Comoros
Public Expenditure and Fiscal Management Review
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INTRODUCTION

The objective of the Comoros public expenditure and fiscal management review is to assist the Government of Comoros in strengthening the basis for the management of its public expenditure program. The review takes stock of expenditure trends and the systems governing public spending, with an emphasis on strengthening fiscal sustainability, budget credibility and strengthening fiscal management in the electricity and service delivery sectors.

The review is composed of a set of policy notes that provide analyses and recommendations that can be used by the Government of Comoros to strengthen expenditure management. An emphasis has also been placed on delivering practical tools that can support the authorities for strengthening fiscal management. The deliverables of the review are as follows:

Policy notes:

1. The fiscal position: trends, sustainability and outlook
2. Issues in budget execution and credibility
3. The fiscal framework for service delivery
4. The fiscal framework for the recovery of the electricity sector

Expenditure management tools/ models:

5. Revenue forecasting framework
6. Financial model of the electricity sector
7. Database of revenue and expenditure and medium term fiscal projections framework

SUMMARY OF FINDINGS

The Fiscal Framework: Trends, Sustainability and Outlook

Comoros made concrete gains in fiscal management in recent years. Although the budget grew by 26 percent in real terms since 2008, Comoros maintained a modest fiscal deficit at an average of 1 percent of GDP. Two factors acted as automatic checks on Comoros’ fiscal balances; the absence of private financing channels, limiting the authorities’ capacity to borrow for spending; and an important fiscal anchor through the Banque Centrale des Comores which restricts central bank advances to the treasury to no more than 20 percent of the average tax revenue of the preceding three years. Reforms that promoted fiscal discipline also contributed, including measures to contain the wage bill and reforms to strengthen customs revenues that resulted in a 55 percent increase in revenues in real terms. These efforts were braced by a steady flow of grants and HIPC debt relief that supported the overall position. However, despite a massive infrastructure financing gap, the opening of fiscal space and increase in spending since 2008 resulted in the expansion of the recurrent budget, with a relatively modest increase in the investment.

However, these gains are fragile and are at risk of being reversed as Comoros’ finances slip into an increasingly unsustainable position. The fiscal landscape has changed since 2013, and the budget now faces more intense spending pressures. Continued civil service recruitment and pay demands, MA-MWE’s sustained financing gap and the expansionary influence of the electoral cycle are pressing on the recurrent budget. At the same time, the customs driven expansion in revenues has stalled and is facing a further decline as a depreciating Comorian franc weakens the demand for imports. Hence, the fiscal framework is becoming increasingly fragile. Growth in import related receipts in recent years, has increased their share to 49 percent of revenues. This trend has
made revenues vulnerable to exchange rate and commodity price shocks. Associated with this is a higher level of revenue volatility, whilst expenditures have become ever more rigid with the expansion in the recurrent budget. At the same time, the overall balance before grants has been deepening and the ratio of recurrent spending to domestic resources has been increased since 2013. These factors indicate an increasing dependence on grants for financing the government’s recurrent costs and a potential strain on the capacity of the budget to cover the basic running costs of government, especially when revenues are low. In addition, Comoros’ limited fiscal buffers, place the burden of adjustment on development and investment spending as occurred most recently in 2014 when the domestic investment budget contracted by 58 percent.

A forward-looking fiscal scenario framework was developed to simulate the potential for augmenting fiscal space and reorienting the budget towards priority spending. The framework integrates the various themes and tools of this review to present an outlook for increasing fiscal sustainability. It analyzes the likely fiscal position under two scenarios, status quo and consolidation reforms. Under the consolidation scenario, revenues are assumed to increase whilst the recurrent budget is held constant in real terms. An exception is made for the non-salary service delivery budget, which is projected to increase. Reductions in electricity subsidies are incorporated based on estimates of the MA-MWE financing gap from the electricity sector model developed as part of this review. Lastly, the framework incorporates revenue estimates generated by the revenue forecasting framework also developed as part of this review.

