

**Union of the Comoros: Third Staff Review and Extension of the
Staff-Monitored Program**

This paper on the Third Staff Review and Extension of the Staff Monitored Program for the Union of the Comoros was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on April 4, 2006. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Union of the Comoros or the Executive Board of the IMF.

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**International Monetary Fund
Washington, D.C.**

INTERNATIONAL MONETARY FUND

UNION OF THE COMOROS

Third Staff Review and Extension of the Staff-Monitored Program

Prepared by the African Department

Approved by Thomas Krueger and Anthony Boote

April 4, 2006

- A mission consisting of Mr. Mumssen (head), Mr. Lopes, and Ms. Al-Zein (all AFR) visited the Union of the Comoros during February 20-March 1, 2006. The mission met with Mr. Mzé Chei Oubeidi, Minister of Finance and the Budget of the Union; Mr. Abdoulbastoi, Governor of the Central Bank of the Comoros; representatives of the three island governments, and other senior officials. The mission also met with representatives of public enterprises, the financial sector, the donor community, and the media.
- Comoros has not had a Fund arrangement since 1994. A Staff-Monitored Program was approved in February 2005, covering the calendar year 2005. The Executive Board concluded the last Article IV consultation on July 18, 2005 and was informed of the first review under the SMP (Country Report No. 05/299). Executive Directors were encouraged by the consolidation of political stability, but disappointed by the lackluster performance of the economy, the fiscal slippages of early 2005, and the slow pace of structural reforms. They urged corrective actions in these areas. The Executive Board was informed of the second review under the SMP on November 14, 2005. Program implementation has been mixed, but performance improved markedly in the fourth quarter of 2005.
- This report describes the authorities' program for 2006 and the policies to be monitored under an extension of the SMP through June 2006. The authorities' Letter of Intent and Memorandum of Economic and Financial Policies (MEFP) for the SMP extension are included in Attachment I. The SMP extension is designed to support policy implementation and provide the track record necessary to enter into a PRGF arrangement, which could open the way for debt relief under the enhanced HIPC initiative and MDRI.
- The completion in 2005 of an interim-poverty reduction strategy paper (I-PRSP) set the stage for a donors' roundtable in December 2005, which resulted in substantial pledges of external support. The I-PRSP and a Joint Staff Advisory Note (JSAN) are expected to be circulated to the Executive Boards of the IMF and World Bank in April 2006.

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EXECUTIVE SUMMARY

- Further progress has been made on national reconciliation, but inter-island cooperation remains fragile. Presidential elections, scheduled for April/May 2006, are expected to lead to the first democratic transfer of power in over a decade.
- Macroeconomic stability has been maintained in the face of significant exogenous shocks, but several important objectives monitored under the 2005 Staff Monitored Program (SMP) were not achieved. Following large deviations from fiscal targets during the first nine months, the authorities took corrective action and performance improved significantly in the fourth quarter.
- Overall fiscal performance improved in 2005, with a sharp increase in the primary surplus and a net reduction in domestic arrears. However, the envisaged reduction in the wage bill was not achieved, revenues did not increase as planned, and external arrears continued to accumulate.
- Important structural reforms were implemented in the fiscal area, but progress was slow in other areas and institutional capacity remained very low.
- Understandings were reached on an extension of the SMP through June 2006 to support policy implementation and establish the track record necessary for a PRGF arrangement, which could open the way for debt relief under the enhanced HIPC initiative and MDRI.
- The authorities' macroeconomic program for 2006 focuses on securing the budgeted primary surplus of about 1 percent of GDP and avoiding new expenditure arrears. The 2006 budget also introduces significant tax policy changes to broaden the tax base and shift from import tariffs towards indirect taxation.
- The structural reform agenda for 2006 centers on the need to alleviate some of the most pressing capacity constraints of Comoros' public institutions, which would facilitate enhanced donor support. Technical assistance will be critical in this respect.
- Comoros has large external arrears, including to many multilateral creditors. Understandings on arrears clearance will be required ahead of a possible PRGF arrangement. Donor and creditor support will also be needed to cover a financing gap for 2006 of about $\frac{3}{4}$ percent of GDP.
- Implementation of the recently completed I-PRSP will require an increase in social spending, as envisaged in the 2006 budget, and enhanced donor support in line with pledges made during a recent donors' roundtable.
- The 2006 economic program is subject to significant risks, in particular in connection with the political transition and possible external shocks.

I. BACKGROUND

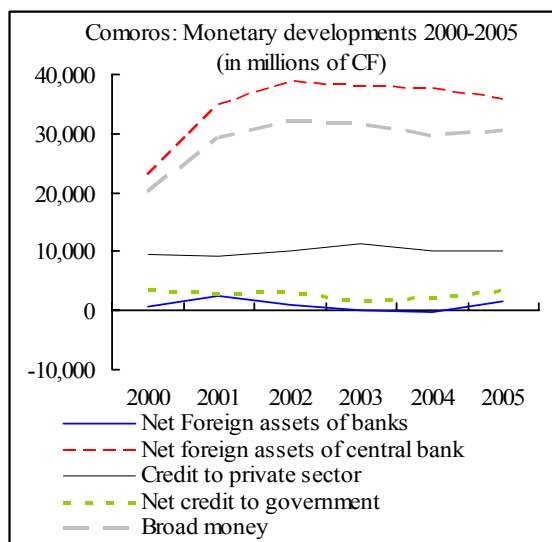
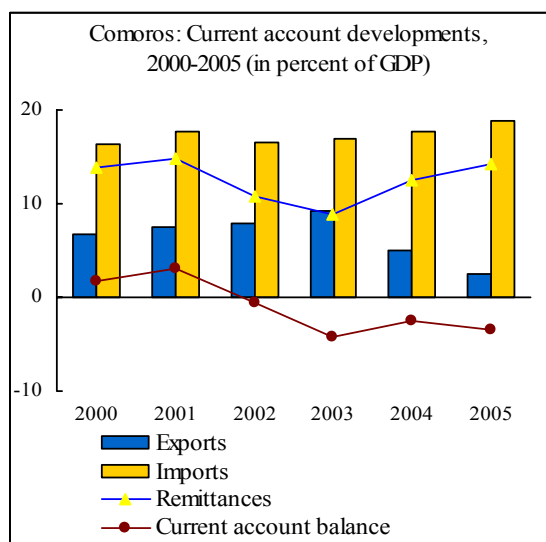
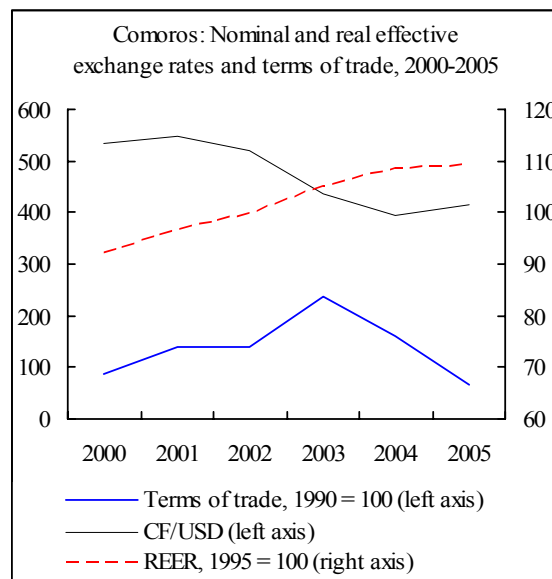
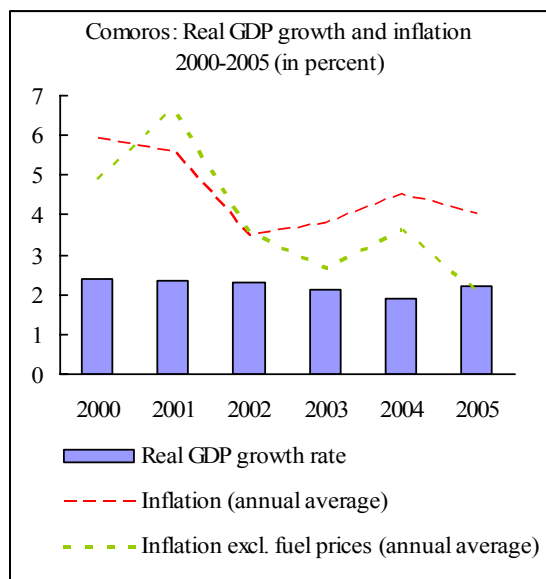
1. **Further progress has been made on national reconciliation, but inter-island cooperation is still fragile.** Cooperation between the union and the three island governments¹ intensified in 2005, with the introduction of a consolidated budget, the implementation of a new revenue sharing mechanism, and the introduction of regular inter-governmental budget meetings. Nonetheless, political risk remains high, following years of inter-island conflict. Tensions between the union and island governments have risen in recent months, partly due to a perceived weakening of coordination on fiscal policy.
2. **Presidential elections, scheduled for April and May 2006, are expected to lead to the first democratic transfer of power in over a decade.** In line with the new constitution, the elections will result in the rotation of the presidency to a representative of the island of Anjouan. The new president is expected to be elected in a country-wide vote in May 2006, following primary elections in Anjouan, scheduled for April. The international community is providing technical and security support for the election process.
3. **Comoros' I-PRSP and a related action plan were presented at a donors' conference in December 2005.** Comoros' I-PRSP was finalized in a broad participatory process comprising representatives from all islands. Donors pledged to boost their assistance to about \$200 million during 2006-09 (about 12 percent of GDP per year), a threefold increase from 2004-05, but only about half of what the authorities estimate is needed for implementation of the I-PRSP. No major aid increase is expected before the presidential transition.

