries, and tourism; governance; and human development. Members of civil society contributed actively to its preparation. The government recognizes the rather general nature of the strategy and
plans to make it more effective by better prioritization and specification of the projects and policies to be carried out within the PRS framework, particularly those related to the HIPC Initiative completion point triggers. With the support of development partners, the government expects to complete this work by end-2010.

29. The government plans to use the savings resulting from the reduction in debt service obligations under the HIPC Initiative to finance the priority sectors defined in its poverty reduction and growth strategy. Accordingly, it is preparing a comprehensive list of priority expenditures which will be closely monitored by the interdepartmental committee responsible for monitoring implementation of the PRSP. Pending the completion of that list, health and education spending are currently subject to regular monitoring by the CREF.

G. External Debt Relief and Management

30. The government was granted debt relief by Paris Club members in November 2009 and has reached understandings with other creditors on debt treatment pending comprehensive resolution of Comoros’ debt situation. Agreements have been notably achieved on the treatment of external debt arrears outstanding at end-2009, as well as on deferral of scheduled debt service payments in 2010 owed to creditors other than the main multilateral lenders. The government is committed to honoring all obligations to the latter creditors on a timely basis. Discussions have been initiated with non-Paris club bilateral creditors, multilateral creditors other than the main donors and lenders, and commercial creditors for debt relief under the HIPC Initiative and on terms comparable to those of the Paris Club.

31. The government fully recognizes the need for prudent debt management. Any external borrowing contracted or guaranteed by the government will be subject to the prior approval of the Minister of Finance of the Union, and the autonomous island executives are not authorized to contract or guarantee external borrowing. In addition, throughout the three-year program, the government will neither contract nor guarantee short-term or nonconcessional external debt as defined in the Technical Memorandum of Understanding (TMU). The authorities will consult with IMF staff before contracting or guaranteeing any concessional external debt in excess of US$20 million. With assistance from the African Development Bank, the Public Debt Directorate will in the near future acquire more effective debt management software and, importantly, will undertake a personnel training program on its use.

H. Statistics

32. The government is determined to continue its efforts to improve the database of socio-demographic and macroeconomic statistics needed to design and monitor its development policy. The government plans to submit to the IMF, by end-May 2010, a request for technical assistance for an assessment of its methodology for preparing the
national accounts and the consumer price index. With support from the World Bank, the government intends to strengthen its statistical capacities, taking into account the decentralization of public administration. The efforts will focus on the establishment of frameworks for the collection, compilation, and dissemination of data from the islands, as well regular data dissemination, and the training of statistical officers.

IV. Monitor Program Execution

33. **Completion of the first review of the arrangement under the ECF for the Comoros will depend on prior accomplishment of the following three actions:**
(i) adoption by the Council of Ministers of the reform strategies for Comores Télécoms; continuation of technical discussions with IFC on reform options for Société Comorienne des Hydrocarbures; and appointment of a Board of Directors for the latter company as specified in paragraph 25, (ii) completion and communication to IMF staff of a comprehensive report on Treasury balances outstanding (“restes à recouvrir”), together with a plan for the recovery of these fiscal obligations, and (iii) submission of a 2010 revised budget law to the National Assembly.

34. **The program will be monitored on the basis of quarterly targets with performance criteria established on a semi-annual basis (Tables 1 and 2).** The authorities will provide the IMF with such information as needed to monitor the program, in accordance with the Technical Memorandum of Understanding. During the program period, the authorities will not introduce or intensify restrictions on payments and transfers for current international transactions, and will not introduce or modify any multiple currency practices, conclude any bilateral payment agreement that are inconsistent with Article VIII of the IMF’s Articles of Agreement, or impose or intensify any restrictions on imports for balance of payments purposes.

35. **The second review of the arrangement under the ECF will take place in November 2010.** In the area of structural reforms, the review will focus primarily on measures aimed at strengthening control of the wage bill, particularly: (i) the introduction of computerized pay slips, (ii) completion of the census of government employees and officials, and (iii) implementation of the Civil Service organizational frameworks.
Table 1. Comoros: Quantitative Performance Criteria, Benchmarks and Indicative Targets Under ECF ¹

(In millions of Comorian francs, cumulative since end of previous year, unless otherwise specified)