Fiscal scenario projections indicate that consolidation reforms could yield up to 6.2 percent of GDP in fiscal space by 2018, whereas under the status quo, a financing gap of up to 1.6 percent of GDP may emerge. These scenarios demonstrate that consolidation reforms that have a tangible impact in the medium term to increase fiscal space are urgent. They show the potential for a significant expansion in fiscal space in the medium term through measures that aggressively augment revenues, limit the growth of recurrent spending and that lower the fiscal burden of the electricity sector. They also demonstrate the potential for reorienting the composition of budget towards, hitherto, under-funded, essential expenditures such as service delivery and domestic investment.

**Issues in Budget Execution and Credibility**

Budget credibility is the major constraint for budget execution in Comoros. The execution analysis shows that while budget execution was robust on an aggregate level, the budget plan itself lacks credibility given the high volume of reallocations within the year, both between economic categories and between ministries/institutions. The arbitrage during the budget execution cycle seems to have happened in a way that disfavors economic and social sectors, and created an expenditure bias towards non-priority administrative and remuneration spending. Moreover, this trend was accompanied by a heavy reliance on undefined budgetary line items labelled as “other” or the pooled expenditures labelled “dépenses communes”.

Bottlenecks in the budget execution process and control environment largely explain the execution trends observed. Major limitations impacting budget credibility include weaknesses in the budget preparation process, a narrow budget classification framework, the concentration of execution authority with the ministry of finance, and weak treasury planning processes.

**The Fiscal Framework for Service Delivery**

Comoros’ fiscal framework for service delivery is defined by a highly decentralized framework, whereby islands are assigned large institutional responsibilities, including the delivery of primary and secondary health and education services. The framework provides islands with the fiscal autonomy to allocate resources at their discretion; and funds their budget through transfers from the union government.

A review of their budgets suggests that the islands have not been strategic in allocating resources for service delivery. The budgets are characterized by significant expenditure bias towards salary spending, as they prioritize staffing and recruitment, even though the indicators show that Comoros has high service delivery staffing ratios on aggregate. These trends have resulted in severe underfunding of the essentials for improved service delivery, including basic provisions such as teaching materials and medical drugs, school inspection, training, sanitation and infrastructure improvements. The underfunding has caused schools and health centers to rely on fees and charges, effectively transferring the cost burden to families and the community. At the same time, the share of the private sector in service delivery has grown to cover the deficit in public services.
The underfunding of non-salary spending is the result of various factors, including the structure of the fiscal transfer system. As is the case in many small fragile states, high unemployment rates and the scarcity of private sector jobs places pressure on the public sector to absorb excess labor. Moreover, Comoros operates what can be described as a general purpose inter-governmental transfer system, whereby transfers to the islands are executed without any imposed expenditure ceilings, nor any targeted allocations to priority expenditure areas. Without a mechanism to directly channel resources to services, it is likely that island budgets would continue to over-provide for salaries and administrative costs, whilst other priorities remain under-funded.

Given these findings, the analysis offers four main recommendations for re-balancing the service delivery budget:
(i) setting firm recruitment caps based on sectoral staffing needs to curb the growth of salary spending;
(ii) identifying the main service delivery gaps and under-funded areas to guide more efficient resource allocations; (iii) engaging in policy dialogue with the communities to stimulate their engagement in this area; and (iv) enhancing the framework for inter-governmental transfers by transitioning from a general purpose transfer system to targeted transfers.

The Fiscal Framework for the Recovery of the Electricity Sector

Comoros has a poorly performing and financially unviable electricity sector that has become a significant burden on public finances. Maintaining MA-MWE’s operations has come at a very high fiscal cost, as direct transfers and accumulated arrears for the public sector reached 1.5 and 9.3 percent of GDP respectively (these include tax payment arrears towards the government and arrears towards other state-owned enterprises). In a fiscally constrained environment like Comoros this situation is not sustainable.