II. PERFORMANCE UNDER THE SMP

4. **External shocks hampered macroeconomic performance in 2005.** Low international vanilla prices disrupted the production and export of vanilla, Comoros' main cash crop. Nonetheless, real GDP grew by about 2¼ percent (Table 1), on account of steady growth in subsistence agriculture, domestic trade, and a rebound in tourism. Consumer price inflation spiked in the fall of 2005 as the government increased retail prices for gasoline (by 20 percent) and for diesel (by 43 percent) to restore margins relative to import prices. Non-fuel inflation remained subdued, given stagnating wages and a pegged exchange rate.
5. **A surge in remittances prevented a potentially disruptive balance of payments deterioration.** The combination of low vanilla prices and high oil prices caused a 58 percent decline in Comoros' terms of trade in 2005, contributing to a sharp increase in the trade deficit to 16½ percent of GDP, compared to 12½ percent of GDP in 2004 (Table 2). At the same time, inflows of remittances from the diaspora increased by some 20 percent in 2005, to more than 14 percent of GDP. Combined with a rebound in tourism, mainly related to the

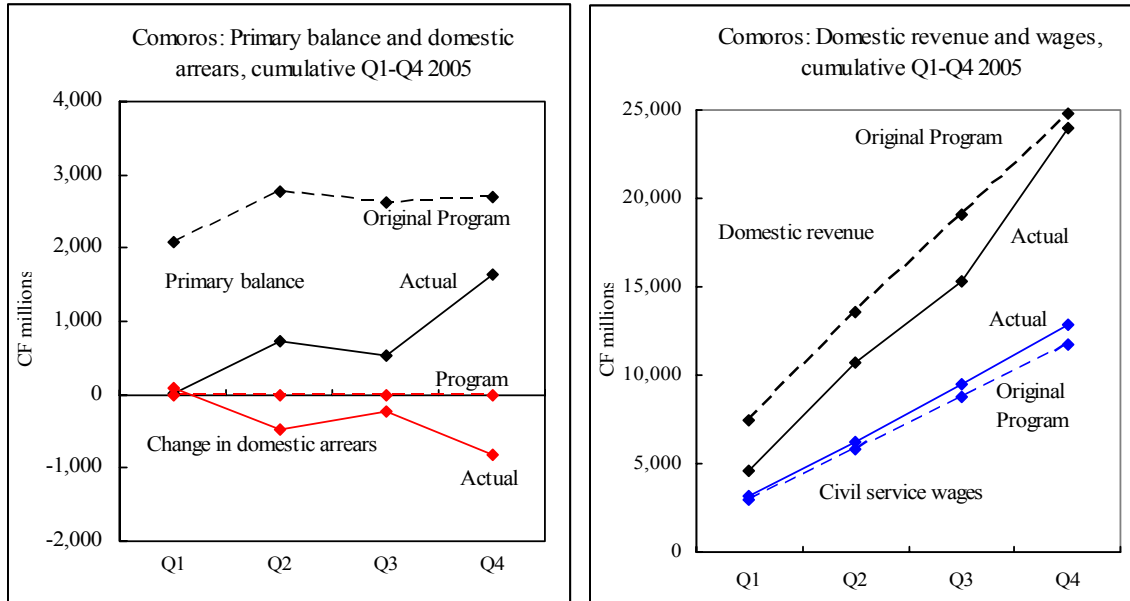
¹ The union government is appointed by the president. The three islands of Grande Comore, Anjouan, and Moheli have independent island governments.

reopening of a major hotel, the increase in private transfers helped cushion the impact of the trade deterioration on the current account deficit, which rose only slightly, to 3½ percent of GDP. Gross international reserves declined, due to the higher current account deficit and capital outflows from the banking system, but remained relatively high at almost 10 months of imports.



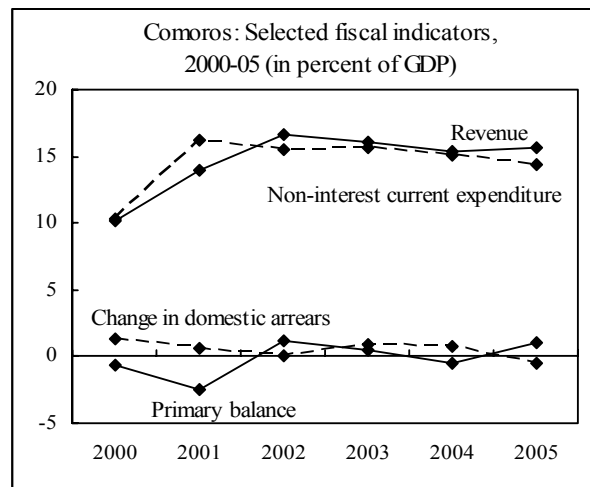
6. **Broad money growth turned positive in 2005, reflecting a rebound in demand deposits (Table 3).** Net central bank credit to government increased by about 1 percentage point of GDP in 2005, while credit to the private sector stagnated, mainly due to the crisis in the vanilla sector. The banking system remained highly liquid and the central bank decreased interest rates in January 2006, including the administered rate for savings deposits with the only commercial bank, which was reduced from 3 percent to 2½ percent.

7. **Fiscal performance was weak in the first nine months of 2005.** Most fiscal targets monitored under the SMP were missed at end-September (Tables 4 and 7), due to large revenue shortfalls and delays in implementing reforms to reduce the public sector wage bill.



8. **The authorities took corrective actions in the second half of 2005 and fiscal performance improved significantly in the fourth quarter.** The government compressed non-wage spending and increased borrowing from the central bank to reduce domestic arrears. It also raised retail prices for fuel, increased taxes on imported luxury items, and removed customs exemptions (see Box 1 further below). To mitigate the social impact of these measures, the government reduced import tariffs on basic foodstuffs. Revenues rebounded strongly in the fourth quarter, making up for much of the earlier shortfalls.

9. **Full-year fiscal performance represented an improvement over 2004, but not all SMP targets were met.** Revenues increased slightly, to 15½ percent of GDP, although this included an exceptional dividend from the state telecom company (equivalent to about ¾ percent of GDP). The reduction of the public sector wage bill originally envisaged for 2005 was not achieved, and its share in total spending remained high, although declining modestly in relation to GDP. The primary domestic surplus increased significantly, to 1 percent of GDP. Domestic expenditure arrears were reduced on a net basis for the first time in years, while external arrears continued to accumulate.



10. **Significant structural reforms were implemented in the fiscal area, but progress was slow in other areas and institutional capacity has remained very low.** Key measures in 2005 included the implementation of a consolidated budget and a new revenue-sharing mechanism between the union and islands; the introduction of a harmonized budget nomenclature; and the adoption of strengthened public procurement rules (Table 8). Other envisaged reforms were not implemented, including on customs and public enterprise reform, partly due to a lack of institutional capacity and delays in the delivery of the envisaged technical assistance. Severe capacity shortcomings persist across most public institutions, including with respect to budget accounting, monitoring of budget execution, public debt management, tax and customs administration, and economic statistics.

III. POLICY DISCUSSIONS

11. **The discussions focused on the economic program for 2006 and the steps necessary to move to a PRGF arrangement.** It was agreed that the authorities' program for 2006 would be underpinned by an extension of the SMP through June. Their program anchors on two central objectives:

- To consolidate macroeconomic stabilization gains made last year, by maintaining prudent central bank lending policies under the franc zone arrangement and implementing the 2006 budget without running new expenditure arrears;
- To strengthen the capacity of public institutions, including in the area of budget management, which would facilitate financial support from development partners.

12. **The authorities were hopeful that achieving these objectives would open the way for a PRGF arrangement and increased donor support.** A PRGF arrangement was seen as critical for supporting macroeconomic policy implementation and opening the way for debt relief under the enhanced HIPC initiative and MDRI. The authorities emphasized that scaled-up technical and financial support from development partners, in line with pledges made during the recent donors' conference, would be needed to achieve Comoros' medium-term development and poverty reduction objectives set out in the I-PRSP.

13. **The authorities stressed the urgency of entering into a PRGF arrangement, in light of the HIPC sunset clause and the upcoming political transition.** They considered that the track record under the 2005 SMP had been broadly successful, with much improved macroeconomic policies and performance despite significant exogenous shocks. They recalled that politically difficult actions had been taken, including tax and fuel price increases, to address deviations from fiscal targets. The authorities also noted that much had been achieved on structural reform in the fiscal area and that the lack of progress in other areas was mainly due to delayed technical assistance. In this context, they regretted that a PRGF arrangement could not be negotiated at this time. The staff noted that, in light of the significant deviations from fiscal targets during the first nine months of 2005, more time would be needed to establish the track record necessary for a PRGF arrangement. Given the positive performance during the fourth quarter of 2005, negotiations could take place as early as mid-2006 on the basis of on-track performance as of end-March 2006 and a positive

outlook for meeting end-June targets. In addition, progress will be needed on the resolution of external arrears and on the agreed structural measures to enhance institutional capacity (Table 2 of the MEFP, Attachment I).

A. Macroeconomic outlook for 2006

14. **Economic growth prospects remain constrained by low international vanilla prices and capacity constraints in tourism.** The authorities considered that GDP growth could increase in 2006, but they did not expect a major acceleration of economic activity until external conditions improve. Real GDP growth is thus projected to increase only marginally, to 2½ percent, on the basis of steady growth in subsistence agriculture, domestic trade, and increased project financing from donors. While the vanilla sector is expected to remain subdued by weak export demand, the production of cloves is expected to increase. Tourism activity will be constrained by the temporary closure of a major hotel in early 2006. The authorities expected that inflation would remain under control in the context of a pegged exchange rate regime and limited wage growth, although fuel price increases in late 2005 are likely to filter into the headline inflation rate for 2006. The current account deficit is expected to increase marginally in 2005, as higher payments for petroleum and investment-related imports are largely offset by a modest rebound in exports and higher official transfers. International reserves are projected to remain high in relation to imports.

Comoros: Selected Economic and Financial Indicators, 2004-06

	2004	2005		2006
	Est.	Prog.	Prelim.	Prog.
Real GDP growth (in percent)	1.9	3.0	2.2	2.5
Average annual inflation (in percent)	4.5	3.0	4.0	4.2
Domestic revenue (in percent of GDP)	15.3	16.2	15.6	15.2
Domestic primary balance (in percent of GDP)	-0.5	1.8	1.1	0.9
Current account balance (in percent of GDP)	-2.6	-4.2	-3.4	-3.8
International reserves (months of imports of goods and services)	10.8	10.0	9.7	9.4
Terms of trade (annual percentage change)	-32.7	-20.5	-57.9	6.6
External assistance (in percent of GDP)	3.7	4.4	4.9	6.7
External debt (in percent of exports of goods and services)	490.1	475.1	505.5	493.3

Sources: Comorian authorities and Fund staff estimates and projections.

15. **The outlook for 2006 is subject to significant uncertainties.** The main risks include (i) a further worsening of the terms of trade; (ii) a decline in remittances from the diaspora; (iii) other potential exogenous shocks – for instance a volcanic eruption or health crisis² – that could disrupt economic activity and tourism; and (iv) political instability and fiscal

² An active volcano on the island of Grande Comore erupted twice during 2005 and poses a permanent risk. In the last two years, several deaths in Grande Comore were attributed to "chikungunya" disease, a mosquito-born dengue-like virus that has spread fast in the southern Indian Ocean region, raising concerns of a major epidemic.

loosening during the election period, which could disrupt donor support and macroeconomic stability. The authorities were confident that the election process would be smooth, but noted that the composition and policies of the new administration are difficult to predict.

B. Fiscal policy

16. **The 2006 budget targets a primary domestic surplus of close to 1 percent of GDP, broadly unchanged from the previous year.**³ This level could be sustainable over the medium term in the context of debt relief and investment spending financed primarily by donors, as envisaged in the I-PRSP. Externally financed projects and technical assistance are projected to increase to 6¾ percent of GDP in 2006, from 4½ percent of GDP in 2005. While most project spending will remain grant-based, about a quarter is expected to be financed through new concessional borrowing from multilaterals, primarily the World Bank. As a result, the overall budget deficit (excluding budget support grants) would rise from ½ percent of GDP in 2005 to 1¾ percent of GDP in 2006.