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<tr>
<td>1. Ceiling on net credit to government (NCG) ²</td>
<td>588</td>
<td>-374 met</td>
<td>1,142</td>
<td>1,131</td>
<td>-391</td>
<td>389</td>
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<td>2. Ceiling on the net accumulation of domestic payments arrears ³, ⁴</td>
<td>217</td>
<td>-2,331 met</td>
<td>-731</td>
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<td>3. Ceiling on new nonconcessional external debt contracted or guaranteed by the</td>
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<td>0 met</td>
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<td>government ⁵</td>
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<td>4. Ceiling on new short-term external debt contracted or guaranteed by the government</td>
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<td>0 met</td>
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<td>5. Ceiling on accumulation of external debt service arrears</td>
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<td>0 met</td>
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<td>Quantitative Benchmarks</td>
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<td>6. Floor on the domestic primary balance</td>
<td>-1,509 met</td>
<td>-2,970</td>
<td>-4,967 not</td>
<td>-1,421</td>
<td>-825</td>
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<td>7. Floor on total domestic revenues</td>
<td>19,761</td>
<td>25,975</td>
<td>26,401</td>
<td>5,232</td>
<td>5,152</td>
<td>11,801</td>
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<td>8. Ceiling on expenditures by cash advances ⁴</td>
<td>226</td>
<td>500</td>
<td>257</td>
<td>100</td>
<td>89</td>
<td>150</td>
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<td>9. Floor on domestically financed social spending</td>
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<td>11,870</td>
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¹ Definitions of targets and adjusters are provided in the Technical Memorandum of Understanding (TMU).
² Unlike in the monetary survey, NCG includes net ECF purchases.
³ Targets and realizations adjusted as specified in the TMU.
⁴ 2009 targets cumulative from July 1, 2009.
⁵ Excluding trade credits.
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<th>Measures</th>
<th>Macroeconomic justification</th>
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<td><strong>Prior Actions</strong></td>
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<td>Submission of the 2010 supplementary draft budget law to the National Assembly</td>
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<td>Adoption by the Council of Ministers of the reform strategy for Comores Télécoms; and appointment of a new Board of Directors for Société Comorienne des Hydrocarbures</td>
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<td>Completion and forwarding to IMF staff of a comprehensive report on Treasury balances outstanding, together with a plan for the recovery of those tax liabilities</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Structural benchmarks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Full computerization of civil servant payment roster and adequate staffing of the unit monitoring wage payments.</td>
<td>Support fiscal consolidation by improving control of the wage bill</td>
<td>March 31, 2010</td>
<td>Partially met</td>
</tr>
<tr>
<td>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</td>
<td>Rightsizing the civil service to achieve medium-term budget viability</td>
<td>March 31, 2010</td>
<td>Met</td>
</tr>
<tr>
<td>Maintaining the petroleum product price-setting mechanism.</td>
<td>Will ensure a reliable supply of petroleum products and limit pressures for subsidies</td>
<td></td>
<td>Ongoing</td>
</tr>
<tr>
<td>Appointment of Union Presidency representative in the reform-monitoring committee (CREF)</td>
<td>Increase the effectiveness reform implementation and monitoring</td>
<td>June 30, 2010</td>
<td></td>
</tr>
<tr>
<td>Introduction of computerized pay slips</td>
<td>Improve control of the wage bill and of government expenditure</td>
<td>End-September 2010</td>
<td></td>
</tr>
<tr>
<td>Completion of the census of government employees and officials</td>
<td>Improve control of the wage bill and of government expenditure</td>
<td>End-December 2010</td>
<td></td>
</tr>
<tr>
<td>Implementation of the Civil Service organizational frameworks</td>
<td>Improve control of the wage bill and of government expenditure</td>
<td>End-June 2011</td>
<td></td>
</tr>
</tbody>
</table>
ATTACHMENT 2

UNION OF THE COMOROS

Technical Memorandum of Understanding

Moroni, June 5, 2010

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 Extended Credit 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 June 30 and December 31, 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, 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 nonbank sources. Net bank credit to the government reflects the net debt 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 nonbank 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, 2009.

Performance criteria

6. The amounts set in Table 1 of the MEFP on Net Credit to Government for June 30 and December 31, 2010 are ceilings and constitute performance criteria. The amount set in the above table for September 30, 2010 is a ceiling and constitutes an indicative target.

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 nonbank 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 June 30 and December 31, 2010 are ceilings and constitute performance criteria. The amount set in the above table for September 30, 2010 is a ceiling and constitutes a quantitative benchmark.

Adjuster
10. If external budget support is less than expected, the floor on the reduction of domestic payment arrears will be lowered by the full amount of the shortfall, up to a maximum preventing new net accumulation of arrears. 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, up to a ceiling of CF 0.750 billion. Amounts in excess of this ceiling would be allocated to priority sectors after consultation between the authorities and IMF staff. Cumulative from January 1, 2010, the program assumes external budget support of CF 16.876 billion by end-June 2010, CF 20.178 billion by end-September 2010 and CF 21.043 billion by end-December 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 ¶¶16-17) 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. 14416-(09/91), effective December 1, 2009, 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 nonresident.

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 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 sometime 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 Extended Credit 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 or 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**


**Reporting requirements**
24. 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 45 days following the end of each month.

B. Government Revenue

Definition

25. Government revenue is defined as reported in the consolidated government financial operations table (TOFE), and includes all tax and nontax receipts and excludes external grants.

Quantitative Benchmarks

26. The floor on government revenue, cumulative from the beginning of the 2010 calendar year, is set at CF 12.028 billion for June 30, 2010, CF 20.491 for September 30, 2010 and CF 28.838 billion for December 31, 2010. These amounts are considered benchmarks under the program, for the respective dates.

Reporting requirements

27. 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

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

Quantitative Benchmarks

29. 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 January 1, 2010 is set at CF 150 million at end-June 2010, September 30, 2010 and at December 31, 2010.

Reporting requirements

30. 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.
D. Domestically financed social spending

Definition

31. Total domestically financed social spending (current and capital) is calculated, for each category of the current expenditure (wages, goods and services, transfers and subsidies and) capital expenditure, as (1) expenditure executed by the Ministry of Health (under “health”) and (2) expenditure executed by the Ministry of Education (under “education”). Domestically financed social spending is classified according to the above categories (health and education) based on a classification of each project presented in the 2010 budget into health and education. Total domestically financed current and capital social spending includes social spending financed by domestic resources, including revenues, domestic financing, and general external budget support, and excludes all social spending financed by project-specific foreign grants and/or loans.

Quantitative Benchmarks

32. The floor on total domestically financed social spending for the period from January to December 2010 is set at CF 11.870 billion. The floor on domestically financed social spending is an indicative target.

Reporting deadlines

33. During the program period, data on domestically financed social spending will be forwarded annually by the Ministry of Finance of the Union government to the staff of the IMF within 45 days following the end of the period.

IV. Additional Information for Program Monitoring

34. 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

35. 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.