A financial model of the electricity sector has been developed as part of this review to analyze the fiscal aspects related to the recovery of the sector. The Government of Comoros has started implementing a comprehensive program of reforms in the electricity sector. This analysis uses the electricity sector model as a simulation tool to investigate the fiscal implications of the planned reforms. The results indicate that MA-MWE will continue to face a financing gap in the first two years of reform implementation, causing it to require a subsidy allocation through the budget. Implementing the program of reforms is the fastest option to relieve fiscal pressures caused by MA-MWE and eventually help boosting the much needed fiscal space in Comoros. Doing so is expected to eliminate the subsidy over a period of two years. It is hence critical for the MoF to account for these transfers, estimated at respectively 1.1 and 0.5 percent of GDP, in the upcoming national budgets to ensure smoother operations at MA-MWE through the early phase of the reforms. These results are sensitive to achieving the plan’s outcome targets namely in terms of reducing technical losses and boosting collection rates. A weaker implementation of the reforms is projected to extend the subsidy needs for two additional years. However, although the successful implementation of the reform package is expected to yield a small operational profit for the utility, the overall position will continue to register a loss.

MA-MWE’s financing gap and subsidy needs would be reduced in the short term through cost cutting reforms, especially those aimed at reducing the price of diesel. An immediate downwards diesel price adjustment would ease MA-MWE’s cost pressures and reduce its financing gap. The model simulations show that a 25 percent reduction from KMF 400 to KMF 300 per liter of diesel, would reduce the financing gap by 45 percent, and that a 50 percent reduction to KMF 200 would further reduce the gap by 89 percent; virtually eliminating the need for a subsidy in the first two years of reform implementation. In the medium term, addressing these constraints and liberalizing the price of diesel can have a large and quick impact on the profitability of the utility. Attention should also be paid to MA-MWE’s large administrative and overhead costs as a potential source of savings to reduce the financing gap.

Reforms should also be accompanied by policy efforts to ensure a normalized financial relation within the sector stakeholders. Decisions related to normalizing financial flows between the company and the public sector need to be considered. These include repayment of taxes and arrears, elimination of exemptions on customs and fees, and collection of government receivables from electricity services provided. Such decisions further enhance MA-MWE’s financial position and reduce fiscal pressures and risks.
DESCRIPTION OF TOOLS

The Energy Sector Model

The energy sector model is a simulation tool developed to investigate the fiscal implications of the planned reforms in the electricity sector. The objective of the model is to provide the Government of Comoros with a tool for analyzing the fiscal impact of the electricity sector reforms and for generating estimates which MA-MWE’s subsidy needs under various reform scenarios. It also allows the authorities to examine the overall financial position of the utility and its links with the budget. The tool is expected to contribute to budgetary discussions with stakeholders in the energy sector.

The first level of analysis projects components of MA-MWE’s income statement to determine operational and net earnings, and consequently determine the oil subsidy. In the first level of analysis, the tool constructs the electricity utility’s income statement by projecting yearly operational revenues, the cost of goods and services sold, and the non-operational revenues and costs. As a result, the tool allows for the deduction of both operating profits and losses and the net earnings of the company. The tool then utilizes these parameters to compute the amount of subsidy to be provided within the year. The model defines the subsidy as the government transfer, needed to cover operating losses under various scenarios.

The second level of analysis constructs the broad items of the utility’s balance sheet. It projects, on the one hand, current and fixed assets including the important items like receivables from non-paying clients, inventories, and investments in physical capital. On the other hand, the model estimates MA-MWE’s current and long term liabilities, notably the accumulated arrears for the central government and the public sector in general. Those elements enable to determine the company’s equity and reserves and hence, design policy simulations that will lift the company from its current financial bankruptcy position.