17. **The budget law introduces significant tax policy changes, including base broadening measures and a shift from import tariffs towards indirect taxation.** These changes, broadly in line with IMF technical assistance recommendations, are aimed at ensuring a stable revenue base following Comoros' entry into the free trade area under COMESA in January 2006.⁴ The authorities were confident that the tax policy measures taken in 2005-06 (see Box 1 for details) would ensure that domestic revenues reach the budget target of 15¼ percent of GDP in 2006, despite the significant reductions in import tariffs and the expected decline in dividends from state-owned companies. They noted, however, that revenues would be relatively low in the first quarter, in line with the seasonal pattern seen in previous years, but aggravated by exceptional losses of customs revenue due to a temporary disruption in sea transportation from Anjouan (following the loss of a vessel) and the absence of rice shipments, which constitute a major revenue source. The mission emphasized the need to strengthen tax administration to mitigate the risk of new revenue shortfalls this year and provide the basis for a gradual increase in the revenue yield over the medium run in support of the objectives set out in the I-PRSP.

³ This would be equivalent to an underlying fiscal adjustment of about ½ percentage point of GDP, if the one-off effects of an exceptional telecom dividends in 2005 are factored out.

⁴ The government estimated the potential revenue loss from entering the COMESA free trade area at about ½ percent of GDP.

Box 1: Fiscal measures introduced in the second half of 2005 and in the 2006 budget law

The government's fiscal measures in 2005-06 resulted in a significant lowering of import tariffs, an expansion of domestic indirect taxation, and a broadening of the revenue base. Measures taken between July and October 2005 were mainly aimed at raising domestic revenue in light of earlier shortfalls, while also advancing other objectives such as trade liberalization and more equitable taxation. The 2006 budget seeks to offset potential revenue losses from Comoros' entry into the free trade area under COMESA on January 1, 2006. In line with IMF technical assistance recommendations, import tariffs on major revenue-raising goods were significantly reduced and excise taxes were introduced to yield the same or slightly higher revenues.

Measures taken in 2005

July

- Elimination of all discretionary customs exemptions;
- Elimination of customs exemptions on selected goods (mainly flour, animal feed, motor oil for fishing boats);
- Simplification of customs duties collection of air freight imports;

October

- Reduction in maximum tariff rate for most goods from 40 percent to 30 percent;
- Reduction in import tariffs on basic foodstuffs from 20 percent to 12 percent;
- Increase in the single tax on high-quality rice by 33 percent;
- Increase in excise taxes on tobacco and spirits by 14-27 percent;

September - November

- Increase of retail prices of fuel products by 20-43 percent (an initial, higher, increase in September was partly reversed in November);

Measures introduced with the 2006 Budget Law

Changes to taxation of mostly imported merchandise

- Reduction of tariffs on the main revenue-raising imported goods (including alcohol, tobacco, soft drinks, perfumes and cosmetics, cement, fuel products, and low-quality rice) and introduction of excise taxes on these commodities at similar or higher rates with a view to preserving revenue after entry into the COMESA free-trade area in January 2006;
- Introduction of licensing fees for importing high-quality rice and for sales of spirits;

Expansion of the tax base

- Application of consumption taxes to phone cards, electricity usage, and casino revenues;
- Requirement of cash register receipts for small retail outlets;

Tax administration changes

- Introduction of a specific tax on wages to replace labor taxation under the general income tax as a first step to enhance tax administration.

18. **Social spending is projected to increase in 2006, whereas the wage bill is expected to decline modestly.** The authorities emphasized their continuing efforts to reduce the public sector wage bill, including through the computerization of the civil service payroll system and introduction of staffing frameworks for each ministry. They acknowledged that progress in these areas had been slow and stressed the need for additional donor support. The 2006 budget provides for an increase in social spending by 1½ percentage points of GDP (see Table 5 for detailed estimates of social expenditures by function and by island). This

could be exceeded if the donor support envisaged for the implementation of priority I-PRSP objectives materializes. The authorities also plan to achieve a net reduction in domestic expenditure arrears in 2006, with priority given to reducing delays in monthly wage payments, but they stressed that the scale of the reduction would depend on the extent of donor support.

19. **A financing gap of about ¾ percent of GDP remains to be filled through external budget support.** The authorities were confident that this could be largely covered by grants from bilateral donors. About a quarter of the gap could also be financed through debt flow relief from bilateral creditors. The authorities agreed with staff that less essential spending (including domestically financed investment spending) should be backloaded until the financing has been secured. If budget support for the year as a whole turns out below target, the authorities plan to scale back the clearance of domestic arrears and, if necessary, postpone less essential spending until 2007.

C. Monetary and financial sector policies

20. **Monetary and exchange rate policy will continue to be anchored in the franc zone framework.** The central bank plans to support low inflation, a stable exchange rate, and an adequate level of reserves through prudent credit policies. For 2006, it does not envisage an increase in net lending to the government, but is prepared to extend limited bridge financing in the first part of the year to alleviate the fiscal pressures caused by the seasonality of revenues. The authorities acknowledged that the appreciation of the real effective exchange rate and the sharp decline in the terms of trade have diminished the country's competitiveness. They agreed with the mission that, in the context of a fixed exchange rate regime, prudent demand policies and structural reforms supportive of productivity growth would be critical for external sustainability.

21. **The central bank noted its efforts to develop the banking system and strengthen supervision.** Comoros' banking system currently consists of one foreign-owned commercial bank, a state-owned development bank, and two microfinance networks. The central bank recently granted licenses to two foreign-owned banks, whose entry would introduce competition and pose new challenges to supervision. The mission stressed the need to monitor closely the impact of the crisis in the vanilla sector on the quality of loan portfolios, with bank loans to the sector estimated at about 15 percent of total credit to the private sector. The authorities noted that banks remained highly liquid and are working with individual debtors on loan restructuring. The central bank recently issued a banking license to one of the two microfinance networks and enhanced its prudential oversight. The authorities agreed with the mission that the supervision of the second microfinance network should also be strengthened.

D. External financing and debt issues

22. **The mission urged the authorities to reach understandings with external creditors and avoid a further accumulation of arrears to multilaterals.** Public external debt reached an estimated \$263 million at end-2005. This included a large stock of arrears (\$92 million or about 150 percent of domestic revenues), of which two-thirds were owed to multilateral creditors (see Table 6 for a list of debt and arrears by creditor). The net present value of Comoros' external public debt, estimated at about four times exports of goods and services at end-2004, is well above the eligibility threshold for debt relief under HIPC. The government acknowledged the accumulation of debt service arrears in 2005 to most multilateral creditors (other than the World Bank), and stressed its intention to avoid a further accumulation of arrears in 2006. The mission noted that arrears clearance plans will be needed in advance of a possible PRGF arrangement. The authorities emphasized that they had approached several creditors to discuss possible debt service relief and that they intended to reach understandings on arrears clearance and debt rescheduling as soon as possible.

E. Structural Reform and Technical Assistance

23. **The structural reform agenda for 2006 centers on the need to alleviate some of the most pressing capacity constraints of Comoros' public institutions.** Years of inter-island tensions, political instability, and emigration of skilled labor have eroded the country's institutional capacity. Fiscal decentralization, while important for the process of national reconciliation, has further weakened the state's ability to monitor and control budget execution of the consolidated government. These institutional weaknesses have discouraged donors from enhancing their budgetary and project support, despite the renewed political stability and the authorities' commitment to prudent policies and structural reforms.

24. **The authorities plan to implement a set of near-term reforms aimed at rehabilitating key fiscal institutions and processes.** For the first half of 2006, the measures, shown in the first section of Table 2 of the MEFP (Attachment I), are mainly based on earlier IMF technical assistance recommendations. They include steps to strengthen budget accounting, monitor budget execution, improve the recording of external debt service, and strengthen tax administration. For the second half of 2006, the authorities envisage additional structural reforms, including steps to strengthen economic statistics, control the civil service wage bill, and promote private sector development. These measures, as well as some of the broader reform measures envisaged under the I-PRSP, could be monitored under a future PRGF arrangement.

25. **The authorities emphasized their extensive technical assistance needs.** The broader reform program under the I-PRSP covers revenue and expenditure management, economic statistics, governance and judicial reform, financial sector reform, private sector development, and the development of health, education, and the environment. These reforms will require a significant increase in technical assistance, including through resident experts.

F. Poverty Reduction Strategy

26. **Comoros' I-PRSP is the first comprehensive economic and social strategy document elaborated through a wide participatory process.** It recognizes that achieving significant poverty reduction will require sustained economic growth, improved human capital development, and improved governance and political stability. To achieve these objectives, the strategy comprises seven core axes: (1) supportive conditions for sustainable economic development, including public finance and infrastructure reform; (2) private sector growth, with a particular emphasis on tourism, agricultural, and fishing; (3) justice system and governance; (4) health; (5) education; (6) the environment; and (7) security.

27. **The I-PRSP's macroeconomic framework is broadly in line with the government's objectives of improving economic opportunities and living conditions for the poor.** It envisages higher real GDP growth, continued low inflation, higher social spending, and an ambitious medium-term public investment program (at an annual cost of about 21 percent of GDP during 2006 – 2009). As highlighted in a forthcoming Joint Staff Advisory Note, further analysis will be required to specify priority actions and link the I-PRSP's objectives to the Millennium Development Goals (Table 9) and to Comoros' medium-term budgetary framework, taking into account the availability of external financial assistance.

G. Program Monitoring and Risk

28. **The authorities' letter dated March 31, 2006, and the attached MEFP (Attachment I) set out their policies for the extension period of the SMP.** Quantitative indicative targets for end-March and end-June 2006 are specified in Table 1 and structural indicative targets through end-June are shown in Part 1 of Table 2 in Attachment I. Definitions were specified in a Technical Memorandum of Understanding for the 2005 SMP (IMF Web, February 2, 2005) Appendix II).

29. **Data quality is not adequate for effective macroeconomic management in most areas.** The most critical shortcomings include: the lack of regular monitoring of budgetary execution and financing; the lack of consistent time series for sub-categories of revenues and expenditures; data weaknesses with respect to domestic and external arrears; the lack of detailed information on customs operations of the island of Anjouan; and the lack of representative indicators to monitor economic output. The structural reforms shown in Table 2 of the MEFP (Attachment I) would address some of these problems, and the authorities have requested technical assistance on statistics, including from the Fund.

30. **Program implementation is subject to substantial risk.** As discussed in Section III.A, the economy is exposed to potential external, natural, and political shocks. Of most immediate concern for performance under the SMP is the possibility of significant fiscal loosening in the context of a possible deterioration of inter-island cooperation and budgetary discipline during the electoral transition period.

IV. STAFF APPRAISAL

31. **Much progress has been made on economic stabilization and national reconciliation.** The preparation of the I-PRSP in a broad participatory process has been an important step to formulate a framework for economic development and poverty reduction. A peaceful presidential transition will be another milestone for the consolidation of political stability. Major challenges lie ahead, however, in particular the need to strengthen further the cooperation between the union and island governments on economic and other policies and to enhance institutional capacity.

32. **Macroeconomic stability has been maintained in the face of significant exogenous shocks, but several important targets under the SMP were missed.** Overall fiscal performance improved in 2005, as evidenced by a sharp increase in the domestic primary surplus and by a net reduction in domestic expenditure arrears, for the first time in years. However, the envisaged reduction in the public sector wage bill was not achieved, revenues did not increase as planned, and Comoros continued to accumulate external arrears.

33. **The authorities have made notable progress in reforming tax and customs policies and consolidating the budget process, but fiscal institutions remain weak.** Key policy measures have included the removal of customs exemptions and the shift from import tariffs to indirect taxes, which should partly offset the revenue losses expected from entering into COMESA's free trade area. However, revenue administration remains fragmented and weak. While the implementation of a consolidated budget and revenue sharing mechanism in 2005 was a major achievement, the monitoring and control of budget execution remains irregular and suffers from a lack of a proper accounting framework.

34. **The economic program for 2006 provides a sound framework for preserving economic stability.** The 2006 budget is realistic and the government's focus is now on implementation and avoidance of new expenditure arrears. The central bank's monetary framework centers around prudent credit policies and should help maintain low inflation and adequate international reserves. In the context of a fixed exchange rate regime, structural reforms will be important for supporting a rebound in exports and growth in tourism.

35. **The authorities' near-term structural agenda rightly focuses on capacity enhancement of public institutions, particularly in the fiscal area.** A significant increase in technical assistance and project support from donors and multilaterals will be required to help the authorities implement the broader development agenda set out in their I-PRSP. To improve social conditions, it will be critical to specify and begin implementing a set of priority measures under the I-PRSP, while avoiding new wage arrears and shifting fiscal spending toward social sectors.

36. **The economic program is subject to significant risks.** A near-term risk is potential political instability and fiscal loosening in the context of the electoral transition period. Comoros is also exposed to significant balance of payments risks, including a possible further deterioration in the terms of trade or a decline in private transfers. Economic activity could be disrupted by exogenous events, such as volcanic eruptions or health threats. Finally,

the low capacity of fiscal institutions and weak coordination between the union and island governments are sources of potential deviations from budget objectives.

37. The staff considers that the authorities' policies, if implementing successfully, could provide the basis for entering into a PRGF arrangement later in 2006.

Performance in the fourth quarter of 2005 provided an important signal of satisfactory macroeconomic performance. The extended SMP can help establish the necessary track record to enter into a PRGF arrangement, possibly in the third quarter of 2006. This would require a clear signal that fiscal performance is on track to achieve budget targets, steps to remedy institutional shortcomings in the fiscal area, and understandings on arrears clearance plans with external creditors.

Table 1. Comoros: Selected Economic and Financial Indicators, 2002-06

	2002	2003	2004	2005		2006
				Prog.	Prel.	Prog.
(Annual percentage change unless otherwise indicated)						
National income and prices						
Real GDP	2.3	2.1	1.9	3.0	2.2	2.5
Real GDP per capita	0.2	0.0	-0.2	0.3	-0.5	-0.2
Nominal GDP (in millions of Comorian francs)	128,980	138,444	146,319	152,839	153,785	160,783
Nominal GDP (in millions of U.S. dollars)	247.5	316.4	369.8	402.2	370.6	392.7
Nominal GDP per capita (in U.S. dollars)	439.1	549.6	629.0	619.9	613.7	633.3
GDP deflator	4.2	5.1	3.7	2.0	2.8	2.0
Consumer price index (annual averages)	3.5	3.8	4.5	3.0	4.0	4.2
External sector						
Exports, f.o.b.	15.9	50.3	-35.7	-15.3	-51.0	21.3
Imports, f.o.b.	4.5	31.1	22.1	0.2	7.6	9.8
Real effective exchange rate (index , 1995=100)	99.6	104.9	108.5	...	109.1	...
Terms of trade	0.8	69.8	-32.7	-20.5	-57.9	6.6
Government budget						
Domestic revenue	27.3	3.8	0.5	14.4	6.8	1.8
Current expenditure	13.7	-5.8	-1.0	4.2	4.4	0.5
Money and credit						
Net foreign assets	6.0	-4.8	-1.6	-2.5	0.9	3.2
Domestic credit	12.3	-3.4	-3.6	14.3	9.0	2.1
Broad money	9.1	-1.1	-6.3	5.1	3.1	3.3
Velocity (GDP/average broad money)	4.0	4.4	4.9	4.3	5.0	5.1
(in percent of GDP unless otherwise indicated)						
Investment and savings						
Investment	12.2	11.6	10.2	10.7	10.3	13.1
Public	5.9	5.5	4.3	4.9	4.5	7.0
Private	6.4	6.1	5.9	5.9	5.8	6.1
Gross national savings	11.6	7.3	7.6	6.5	6.9	9.3
Public	2.1	2.0	2.7	4.4	4.5	5.3
Private	9.5	5.4	5.0	2.2	2.4	4.0
Government budget						
Domestic revenue	16.7	16.1	15.3	16.2	15.6	15.2
Total grants	4.2	2.3	2.7	3.1	4.3	4.8
Total expenditure	26.0	22.5	19.7	19.8	19.8	21.7
Current expenditure	18.7	16.4	15.4	14.9	15.3	14.7
Capital expenditure	5.9	5.5	4.3	4.9	4.5	7.0
Change in arrears						
External interest	0.7	0.7	0.5	0.0	0.4	0.0
Domestic	0.1	0.9	0.8	0.0	-0.5	-0.4
Domestic primary balance	1.1	0.5	-0.5	1.8	1.1	0.9
Overall balance						
Commitment basis, including grants	-5.1	-4.1	-1.6	-0.5	0.0	-1.7
Cash basis, including grants	-4.3	-2.5	-0.3	-0.4	-0.5	-2.2
Total debt	104.5	100.1	80.5	73.9	72.8	70.3
External sector						
Exports of goods and services	15.8	18.2	16.1	15.0	14.0	13.8
Imports of goods and services	26.2	28.5	27.8	30.4	29.0	29.2
Current account balance						
Incl. transfers	-0.6	-4.3	-2.6	-4.2	-3.4	-3.8
Excl. official transfers	-3.3	-5.4	-2.7	-4.9	-4.4	-5.3
Excl. official and private transfers	-10.7	-10.7	-12.2	...	-15.7	-15.9
External debt (end of year)						
In millions of U.S. dollars	230.2	294.4	285.2	286.6	263.4	270.1
Of which: Arrears	65.4	85.1	85.2	112.1	91.8	93.2
In percent of exports of goods and services	542.7	454.5	490.1	475.1	505.5	493.3
In percent of GDP	85.7	82.9	79.0	72.6	70.6	68.2
External debt service						
In percent of exports of goods and services	14.9	12.4	13.6	13.7	15.0	13.4
In percent of government revenue	14.1	14.0	14.3	12.9	13.4	12.2
Gross international reserves (end of period)						
In millions of U.S. dollars	80.9	97.2	92.7	101.4	87.1	90.1
In months of imports of goods and services	15.0	12.9	10.8	10.0	9.7	9.4
Exchange rate						
Comorian francs per U.S. dollar (period average)	521.1	437.6	395.7	...	415.0	409.4

Sources: Comorian authorities; and staff estimates and projections.

Table 2. Comoros: Balance of Payments, 2002-06

	2002	2003	2004	2005 Prel.	2006 Prog.
	(in millions of U.S. dollars)				
Current account	-1.6	-13.5	-9.5	-12.6	-15.0
Goods and services	-25.8	-32.5	-43.1	-55.7	-60.4
Trade balance	-21.4	-24.3	-46.5	-61.0	-65.9
Exports (f.o.b.)	19.3	29.0	18.7	9.1	11.1
Of which: vanilla	12.7	20.9	8.6	2.5	3.0
cloves	4.1	5.9	7.3	3.6	4.7
ylang-ylang	2.0	1.5	2.1	2.4	2.6
Imports (f.o.b.)	-40.7	-53.3	-65.1	-70.1	-77.0
Of which: petroleum products	-10.8	-13.6	-17.9	-18.6	-20.5
Net services	-4.4	-8.2	3.4	5.2	5.5
Services, receipts	19.8	28.7	41.0	42.6	43.2
Of which: travel	8.6	11.8	17.7	19.4	19.6
Services, payments	-24.2	-36.9	-37.5	-37.4	-37.7
Income (net)	-0.8	-1.3	-2.2	-2.3	-2.0
Credit	1.7	1.7	0.8	0.2	0.3
Debit	-2.4	-3.0	-3.0	-2.5	-2.3
Current transfers (net)	25.0	20.3	35.8	45.4	47.4
Government	6.7	3.4	0.4	3.5	5.7
Private	18.3	16.9	35.4	41.8	41.7
Capital and financial account	5.8	7.2	5.2	5.1	13.7
Capital transfers	3.7	3.8	9.7	12.2	13.2
Financial account	2.1	3.4	-4.5	-7.2	0.5
Direct investment	0.4	0.8	0.7	1.2	1.2
Net Portfolio and other investment	1.7	2.6	-5.2	-8.4	-0.7
Government	10.4	5.7	-1.2	-2.7	2.6
Drawings	13.5	9.5	3.7	2.5	7.6
Amortization	-3.1	-3.7	-4.9	-5.2	-5.0
Banks, net	3.1	2.2	0.8	-4.9	-1.2
Other	-11.8	-5.3	-4.8	-0.8	-2.1
Trade credit	-0.5	0.1	1.9	1.9	--
Short-term capital (incl. errors and omissions)	-11.3	-5.4	-6.7	-2.6	-2.1
Overall balance	4.2	-6.3	-4.3	-7.6	-1.4
Financing	-4.2	6.3	4.3	7.6	1.4
Net foreign assets of central bank (increase -)	-7.4	2.2	0.7	4.1	-1.7
Use of fund credit (net)	-0.3	-0.4	-0.2	--	--
Others (net)	-7.1	2.5	0.9	4.1	-1.7
Net change in arrears	3.1	4.2	3.5	3.5	--
Exceptional financing	--	--	--	--	--
Financing gap	--	--	--	--	3.1
Memorandum items:	(In units indicated)				
Current account (in percent of GDP)	-0.6	-4.3	-2.6	-3.4	-3.8
Excluding transfers	-10.7	-10.7	-12.2	-15.7	-15.9
Exports of goods and services (in percent of GDP)	15.8	18.2	16.1	14.0	13.8
Imports of goods and services (in percent of GDP)	26.2	28.5	27.8	29.0	29.2
External debt					
In millions of U.S. dollars	231	295	285	263	270
Of which: Arrears	65	85	85	92	93
In percent of GDP	85.7	82.9	79.0	70.6	68.2
Debt service ratio (percent of exports of goods and services)	14.9	12.4	13.6	15.0	13.4
Exchange rate CF/US\$ (period average)	521	438	396	415	409
Gross international reserves of Central Bank in millions of U.S. dollars	81	97	93	87	90
In months of imports of goods and services	15.0	12.9	10.8	9.7	9.4
Nominal GDP in millions U.S. dollar	248	316	370	371	393

Sources: Comorian authorities, and fund staff estimates and projections.