The third level depicts the budgetary flows between the Government and MA-MWE. This level of analysis depicts i) all in-flows to the central government budget coming from potential taxes, dividends, interests on any contracted loans, and re-payments; ii) all outflows or payments made from the budget to the utility, namely future subsidies and potential investment transfers, equity projections and government credits. Adding up these parameters, the outcome indicator of interest in this tool is therefore the net budgetary flows.

The model is designed to be a flexible tool that can be adapted by the users, to analyze diverse scenarios and to update the underlying data on a regular basis.

The Revenue Forecasting Framework

Government revenue forecasts that deliver realistic revenue projections are an essential part of a healthy budgeting system. The method currently used in Comoros for estimating future revenues is an incremental one, which takes the previous years’ collections and typically augments them in line with a simple linear trend. This method is likely to yield misleading results. It does not take economic conditions into consideration, and had no direct link to show or include the impact of tax policy and tax administration.

The purpose of the revenue forecasting framework is to assist the Government of Comoros in creating accurate and reliable revenue estimates. These revenue projections would be used to determine the total resource envelope and the resulting budget allocations.

The revenue forecasting framework is based on an economic analysis of the relationship between the tax revenue items and the relevant economic aggregates. This relationship is determined by applying regression analysis to data that spans at least an eight year period. This relationship is then used to forecast the future changes in the revenue collections. The model also takes the impact of tax policy changes into account. In cases when regression analysis is not applicable, the framework accommodates estimates based on other measures, including the effective rate of the applicable revenue.

The forecasting procedure is as follows:
Executive Summary

1. Compile a detailed database of revenues spanning as long a period as possible.
2. Compile a database of tax policy and administration changes for each tax item and year included in the database.
3. Identify an appropriate proxy base for each revenue source based on economic relationships and data availability.
4. Compile medium term forecasts for each proxy base that has been selected.
5. Calculate the revenue forecast estimates based on regression estimates, effective rates and the linear trend (for the purpose of comparison).
6. In cases where a regression estimate is not applicable, use the effective rate estimates.
7. Aggregate the various revenue estimates into an overall forecast.
8. Hold consultations with the relevant revenue and economic management authorities to validate the results of the model and the underlying assumptions.

The data requirements for the framework include a sufficiently lengthy time-series, covering the individual tax categories and the economic tax base proxies including: (i) changes in tax policy; (ii) national accounts aggregates; (iii) value and volume of excisables; (iv) exports by commodity (quantity and value); (v) capital formation; (vi) compensation of employees; (vii) inflation and GDP deflators; and (viii) exchange rates.

Summary of Main Recommendations

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<th>SHORT-TERM</th>
<th>MEDIUM-TERM</th>
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<td>Fiscal Sustainability</td>
<td>Adopt a medium term fiscal plan with targets for expanding fiscal space and reorienting public expenditure. The plan would include targets for:</td>
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<td>• Increasing revenue collection</td>
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<td>• Savings in recurrent salary and non-salary spending</td>
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<td>• Increasing allocations to service delivery and domestic investment</td>
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<td>• Debt sustainability ratios.</td>
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<td>Take actions to reduce the volume of exemptions; both the stock of exemption agreements and the size of the exemptible tax base.</td>
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<td>Operationalize the integrated human resource management system (GISE) for all civil service salary and wage transactions.</td>
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<td>Adopt the debt management bill and a medium term debt management strategy.</td>
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<td>Budget Credibility</td>
<td>Improve treasury planning functions by adopting monthly and quarterly cash plans, in coordination with the treasury single account, to help reduce and avoid arrears.</td>
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<td>Adopt an improved budget classification framework across union and island governments.</td>
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**SHORT-TERM** | **MEDIUM-TERM** |

**Budget Credibility**

- Reduce the recourse to exceptional payment procedures “paiement par anticipation” to no more than 5 percent of total expenditures.

- Re-classify the undefined budgetary items and reduce allocations of line items denominated as “others”, including “dépenses communes”, to less than 10 percent.

- Review the budget preparation calendar and foster more deliberation between sectoral ministries and the Ministry of Finance.