Table 3. Comoros: Monetary Survey, 2002-06

	2002	2003	2004	2005	2006			
	Dec.	Dec.	Dec.	Dec.	March	June	Sept	Dec
	Act.	Act.	Act.	Prel.	Prog.	Prog.	Prog.	Prog.
(In millions of Comorian francs)								
Monetary Survey								
Net foreign assets	39,582	37,666	37,057	37,398	36,826	37,006	37,538	38,594
Net domestic assets	-7,242	-5,845	-7,326	-6,748	-5,927	-5,856	-6,138	-6,944
Domestic credit	13,565	13,108	12,641	13,780	14,400	14,459	14,223	14,066
Net credit to government	3,148	1,604	2,170	3,450	4,070	4,052	3,713	3,406
Claims on government	4,231	3,420	4,238	5,139	5,759	5,741	5,402	5,095
Deposits of government	-1,083	-1,816	-2,068	-1,689	-1,689	-1,689	-1,689	-1,689
Claims on public enterprises	86	70	167	44	44	44	44	44
Claims on other financial institutions	58	60	68	60	60	60	60	60
Claims on private sector	10,273	11,374	10,236	10,227	10,227	10,304	10,407	10,557
Other items net	-21,065	-19,031	-19,967	-20,528	-20,327	-20,316	-20,361	-21,010
Broad money	32,082	31,743	29,730	30,649	30,900	31,150	31,400	31,650
Money	23,208	23,206	20,894	22,802	22,800	22,767	22,879	23,547
Currency in circulation	12,503	11,505	11,730	11,456	11,269	11,142	11,161	11,830
Demand deposits	10,705	11,701	9,164	11,346	11,531	11,625	11,718	11,717
Quasi-money	8,874	8,537	8,836	7,847	7,975	8,040	8,104	8,103
Long term liabilities	258	78	--	--	--	--	--	--
Central Bank								
Net foreign assets	38,657	37,715	37,420	35,718	35,021	35,076	35,482	36,414
Net domestic assets	-10,317	-9,872	-9,926	-8,966	-8,291	-8,255	-8,536	-8,789
Domestic credit	3,479	2,109	2,286	3,781	4,401	4,383	4,047	3,740
Net credit to government	3,348	1,994	2,188	3,677	4,297	4,279	3,940	3,633
Claims on government	3,930	3,120	3,457	4,538	5,158	5,140	4,801	4,494
Deposits of government	-582	-1,126	-1,270	-860	-860	-860	-860	-860
Claims on other fin. institutions	50	50	50	50	50	50	50	50
Claims on private sector	81	65	48	54	54	54	57	57
Other items net	-13,796	-11,982	-12,212	-12,747	-12,693	-12,638	-12,583	-12,529
Reserve money	28,340	27,842	27,494	26,751	26,730	26,821	26,946	27,625
Currency in circulation	12,503	11,505	11,730	11,456	11,269	11,142	11,161	11,830
Bank reserves	13,690	14,222	13,841	12,973	13,101	13,300	13,386	13,396
Cash holdings	297	66	120	98	121	215	196	101
Deposits	13,393	14,156	13,721	12,875	12,980	13,085	13,190	13,295
Deposits of other financial institutions	2,097	1,905	1,762	1,470	1,494	1,506	1,518	1,518
Deposits of public enterprises	50	211	160	853	867	874	881	881
Deposit Money Banks								
Net foreign assets	925	-49	-363	1,680	1,805	1,930	2,055	2,180
Net Domestic Assets	18,604	20,076	18,203	16,660	16,835	16,861	16,886	16,759
Bank reserves	12,547	13,214	13,156	11,854	12,069	12,260	12,338	12,241
Cash holdings	297	66	120	98	121	215	196	101
Deposits at the central bank	12,250	13,148	13,036	11,756	11,948	12,045	12,142	12,140
Domestic credit	10,086	10,999	10,355	9,999	9,999	10,076	10,176	10,326
Net credit to government	-200	-390	-18	-228	-228	-228	-228	-228
Bank financing	-200	-390	-18	-228	-228	-228	-228	-228
Claims on government	301	300	781	601	601	601	601	601
Deposits of government	-501	-690	-798	-829	-829	-829	-829	-829
Deposits at Treasury	--	--	--	--	--	--	--	--
Claims on public enterprises	86	70	167	44	44	44	44	44
Claims on other financial institutions	8	10	18	10	10	10	10	10
Claims on private sector	10,192	11,309	10,187	10,173	10,173	10,250	10,350	10,500
Claims on other financial institutions	8	10	18	10	10	10	10	10
Other items net	-4,028	-4,137	-5,308	-5,193	-5,233	-5,475	-5,628	-5,809
Liabilities to the private sector (deposits)								
Total deposits	19,529	20,027	17,840	18,341	18,640	18,791	18,942	18,939
Demand deposits	10,655	11,490	9,004	10,493	10,665	10,751	10,837	10,836
Term and savings deposits	8,874	8,537	8,836	7,847	7,975	8,040	8,104	8,103
Memorandum items:	(change in percent of end-year broad money, unless otherwise indicated)							
Net foreign assets	7.6	-6.0	-1.9	1.1	-1.9	-1.3	0.5	3.9
Domestic credit	5.1	-1.4	-1.5	3.8	2.0	2.2	1.4	0.9
Net credit to government	1.4	-4.8	1.8	4.3	2.0	2.0	0.9	-0.1
Credit to public enterprises	0.0	-0.1	0.3	-0.4	0.0	0.0	0.0	0.0
Credit to private sector	3.6	3.4	-3.6	0.0	0.0	0.3	0.6	1.1
Other items (net)	0.7	4.4	-4.7	3.9	2.7	2.9	2.0	-0.6
Broad money	9.1	-1.1	-6.3	3.1	0.8	1.6	2.4	3.3
Money	6.2	0.0	-7.3	6.4	0.0	-0.1	0.3	2.4
Quasi-money	2.8	-1.1	0.9	-3.3	0.4	0.6	0.8	0.8
Velocity (GDP/average M2)	4.0	4.4	4.9	5.0	5.2	5.2	5.1	5.1
Credit to private sector (percent change)	11.4	10.7	-10.0	-0.1	0.0	0.8	1.8	3.2

Sources: Central Bank of Comoros; and Fund staff estimates and projections.

Table 4. Comoros: Consolidated Government Financial Operations, 2004-06
(in millions of Comorian francs)

	2004		2005					2006 Program			
	Jan.-Dec.	Jan.-Mar.	Jan.-Jun	Jan.-Sept.		Jan.-Dec.		Jan-	Jan-	Jan-	Jan-
	Actual	Actual	Actual	Prog.	Actual	Prog.	Prelim.	Mar.	June	Sept.	Dec.
Total revenue and grants	26,434	5,535	12,862	22,400	19,557	29,496	30,509	5,825	14,178	23,370	32,114
Revenues	22,445	4,641	10,724	19,082	15,352	24,756	23,972	4,650	11,600	18,075	24,400
Tax revenues	19,407	3,498	7,517	16,466	10,823	21,385	17,797	3,592	8,700	14,470	19,850
Nontax revenues	3,038	1,143	3,207	2,616	4,529	3,371	6,175	1,058	2,900	3,605	4,550
External grants	3,989	894	2,138	3,318	4,204	4,740	6,537	1,175	2,578	5,295	7,714
Budgetary assistance	153	0	177	0	177	0	669	0	0	0	0
Projects (incl. techn.assist.)	3,836	894	1,961	3,318	4,027	4,740	5,868	1,175	2,578	5,295	7,714
Total expenditure and net lending	28,847	5,902	13,128	22,128	20,556	30,236	30,437	6,550	15,497	24,434	34,888
Current expenditure	22,546	4,917	10,912	16,921	16,483	22,796	23,535	4,844	11,061	16,364	23,644
Primary current expenditures	20,658	4,598	9,560	15,276	14,288	20,368	20,918	4,482	10,084	14,849	21,399
Wages and salaries	12,631	3,214	6,243	8,800	9,465	11,732	12,872	3,300	6,500	9,650	12,799
Goods and services	6,038	1,075	2,463	4,650	3,478	6,288	5,167	925	2,736	3,864	5,741
Transfers	1,989	309	854	1,826	1,345	2,348	2,879	257	848	1,336	2,859
Interest payments	1,282	259	589	935	805	1,414	1,186	212	527	715	1,045
External debt	1,187	228	523	845	739	1,306	1,052	190	480	668	950
Domestic debt	95	31	66	90	66	108	134	22	47	47	95
Technical assistance	606	60	763	710	1,390	1,014	1,431	150	450	800	1,200
Capital expenditure	6,301	985	2,216	5,208	4,073	7,440	6,902	1,706	4,436	8,070	11,244
Domestically financed investment	2,539	35	431	1,186	544	1,694	1,411	63	580	950	1,628
Foreign-financed investment	3,762	950	1,785	4,022	3,529	5,746	5,491	1,643	3,856	7,120	9,616
Domestic primary balance	-752	8	733	2,620	521	2,694	1,643	105	936	2,276	1,373
Overall balance (commitment basis)	-2,413	-367	-266	272	-999	-740	72	-725	-1,318	-1,064	-2,774
Excluding budget support	-2,566	-367	-443	272	-1,176	-740	-597	-725	-1,318	-1,064	-2,774
Change in net arrears (+: accumulation)	1,862	149	-232	41	98	54	-270	0	0	-300	-700
Interest on external debt	665	66	245	41	334	54	544	0	0	0	0
Domestic arrears	1,197	83	-477	0	-237	0	-814	0	0	-300	-700
Change in the accounts at the Treasury	125	2	-226	0	143	0	-548	0	0	0	0
Overall balance (cash basis)	-426	-216	-724	312	-758	-686	-746	-725	-1,318	-1,364	-3,474
Financing	829	340	735	-12	775	119	1,182	724	1,319	1,364	2,225
Foreign (net)	262	-157	-84	-12	-184	119	-168	104	717	1,101	1,069
Drawings, PIP (identified)	1,462	210	587	1,414	892	2,020	1,054	618	1,728	2,625	3,102
Amortization	-1,935	-546	-1,080	-1,646	-1,624	-2,195	-2,160	-514	-1,011	-1,524	-2,033
Arrears (principal)	735	179	408	221	548	294	939	0	0	0	0
Domestic (bank financing, net)	567	497	819	0	959	0	1,349	620	602	263	-44
Privatization revenues											1,200
Errors and omissions/financing gap	-403	-124	-10	-300	-16	567	-435	0	0	0	1,249
Memorandum items:				(in percent of GDP)							
Domestic revenue	15.3	3.0	7.0	12.4	10.0	16.1	15.6	2.9	7.2	11.2	15.2
Expenditure	19.7	3.8	8.5	14.4	13.4	19.7	19.8	4.1	9.6	15.2	21.7
Non-interest domestic expenditure	15.1	3.0	6.5	10.7	9.6	14.3	14.5	2.8	6.6	9.8	14.3
Wages and salaries	8.6	2.1	4.1	5.7	6.2	7.6	8.4	2.1	4.0	6.0	8.0
Social expenditure (education, health, social welfare, community development)	...	...	...	...	...	...	8.1	2.1	4.3	6.9	9.5
Domestic primary balance	-0.5	0.0	0.5	1.7	0.3	1.8	1.1	0.1	0.6	1.4	0.9
Overall balance (commitment basis)	-1.6	-0.2	-0.2	0.2	-0.6	-0.5	0.0	-0.5	-0.8	-0.7	-1.7
excluding budgetary support	-1.8	-0.2	-0.3	0.2	-0.8	-0.5	-0.4	-0.5	-0.8	-0.7	-1.7
Overall balance (cash basis)	-0.3	-0.1	-0.5	0.2	-0.5	-0.4	-0.5	-0.5	-0.8	-0.8	-2.2

Sources: Ministry of Finance; and IMF staff estimates.

Table 5. Comoros: Social Expenditures, 2005-06
(in millions of Comorian Francs)

	2005					2006 Budget				
	Union	Ngazidja	Anjouan	Mohéli	Total	Union	Ngazidja	Anjouan	Mohéli	Total
EDUCATION	1,910	2,992	2,310	420	7,632	4,313	2,880	2,391	469	10,053
Wages and salaries	280	2,798	2,117	375	5,570	240	2,700	2,216	402	5,558
Goods and services	228	107	87	40	462	230	160	90	55	535
Transfers	460	87	106	5	658	472	20	85	12	589
Capital expenditure	942	--	--	--	942	3,371	--	--	--	3,371
Domestically financed	130	--	--	--	130	210	--	--	--	210
Externally financed	812	--	--	--	812	3,161	--	--	--	3,161
HEALTH AND WELFARE	3,774	283	613	78	4,748	4,059	283	776	98	5,216
Wages and salaries	477	262	274	69	1,082	495	262	250	78	1,085
Goods and services	19	4	5	4	32	23	4	76	12	115
Transfers	1,042	17	334	5	1,398	1,276	17	450	8	1,751
Capital expenditure	2,236	--	--	--	2,236	2,265	--	--	--	2,265
Domestically financed	1,018	--	--	--	1,018	100	--	--	--	100
Externally financed	1,218	--	--	--	1,218	2,165	--	--	--	2,165
TOTAL SOCIAL EXPENDITURES	5,684	3,275	2,923	498	12,380	8,372	3,163	3,167	567	15,269
in percent of GDP	3.7	2.1	1.9	0.3	8.1	5.2	2.0	2.0	0.4	9.5

Sources: Directorate of the Budget, Ministry of Finance of the Union of Comoros.

Table 6. Comoros: Public external debt and arrears to official creditors, end-2005

Creditors	Total stock of debt	of which: Arrears
	(in millions of U.S. dollars)	
Total	263.4	91.8
Multilaterals	215.5	59.6
AfDB	17.9	17.9
ADF	44.1	10.5
BADEA	24.7	24.7
EIB	0.8	0.1
IDB	8.6	3.0
IFAD	8.2	0.1
IDA	108.0	0.0
OPEC	3.3	3.3
Bilaterals	47.9	32.2
UAE (Abu Dhabi)	1.2	1.2
France (AFD)	4.4	0.0
China	1.3	1.2
Kuwait fund	26.2	15.8
Saudi fund	14.0	14.0
Mauritius	1.0	0.0

Source: Comorian authorities. Data not reconciled with creditor statements.

Table 7. Comoros: Quantitative Indicative Targets Under the Staff Monitored Program 1/
January - December 2005
(In millions of Comorian francs, cumulative since the beginning of the year)

	2005											
	March		June		September		December					
	Indicative Targets	Actual	Indicative Targets (original)	Indicative Targets (revised)	Actual	Indicative Targets (original)	Indicative Targets (revised)	Prelim. Targets	Indicative Targets	Prelim. Targets		
(a) Floor on the domestic primary balance	2,081	8	2,759	295	733	2,620	2,620	521	2,694	1,643		
(b) Floor on total domestic revenues	7,427	4,641	13,621	10,155	10,724	19,082	19,082	15,352	24,756	23,972		
(c) Ceiling on the wage bill	2,933	3,214	5,866	6,268	6,243	8,800	9,000	9,465	11,732	12,872		
(d) Ceiling on expenditures made by cash advances (without prior budget commitment)	200	128	425	425	285	665	665	403	900	550		
(e) Ceiling on the net accumulation of domestic arrears	0	83	0	0	-477	0	0	-237	0	-814		
(f) Ceiling on new nonconcessional external debt contracted or guaranteed by the State 2/	0	0	0	0	0	0	0	0	0	0		
(g) Ceiling on new short-term external debt contracted or guaranteed by the State 2/	0	0	0	0	0	0	0	0	0	0		
(h) Ceiling on accumulation of debt service arrears towards multilateral creditors	0	141	0	0	426	0	0	552	0	1,027		

1/ The definitions of the indicative targets and the adjusters are provided in the Technical Memorandum of Understanding (TMU).

2/ Excluding trade credits.

Table 8. Comoros: Structural Indicative Targets under the 2005 Staff-Monitored Program

Sector	Measure	Deadline	Progress
Fiscal	Transfer of shared revenues to the special account with the Central Bank of the Comoros and strict application of the revenue sharing mechanism based on the quotas.	Continuous	Implemented
Legal environment	Adoption by Parliament of the final version of the organic law on the distribution of the competencies.	End-February 2005	Implemented
Fiscal	Amend prevailing laws and practices for tendering with a view to strengthen public procurement rules.	End-June 2005	Adopted on August 1, 2005.
Fiscal	Preserve the single customs administration and subcontract customs services to a private provider, with performance requirements.	End-June 2005	Partially implemented. Principle of a single set of customs tariffs maintained. At the request of the World Bank experts, subcontracting was delayed until the reform program is fully implemented.
Fiscal	Harmonize all levels of budget nomenclature, and introduce computerized system for real-time monitoring of the expenditures.	End-September 2005	Partially implemented. The harmonized budget nomenclature was adopted and the terms of reference for the consultant to implement it have been finalized. The computerized monitoring of expenditure is awaiting donor financing.
Fiscal	Offset the debts of the government and the public and parapublic enterprises, and clear the balance.	End-December 2005	Partially implemented. Inventory completed in November 2005. Preparations for clearance underway.
Structural	Privatize the Comorian Hydrocarbons Company.	End-December 2005	Not implemented. Measure being reassessed in consultation with World Bank-IFC.
Structural	Privatize Comoros Telecom.	End-December 2005	Not implemented. Measure being reassessed in consultation with World Bank-IFC.

Table 9: Comoros: Millennium Development Goals

	1990	1995	2001	2002	2015 Target
<u>Goal 1. Eradicate extreme poverty and hunger</u>					
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.					
1. Population below US\$ 1 a day (percent)	...	...	...	...	...
2. Poverty gap ratio at US\$ 1 a day (percent)	...	...	...	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	...	...	...
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	18.5	25.8	25.4	26	9.3
5. Population below minimum level of dietary energy consumption (percent)	...	...	...	...	...
<u>Goal 2. Achieve universal primary education</u>					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	...	52.0	54.7	...	100.0
7. Percentage of cohort reaching grade 5	45.5	...	...	...	100.0
8. Youth literacy rate (percent age 15-24)	56.7	57.7	58.8	59.0	...
<u>Goal 3. Promote gender equality and empower women</u>					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015					
9. Ratio of girls to boys in primary and secondary education (percent)	71.0	81.3	82.4	...	100.0
10. Ratio of young literate females to males (percent ages 15-24)	77.8	78.5	79.4	79.5	100.0
11. Share of women employed in the nonagricultural sector (percent)	...	...	...	...	...
12. Proportion of seats held by women in the national parliament (percent)	...	...	...	...	...
<u>Goal 4. Reduce child mortality</u>					
Target 5: reduce by two-thirds between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	120.0	100.0	82.0	79.0	40.0
14. Infant mortality rate (per 1,000 live births)	88.0	74.0	61.0	59.0	...
15. Immunization against measles (percent of children under 12-months)	87.0	69.0	70.0	71.0	...
<u>Goal 5. Improve maternal health</u>					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	480.0	...	...
17. Proportion of births attended by skilled health personnel	...	51.6	61.8	...	...
<u>Goal 6. Combat HIV/AIDS, malaria and other diseases</u>					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	...	...	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	...	21.0	...	...	...
20. Number of children orphaned by HIV/AIDS	...	...	...	...	...
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
21. Prevalence of death associated with malaria	...	...	...	...	...
22. Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...	...
23. Incidence of tuberculosis (per 100,000 people)	...	...	61.0	60.7	...
24. Tuberculosis cases detected under DOTS (percent)	...	60.0	43.0	...	...

Table 9: Comoros: Millennium Development Goals (continued)

	1990	1995	2001	2002	2015 Target
<u>Goal 7. Ensure environmental sustainability</u>					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources					
25. Forest area (percent of total land area)	5.4	...	3.6	...	...
26. Nationally protected areas (percent of total land area)	...	0.0	0.0	...	...
27. GDP per unit of energy use (PPP \$ per kg oil equivalent)	...	...	...	...	...
28. CO2 emissions (metric tons per capita)	0.2	0.1	0.1	...	...
29. Proportion of population using solid fuels	...	...	...	...	...
Target 10: Halve by 2015 proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	88.0	...	96.0	...	...
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers					
31. Access to improved sanitation (percent of population)	98.0	...	98.0	...	...
32. Access to secure tenure (percent of population)	...	...	...	...	...
<u>Goal 8. Develop a Global Partnership for Development 1/</u>					
Target 16: Develop and implement strategies for productive work for youth.					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	...
Female	...	...	...	...	...
Male	...	...	...	...	...
Target 17: Provide access to affordable essential drugs					
46. Proportion of population access with access to affordable essential drugs	...	...	...	...	...
Target 18: Make available new technologies, especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	7.5	7.2	12.2	13.5	...
48. Personal computers (per 1,000 people)	0.1	0.3	5.5	5.5	...

Sources: World Bank; and Fund staff estimates.

1/ Targets 12-15 and indicators 33-44 are excluded because they can not be measured on a country specific basis. These are related to official development assistance, market access, and the HIPC initiative.