- De-concentrate budget execution authorities to line ministries.

**Service Delivery**

- Set recruitment caps based on a minimum student-teacher ratio per school and maximum number of physicians per health facility, to manage sectoral staffing pressures.

- Commission a policy review to assess the options and feasibility of transitioning from a general purpose transfer system to targeted transfers. This is to re-balance service delivery allocations.

- Institute an evidence-based policy dialogue and consultation process with communities and island authorities to improve service delivery management.

- Identify the under-funded priority areas for strengthening service delivery, for guiding budget allocations.

**Electricity**

- Accelerate the execution of MA-MWE’s Recovery Plan by fast-tracking implementation of both commercial and infrastructure reform projects in tandem.

- Implement an immediate reduction of SCH’s diesel price to MA-MWE, to pass on price reductions in global oil prices. Initiate a review of the potential design and impact of the transition to a flexible price mechanism.

- Account for MA-MWE’s subsidy in the budget to avoid fiscal uncertainty during the year.

- Prepare an up-to-date set of financial reports for MA-MWE and SCH to be submitted for a full financial audit.

- Reform the fuel purchasing process with the SCH to introduce flexibility in the diesel price setting mechanism, and to increase competition in the bidding contracts, in order to benefit from the lower international oil prices.

- Normalize the flow of funds among the public entities and clear out MA-MWE’s arrears along with the GoC’s outstanding electricity bills.

- Review MA-MWE’s administrative costs with a view to identifying potential savings.

- Diversify the sources of electricity production to reduce reliance on diesel.

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- Review MA-MWE’s administrative costs with a view to identifying potential savings.

- Diversify the sources of electricity production to reduce reliance on diesel.
The Fiscal Framework: Trends, Sustainability & Outlook
1. OVERVIEW

Comoros made concrete gains in fiscal management over the past seven years, but recent pressures are likely to unravel these advances if not prudently managed. Comoros’ budget grew steadily in real terms since 2008, expanding allocations to all areas of expenditure, yet the rate of growth has been reserved as it has been maintained at 26 percent of GDP. Revenues were boosted by reforms that expanded customs receipts and supplemented by a regular flow of grants. These factors helped to limit the fiscal deficit to an average of 1 percent of GDP between 2008 and 2014. The fiscal position also benefited from a steep reduction in external debt and interest payments after the completion of the HIPC/MDRI process in 2013. However, these gains are fragile and are at risk of being reversed. The fiscal landscape has changed since 2013 and the budget now faces more intense pressures. Continued civil service recruitment and pay demands, MA-MWE’s sustained financing gap and the expansionary influence of the electoral cycle have been placing a strain on expenditures. At the same time, the customs driven expansion in revenues has stalled and is facing a further decline as a depreciating Comorian franc weakens the demand for imports. Revenues have taken a further hit as receipts from the economic citizenship program have ceased.

These recent trends are placing Comoros’ finances in increasingly unsustainable position. Growth in import related receipts in recent years has increased their share to 49 percent of revenues. This trend has made revenues increasingly vulnerable to exchange rate and commodity price shocks. Associated with this is a higher level of revenue volatility, whilst expenditures have become ever more rigid with the expansion in the recurrent budget. At the same time, the overall balance before grants has been deepening and the ratio of recurrent spending to domestic resources has been increased since 2013. These factors indicate an increasing dependence on grants for financing the government’s recurrent costs and a potential strain on the capacity of the budget to cover the basic running costs of government when revenues are low. In addition, Comoros’ shallow banking systems, its inability to access international capital markets and its fragile debt position limit its fiscal buffers and place it on a fragile fiscal footing. The debt position remains fragile and the need to finance the country’s large financing gap has been driving a steady accumulation of new liabilities in the post-HIPC period. These factors, taken together with the non-existence of savings, place the burden of adjustment on development and investment spending.