Comoros: Relations with the Fund

(As of February 28, 2006)

I. Membership Status: Joined 09/21/76; Article VIII

II. General Resources Account:	SDR Millions	% Quota
Quota	8.90	100.00
Fund holdings of currency	8.36	93.91
Reserve position in Fund	0.54	6.11

III. SDR Department:	SDR Millions	% Allocation
Net cumulative allocation	0.72	100.00
Holdings	0.00	0.84

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR millions)</u>	<u>Amount Drawn (SDR millions)</u>
SAF	06/21/91	06/20/94	3.15	2.25

VI. Projected Obligations to Fund (SDR millions; based on existing use of resources and present holdings of SDRs):

	<u>Forthcoming</u>				
	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
Principal					
Charges/interest	0.02	0.02	0.02	0.02	0.02
Total	0.02	0.02	0.02	0.02	0.02

VII. Implementation of HIPC Initiative: Not applicable

VIII. Exchange Rate Arrangements

The currency of the Comoros is the Comorian franc, which is pegged to the Euro at €1 = CF 492. The Comoros has accepted the obligations of Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

IX. Article IV Consultation

The Comoros is on the standard 12-month cycle. The 2005 Article IV consultation was concluded on July 18, 2005 (Country Report No. 05/299). Executive Directors were encouraged by the consolidation of political stability, but disappointed by the lackluster performance of the economy, the fiscal slippages of early 2005, and the slow pace of structural reforms. They urged corrective actions in these areas.

X. Recent Technical Assistance

Department	Dates	Subject
MFD	July 2003	Mission to review the role of the central bank in banking supervision and to evaluate technical assistance needs
MFD	Sep.- Oct. 2003	Mission to review the envisaged resumption of activities by the Comoros Development Bank, the possible opening of a postal bank, and the supervision of microfinance institutions
MFD	Feb. 2004	AML/CFT
MFD	Feb. 2004	Internal audit
MFD	March 2004 / Oct. 2004 / March 2005/ December 2005	Bank supervision
FAD	August 2005	Tax policy
STA	September 2005	Government finance statistics
FAD	February 2006	Tax policy

XI. Resident Representative

A resident representative post established in September 1991 was closed in December 1995.

Comoros: IMF-World Bank Group Relations
(As of February 28, 2006)

1. The World Bank Executive Board has approved 19 IDA credits totaling US\$132.5 million to support Comoros since the World Bank became active in the country in 1976. The active portfolio consists of one project, which became effective on September 29, 2004. This community-based Social Services Project (SSP) seeks to maintain basic service delivery and addresses most urgent health and water sector needs. The SSP is a four-year operation in the amount of US\$13.3 million. Current Bank support strategy - presented to the Board of Directors in March 2004 - has two key objectives: (i) maintaining basic social services; and (ii) supporting the process of national reconciliation and facilitating the transition to a viable institutional structure. The Bank is preparing an update of this strategy which is scheduled to go to the Board in the fourth quarter of 2006.
2. The Government of Comoros has made good progress in defining its Poverty Reduction Strategy (PRS) in the context of the PRSP preparation, which was launched in March 2002 with assistance from the donor community. A draft I-PRSP was produced and discussed in participatory workshops in May 2003. After further consultative rounds, the draft was updated and complemented with an action plan for 2006-09. The documents were submitted to the Bank in October 2005 and a Joint Staff Assessment Note (JSAN) is scheduled to go to the Board in May 2006.
3. Since the signing of the national reconciliation agreement in December 2003, the Bank has worked in close collaboration with the Fund to support the transition in Comoros, focusing notably on improving the overall economic management and strengthening institutions responsible for revenue collection and budget execution. The Bank will continue to work closely together with the Fund in these areas, and in monitoring and facilitating I-PRSP implementation.
4. The IFC does not have any activities in Comoros, and the country has not yet joined the MIGA. The Government of Comoros has requested technical advice from the IFC with respect to the envisaged privatization of the oil and telecom companies. The IFC is planning a mission to Comoros in March 2006 to assess the situation and discuss with the authorities a strategy to move this process forward.

Active Portfolio in Comoros—IDA Lending Operations, as of February 28, 2006
(In millions of U.S. dollars)

Purpose	Approved (Fiscal year)	Committed (Less cancellations)	Disbursed
Number of closed credits (18)	119.1	106.1	109.2 ⁵
Active credits			
Services Support Project	FY2004	13.3	4.2
Total active		13.3	4.2

Source: World Bank Client Connection.

Comoros: IDA Loans and Debt Service CY 1997–CY 2005, as of December 31, 2005
(In millions of U.S. dollars)

	CY 97	CY 98	CY 99 ^{1/}	CY 00	CY 01	CY 02	CY 03	CY 04	CY 05
IDA net Disbursements	4.8	2.8	(0.5)	1.3	10.7	11.1	7.3	1.3	0.6
Gross Disbursements	5.2	3.1	0.0	2.1	11.5	12.1	8.6	3.2	2.6
Repayments	0.4	0.2	0.5	0.7	0.8	1.1	1.2	1.8	2.0
Interest payment	0.5	0.3	0.6	0.7	0.5	0.6	0.7	0.9	0.8

Source: World Bank Client Connection

^{1/} Under IDA suspension of disbursements because of arrears.

⁵ Disbursed amount more than approved and committed amounts because of exchange rate depreciation of USD to SDR.

Moroni, March 31, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato,

During 2005, Comoros made decisive progress with national reconciliation, economic stabilization, and addressing social conditions. Our Interim-Poverty Reduction Strategy Paper (I-PRSP) was finalized in a broad and unprecedented participatory effort to develop a national strategy aimed at improving economic and social prospects for all Comorians. It also provided the foundation for the first donors' conference in over a decade that resulted in major financial pledges in support of the government's medium-term program. The first presidential elections under the new constitutional power-sharing agreements – a milestone in the national reconciliation process – will be held in April and May 2005.

The authorities' economic program for 2005, monitored under a Staff Monitored Program (SMP), provided a sound framework for economic stability in a year marked by large terms of trade shocks and volcanic eruptions. It has enabled us to make significant progress in strengthening fiscal policies and budget management. The implementation of revenue-sharing and expenditure-allocation arrangements between the Union and island governments has helped reestablish cooperation and trust in the conduct of public finances. The intensification of the policy dialogue in the context of the SMP has also helped the government strengthen its policies in other sectors.

Although not all objectives under the 2005 SMP were achieved, the overall fiscal situation has improved markedly from a year ago. In light of the shortfall in fiscal revenues in the first nine months, we took a number of corrective measures, including politically difficult tax and fuel price increases. As a result, fiscal performance in the fourth quarter came back into line with SMP objectives. For 2005 as a whole, domestic revenue as well as the primary and overall fiscal balances improved noticeable over 2004. Moreover, for the first time in years, we were able to achieve a net reduction in domestic expenditure arrears. Progress on structural reform was slower than we had hoped, partly reflecting the significant capacity constraints in Comoros, having only recently emerged from a long period of instability and internal conflict, but also due to delays in the delivery of envisaged technical assistance.

We would like to request an extension of the SMP through June 2006, to establish a credible basis for entering into a Poverty Reduction and Growth Facility (PRGF) arrangement. We expect that this will lay the ground for negotiations in June 2006, which could allow consideration of our PRGF request by the IMF's Board of Executive Directors in the third

quarter of 2006. This would pave the way for eventual debt relief under the enhanced HIPC initiative and MDRI, which will be critical for the Union of Comoros to achieve its economic development and poverty reduction objectives, as set out in our I-PRSP.

The attached Memorandum of Economic and Financial Policies reviews economic developments in 2005 and describes the policies that we intend to implement to achieve our macroeconomic and structural objectives for 2006. Table 1 shows quantitative indicative targets for end-March and end-June 2006. Table 2 identifies priority structural measures for 2006, including steps to be taken during the extension period of the SMP.

We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of our program, but will take any further measures that may become appropriate for this purpose. Throughout the duration of the program, the government will consult the Managing Director, on its own initiative or at your request, to discuss the economic and financial policies of the Union of the Comoros. We will provide the staff with information it requests for monitoring progress in program implementation.

Sincerely yours,

/s/

Oubeidi Mze Chei
Minister of State
Minister of Finance and Budget

/s/

Ahamadi Abdoulastoi
Governor
Central Bank of the Comoros

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. This memorandum reviews economic performance under the staff monitored program (SMP) in 2005 and sets out the government's main policy objectives for 2006, including those to be monitored under an extension of the SMP through June 2006. Indicative quantitative and structural targets are shown in Tables 1 and 2.

I. DEVELOPMENTS IN 2005

2. Terms of trade shocks and volcanic eruptions hampered macroeconomic performance in 2005. With the plunge in world vanilla prices and surge in oil prices over the last two years, Comoros has experienced a sharp deterioration in the trade balance. The vanilla sector has virtually ceased exporting and is burdened by large debts to the financial sector. This has adversely affected economic and social conditions throughout the country.

3. Nonetheless, real GDP grew modestly in 2005. This reflected steady growth in subsistence agriculture, domestic trade, and a rebound in tourism. Inflation remained under control, despite a sharp increase in fuel prices. The large deterioration in the trade balance was broadly offset by rapid growth in remittances from the diaspora and higher tourism receipts. International reserves declined modestly, but remained high in relation to imports. Public external debt remained unsustainably high.

4. We took corrective action in the second half of 2005 to address deviations from our fiscal objectives. Most fiscal objectives monitored under the SMP were missed as of end-September, due to large revenue shortfalls and delays in implementing reforms aimed at reducing the wage bill. We compressed non-wage expenditures, raised fuel prices (by 20 percent for gasoline and by 43 percent for diesel), increased taxes on imported luxury products, and removed customs exemptions. To mitigate the social impact of these measures, import tariffs were lowered on basic foodstuffs and some other necessities.

5. Fiscal performance improved in 2005, notwithstanding the significant deviations from end-September targets. A strong rebound in domestic revenues in the fourth quarter made up for much of the earlier shortfalls. For the year as a whole, domestic revenues increased modestly relative to 2004, reaching 15½ percent of GDP, although this included the one-off effect of an exceptional dividend from the state telecom company. The envisaged ambitious reduction in the public sector wage bill was not achieved, and its share in total spending remained high, while it declined modestly in relation to GDP. As a result of the tight control of non-wage spending, the domestic primary surplus increased markedly, to 1 percent of GDP. Domestic expenditure arrears were reduced on a net basis for the first time in years. At the same time, we were not able to reach agreements on debt service relief with our major creditors, and external arrears continued to accumulate in 2005, in a reflection of the tight budgetary situation and balance of payments deterioration.

6. Regarding structural reforms, we took significant steps in the area of public finances, while progress in other areas was slower than envisaged. Our most important achievements

in 2005 included the implementation of a consolidated budget with the new revenue-sharing mechanism between the union and island budgets, the adoption of a harmonized budget nomenclature, the application of common tariffs throughout the union, the assessment of cross-debts of public entities, and the finalization of the interim Poverty Reduction strategy Paper (I-PRSP). Other reforms lagged, including on public enterprise reform, partly due to a lack of institutional capacity and delays in the delivery of envisaged technical assistance.

II. ECONOMIC AND FINANCIAL POLICIES FOR 2006

A. Macroeconomic Framework

7. Our economic program for 2006 aims to consolidate the stabilization gains achieved in 2005. It is unlikely that a broad-based economic acceleration will materialize this year, given the persistence of low international vanilla prices, high oil prices, and capacity constraints in tourism. Real GDP growth of 2½ percent is projected on the basis of steady growth in agriculture and domestic trade, and higher project financing from donors. Inflation is expected to remain under control in the context of a pegged exchange rate regime and limited wage growth. The current account deficit is expected to remain broadly unchanged from 2005, as higher payments for petroleum and investment-related imports are largely offset by a rebound in exports and official transfers. International reserves are projected to remain comfortable in relation to imports.

B. Fiscal Policy

8. Our central objective for 2006 is to consolidate the fiscal adjustment and stabilization gains we achieved in 2005. The 2006 budget provides for a domestic primary surplus of about 1 percent of GDP, broadly unchanged from the previous year, a level that should be sustainable over the medium term in the context of debt relief and the scaling-up of external financing of investment projects. The budget identifies external project and technical assistance spending of about 6¾ percent of GDP, up from 4½ percent of GDP in 2005, three-quarters of which would be grant-financed and one-quarter financed by new concessional lending from multilateral creditors. The overall budget deficit is projected to reach about 1¾ percent of GDP.

9. The 2006 budget introduces significant tax policy changes to ensure a stable revenue base in the context of sharply lower revenues from import tariffs and state-owned companies. With the support of the IMF's technical assistance, we have significantly reduced customs tariffs and expanded indirect taxation. Following earlier reductions in import tariffs on basic foodstuffs, the 2006 budget provides for a conversion of the main revenue-collecting customs tariffs into excise taxes. To compensate for the revenue loss expected from entering COMESA's free trade area in January 2006, the effective taxation (customs, excise, and sales taxes) on key non-essential products was increased and the tax base was broadened by administrative improvements to strengthen tax collection from small retail outlets and new

taxes on casinos and phone cards. The general tax on income was redesigned as a tax on salaries, as recommended by the IMF's technical assistance. These compensating measures should help keep the domestic revenue-to-GDP ratio at about 15¼ percent of GDP in 2006, notwithstanding the customs losses and the expected decline in profit taxes and dividends from state-owned companies.

10. The 2006 budget provides for an increase in social spending and a moderate decline in the total wage bill. We will continue our efforts to reduce the public sector wage bill, freeing resources for a moderate unwinding of the compression of non-wage spending in 2005. The 2006 budget allows for an increase in health and education spending, and the government will work with donors to identify possible additional funding of social expenditures. The monitoring of social expenditures has improved significantly over the last few months and should become more explicit as the new budget nomenclature is being implemented.

11. A key objective for 2006 is to avoid the accumulation of new domestic and external arrears. We will remain current on multilateral debt service and actively seek arrears clearance and debt rescheduling agreements with creditors (see Section F below). Arrears on wages and other domestic expenditure are projected to be reduced in net terms, although the degree of reduction will depend on the scale of budgetary support from donors and the degree of external debt service relief (see Section F).

C. Financial Sector and Monetary Policies

12. Our membership in the franc zone will continue to serve as the anchor for price stability and sound macroeconomic policies. With limited monetary policy options available, the central bank will seek to influence liquidity conditions through interest rate margins and prudent credit policies. The government will have access to limited bridge financing in the first half of the year, to be repaid in the second half, to support the timely payment of wages and debt service throughout the year in the context of highly seasonal revenues.

13. The central bank will seek to support the development of the financial system and strengthen its supervision. The opening of a second commercial bank will bring competition into the system and pose new challenges to supervision. The central bank will seek to expand channels of exchange of information with the supervisory authorities of the countries of origin of the banks established in Comoros. It will also expand its supervisory regime to both microfinance networks and monitor closely the quality of financial sector credit to the vanilla sector and the adequacy of provisioning for credit risk more generally.

D. Structural Reforms

14. Our structural reform agenda for 2006 centers on capacity enhancement in the public sector. This will be critical to strengthen budget management and enhance the effectiveness of foreign aid. Specific reform measures for 2006 are listed in Table 2, including those steps the government will take during the SMP extension period. The focus will be on fiscal

institutions, including steps to strengthen budget accounting and management, control the wage bill, and improve tax and customs administration. An important element is to maintain the continuity of monthly coordinating meetings of the budget committee comprising representatives of the union and the three islands. Another key area will be to address the severe shortcomings in economic statistics. Finally, we intend to set in motion reforms aimed private sector expansion, including by developing the financial sector and reforming state-owned enterprises.

15. These reforms will be difficult to implement without extensive technical assistance from our multilateral and bilateral partners. Priority areas include: (i) budget management, (ii) tax reform; (iii) expenditure reform, and (iv) economic statistics, in particular on national accounts, the balance of payments, and on social and poverty indicators.

E. PRSP Process

16. The government's medium-term structural reform agenda is to be pursued in the context of the implementation of the I-PRSP and the prospective PRGF-supported economic program. The I-PRSP identifies priority sectors and measures, including fiscal management, private sector development, governance, health, education, security, and the environment. Many of those measures hinge on the availability of financial and technical assistance. The scope and pace of implementation will thus depend on the involvement of our development partners and the realization of their pledges during the December 2005 donors' conference. Work on the full PRSP is to commence this year, with a focus on specifying short-term actions, linking priority programs to the budget framework, enhancing monitoring procedures, and identifying implementation risks.

F. External Debt and Program Financing

17. Both the stock of external public debt and near-term debt service obligations are at unsustainable levels. We intend to remain current on external debt service to multilateral creditors and build a track record of debt service to official bilateral creditors. At the same time, we will seek understandings with our official creditors on arrears clearance and rescheduling of near-term debt service. We have approached several creditors in this context. Eventually, the stock of external public debt should be addressed under the enhanced HIPC and MDRI initiatives.

18. External non-project financing needs are estimated at about \$3 million in 2006. This is expected to be covered by budget support grants and debt service relief. Shortfalls will be addressed primarily through a reduction in the clearance of past domestic arrears and, if necessary, postponement of less essential spending. The authorities believe that successful implementation of the SMP and an eventual PRGF arrangement will serve as a catalyst for a further increase in foreign assistance, in line with pledges during the December 2005 donors' conference, and eventual debt relief. This will be critical for bringing Comoros's debt burden down to a sustainable level and free resources for much-needed social and development spending.

G. Program Monitoring

19. To monitor performance under the extended SMP, quantitative indicative targets have been set of end-March and end-June 2006. These concern (a) the domestic primary fiscal balance; (b) government domestic revenue; (c) the government wage bill; (d) expenditures made by cash advances; (e) domestic expenditure arrears; (f) contracting or guaranteeing nonconcessional government external debt; (g) short-term external debt, and; (h) accumulation of new public sector external arrears to multilateral institutions (Table 1). Structural indicative targets have also been established (Table 2).

20. To assess progress in implementing the program, the IMF staff and the authorities of the Union of the Comoros will jointly review progress under the SMP in June 2006. If performance is in line with quantitative indicative targets as of end-March (and if preliminary data for April and May indicate that the end-June targets are likely to be met) and if good progress is made in implementing the structural benchmarks specified through end-June, the government would like to reach understandings on a PRGF-supported program with the IMF, with a Board meeting in the third quarter of 2006 and the program period to commence on July 1, 2006.

Table 1. Comoros: Quantitative Indicative Targets Under the Staff Monitored Program 1/
January - June 2006
(In millions of Comorian francs, cumulative since the beginning of the year)

	2006		
	March	Jun	Dec
	Indicative targets under the SMP		
			Indicative targets
(a) Floor on the domestic primary balance	105	936	1,373
(b) Floor on total domestic revenues	4,650	11,600	24,400
(c) Ceiling on the wage bill	3,300	6,500	12,799
(d) Ceiling on expenditures made by cash advances (without prior budget commitment)	100	200	400
(e) Ceiling on the net accumulation of domestic arrears	0	0	-
(f) Ceiling on new nonconcessional external debt contracted or guaranteed by the State 2/	0	0	0
(g) Ceiling on new short-term external debt contracted or guaranteed by the State 2/	0	0	0
(h) Ceiling on accumulation of debt service arrears towards multilateral creditors	0	0	0

1/ Definitions of the indicative targets and adjusters are provided in the Technical Memorandum of Understanding (TMU), see IMF report (IMF web, February 2, 2005) Appendix

2/ Excluding trade credits.

Table 2. Structural Indicative Targets and Other Structural Measures for 2006

Sector	Measure	Time Frame
Structural Indicative Targets for January - June 2006		
Budget reform	Establish accounting unit to compile and consolidate budget execution data from the union and island governments	April 2006
	Conduct monthly meetings of the budgetary committee comprising representatives of the union and all three islands	continuous from April 2006
	Start issuing monthly reports on budget execution by the union and islands to all ministries of finance, within 45 days after the end of each month	continuous from April 2006
	Start issuing monthly reports on public external debt service by creditor to the union ministry of finance (with breakdown of amortization and interest accrued and paid)	continuous from April 2006
	Start compiling on a quarterly basis social expenditures for union and island governments, within 2 months after the end of a quarter	continuous from May 2006
Revenue reform	Create a large taxpayers unit responsible for registration, management, arrears collection and audit of all large enterprises on the three islands	April 2006
	Perform a census of enterprises with revenues above CF 20 millions on the three islands	April 2006
Private sector development	Submit investment law to parliament that includes the introduction of a one-stop shop for investors and provides for legal procedures that give investors recourse to the courts.	April 2006
Other Structural Reform Measures for 2006		
Budget reform	Adopt template for a new chart of accounts for the public sector	Sep 2006
	Report arrears by economic type and keep an auxiliary recording of actual cash payments by major category	continuous from Oct 2006
	Implement the new budget nomenclature for the health and education sectors	Dec 2006
Revenue reform	Begin reporting of detailed monthly customs data of each island to the general customs directorate	Sep 2006
	Computerize all tax offices	Dec 2006
	Extend pre-shipment inspections to all islands	Dec 2006
Expenditure reform	Complete computerization of civil servant payment roster and staff the administration to monitor and control wage payments	Dec 2006
	Adopt organic frameworks for union and island ministries	Dec 2006
Statistics	Restructure the statistics office to expand its responsibilities to include the compilation and dissemination of union and island-level data	Sep 2006
	Develop a multi-sector action plan for enhancing the availability of economic and social statistics	Oct 2006
Financial sector	Extend banking supervision to microfinance institutions	Sep 2006
	Update the legal and supervisory framework in light of greater competition in the banking sector	Dec 2006
Private sector development	Prepare a strategy for introducing greater competition and private sector involvement in state-owned enterprises, including for telecommunications and hydrocarbons	Sep 2006
	Adopt an action plan for addressing cross-debts of public enterprises.	Sep 2006
	Adopt an action plan to reduce financial losses of the public electricity company	Dec 2006