Fiscal scenario projections indicate that consolidation reforms could yield up to 6.2 percent of GDP in fiscal space by 2018, whereas under the status quo, a financing gap of up to 1.6 percent of GDP may emerge. These scenarios demonstrate that consolidation reforms that have a tangible impact in the medium-term to increase fiscal space are urgently required. They also show the potential for a significant expansion in fiscal space in the medium-term through measures that aggressively augment revenues, limit the growth of recurrent spending and that lower the fiscal burden of the electricity sector. They also demonstrate the potential for reorienting the composition of budget towards hitherto under-funded essential expenditures such as service delivery and domestic investment. Overall, the state of the current fiscal framework calls for a renewed focus on fiscal consolidation reforms spanning both expenditure control and revenue enhancing measures. In compliment to these reforms, measures that seek to improve the composition of expenditures are necessary to move away from allocations that are heavy on administrative costs and light on social and economic spending, especially at the island level.

2. CONTEXT

Recent economic developments point to a deteriorating fiscal context as economic growth slows and the Comorian franc depreciates. Comoros has a small and non-diversified economy. The economy had recently started recovering from years of political instability, achieving an eight year high in terms of economic growth at 3.5 percent in 2013. However, conditions deteriorated since then as growth slowed to 2.1 percent in 2014 (figure 1). Severe shortages in electricity supply and sluggish progress in the implementation of structural reforms presented a drag on all sectors of the economy. Slowing growth has been accompanied with a rapid depreciation of the Comorian franc, which is pegged to the euro. Domestic purchasing power took a severe hit over the past year as the Comorian franc depreciated by approximately 24 percent since June 2014 (figure 2), placing a strain on the import capacity 1 of this highly import dependent economy, and increasing pressure on domestic prices. For these reasons, the fiscal outlook is fragile. Customs revenues are expected to slow down as the depreciation of the Comorian franc inflates the cost of imports, whilst expenditure pressures related to the wage bill and the electricity sector continue in 2015.
The 2008-14 period marks the end of a long period of political instability and the launch of reforms for improved economic management. This note reviews Comoros’ fiscal performance between 2008 and 2014. This period marks the start of a period of increased political stability. During this time, Comoros navigated its way through the HIP C debt relief process, launched a series of fiscal and structural reforms and sought to strengthen cooperation between union and island authorities. This note aims to shed light on the way in which Comoros managed its finances since the country began to experience stability and what it would take to set it on the path towards fiscal sustainability and improved budget management. The analysis combines union and island budgets to present integrated trends for the whole of government. It discusses the main fiscal trends, presents the composition of expenditure and offers scenario-based projections of Comoros’ fiscal reform path.

3. FISCAL TRENDS: 2008 TO 2014

With a fiscal deficit averaging 1 percent of GDP, Comorian finances have shown a considerable level of aggregate fiscal control. The fiscal deficit remained generally contained at an average of 1 percent of GDP over the past seven years. The exceptions to this trend occurred in 2008 and 2013, when the deficit reached 3.2 percent and 3.7 percent respectively (figure 3). At the same time, the size of the public sector remained in line with the economy as spending was maintained at 26 percent of GDP throughout most of the period (figure 4). Two factors acted as automatic checks on Comoros’ fiscal balances; the absence of private financing channels 2, limiting the authorities’ capacity to borrow for spending, and an important fiscal anchor through the Banque Centrale des Comores (BCC), which restricts central bank advances to the treasury to no more than 20 percent of the average tax revenue of the preceding three years. Reforms that promoted fiscal discipline also contributed, including measures to contain the wage bill and reforms to strengthen customs revenues. These efforts were braced by a three year IMF program 3, a steady flow of grants and HIPC debt relief that supported the overall position.

Underlying the aggregate control was an expansion in current spending, funded by an increase in the volume of domestic revenues and grants. A surge in import taxes and large, but irregular receipts from the economic citizenship program 4 (ECP) widened the revenue envelope, opening some fiscal space to fund the government’s program. However, despite a massive infrastructure financing gap, this opening of fiscal space resulted in the expansion of the recurrent budget, with a relatively modest increase in the investment. Moreover, the suspension of the ECP accumulated wage bill demands and other spending pressures relating to the energy crisis and the ongoing electoral season have recently placed a strain on public finances, and have driven the accumulation of arrears. These trends are discussed in more detail below:

Revenue trends

Revenues experienced a significant increase since 2008, driven by an expansion in import related receipts 5. Revenues increased by 55 percent in real terms since 2008 (equivalent to an 8 percent annual increase). The most notable trend was the acceleration in import related receipts, which increased from 23 to 49 percent of total revenues, and accounted for 97 percent of revenue growth between 2008 and 2014 (figure 5). This surge resulted from improvements in customs administration such as the harmonization of the island port operations,
computerization and modernization of administrative procedures, and a tightening of payment procedures. These reforms increased the ratio of customs receipts from 5 percent of taxable imports in 2010 to 29 percent in 2012. Hence, import receipts accelerated steadily as the new measures took hold, before slowing down in 2014. ECP receipts also provided a boost to revenues between 2010 and 2012 but proved to be an unpredictable and short-lived source of revenue as the program was suspended in 2014. The other sources of revenue remained broadly stable over the period.

At 15 percent of GDP, Comoros’ revenues are low and under-performing. Comoros ranks amongst the lowest when compared with neighboring African states and other small developing economies (figure 7). Although the
size of the economy is small, the weak performance is driven by a large revenue gap. Recent IMF estimates place this gap in the range of 9 percent of GDP. Weak revenue administration, a generous exemptions regime and a small tax base are factors that contribute to the low revenue envelope and the underlying revenue gap.

Figure 7: Comparisons - revenue as a % of GDP

Expenditure trends

Total expenditure remained at 26 percent of GDP since 2008, despite mounting budget pressures. Public spending totaled 26 percent of GDP at the start of the period, then dipped to 23 percent between 2009 and 2011 as consolidation measures were implemented, before rising up to 26 percent of GDP by 2014 (figure 8). Tight control of the wage bill and savings in recurrent spending were the measures that supported the dip in the level of spending. However, this period of expenditure consolidation was short-lived. An injection of resources from the ECP in 2012 boosted the budget in 2012 and 2013 bringing spending back up to 26 percent of GDP. Much of this expansion was realized in the investment budget which experienced an upsurge as ECP receipts were channeled towards the underfunded development program. This was a brief period of relative comfort for Comorian budget during which non-tax revenues increased and recurrent spending pressured remained subdued. This situation changed in late 2013. ECP receipts dried up by the end of that year and pressures to increase civil servants’ salaries after a few years of tight controls were mounting. These pressures materialized in 2014, making it a difficult year in terms of budget implementation. The authorities implemented a salary settlement in 2014, mainly for teachers, and also financed the funding gap of the electricity utility to ease the on-going energy crisis. Additional outlays were incurred to fund local government election preparations. At the same time, import related taxes stagnated and in the continued absence of ECP receipts, overall aggregate control was maintained at the expense of the investment budget. Total expenditure was maintained at 26 percent of GDP and a small fiscal deficit of 0.8 percent of GDP was registered in 2014, but domestic investment spending shrank by almost 60 percent in one year.

In real terms, public spending increased by 26 percent between 2008 and 2014; most of this increase funded an expansion of the recurrent budget. The recurrent budget accounted for 86 percent of the increase in total spending. The increase was almost evenly split between salary (42 percent) and non-salary (44 percent) recurrent spending (figure 9). The investment budget absorbed a small share for the increase in spending over the period (14 percent).

Non-salary recurrent spending represents a third of total expenditure and has been the fastest growing budget category since 2008. The composition of non-salary recurrent spending is difficult to determine due to gaps in the budget classification and reporting systems at both the union and island levels. However, a review of detailed execution data at the union level in 2013 provides an indicative view of how this large component of the budget is allocated. Routine government running expenses such as office rent and materials, mission travel, fuel and hospitality were the largest spending category (30 percent). Social and developmental costs such as transfers to social projects, medical evacuation fees and road maintenance represented 19 percent of the budget. Transfers to public agencies (including subsidies), military operational costs and debt service respectively accounted for 14 percent, 10 percent and 5 percent. The remainder of the union non-salary recurrent budget was allocated to other goods and services (22 percent). This composition suggests that there may be potential for savings in government running expenses. There is additional potential for savings in subsidies, particularly those made to the electricity sector. Budget transfers made to this sector accelerated from 0.3 percent of GDP in 2008 to 1.5 percent in 2013. Most of this spending goes towards a direct subsidy for the purchase of diesel, the costs
of which amounted to 7.5 percent of the recurrent budget in 2013. Hence, recovery reforms in this sector that increase its cost recovery rates, cut its operational costs and diminish its reliance on diesel based generation are an important source of potential fiscal space. Improved budget classification would also strengthen oversight over these categories of spending. It would reduce the share of the budget classified as “other” and facilitate the process of identifying savings.

The investment budget is small and is dominated by donor funded projects. With the exception of 2012 and 2013 when the domestic budget accommodated higher investment spending, domestically funded investments remained at 1 percent of GDP. Externally funded projects have been the cornerstone of the investment budget and are likely to continue as such in the medium-term. Almost the entire investment budget is administered by the union government. Island authorities allocated only 3 percent of their budget to investment on average.

Wage bill trends

The wage bill had remained broadly contained over the period, but salary pressures in 2014 have reversed some of these gains. The wage bill expanded by 29 percent in real terms between 2008 and 2014, equivalent to 4 percent annual growth. Island governments account for over half the national wage bill (57 percent) as they maintain the bulk of service delivery personnel (including all primary and secondary teachers and primary health care providers) on their payroll (figure 12). In terms of sectoral composition (figure 13), the education sector has the highest salary expenditure (45 percent of the wage bill), closely followed by the administrative institutions (35 percent of the wage bill).
Is the wage bill too large? Salary-spending has remained constant at 9 percent of GDP since 2008. During this period, the ratio of salaries to revenues declined from 70 percent to 58 percent, with the lowest ratio having been achieved in 2012 at 40 percent of revenue (figure 14). Hence, the efforts to control the wage bill between 2009 and 2012 helped to restrain the growth of the wage bill even though pressures in 2014 have started to reverse some of the gains. When compared to other neighboring and small economies, (figures 15 & 16) Comoros’ wage bill appears to be middling and seems to be within the average range for small low-income economies. When taken together, these factors suggest that although there may be room for consolidation, Comoros’ wage bill is not necessarily overblown. This is more so the case when the high cost of government typical in small states is taken into account (figures 17 & 18).

Composition of expenditure: islands and union

The Union government has the largest budget amongst the entities and has been securing a growing share. The union budget represents 60 percent of total domestic expenditure on average, compared to a 40 percent share for the island governments (figure 19). The relative shares of the union and island budgets betray the large expenditure assignment of the latter. Island governments are responsible for funding and delivering primary social services as well as developing and maintaining local infrastructure. These costs, combined with the overheads of running island administrations, suggest that their budgets may be underfunded. Budget allocations since 2011 have deepened this imbalance. Almost two thirds of the increase in the budget between 2011 and 2014 were captured by the union budget to expand spending on both the recurrent budget and domestically funded investments (figure 20). Islands budgets increased at a slower pace and the bulk of the additional resources were allocated to their recurrent budgets.
Island budgets are dominated by recurrent expenditures; their allocations to the investment budgets are negligible. Their recurrent outlays are split evenly between salary and non-salary costs, reflecting the recurrent nature of service delivery costs, most notably, teacher salaries. Their allocations to the investment budgets are negligible, diminishing their ability to fulfill their local infrastructure maintenance and development mandate.
Is Comoros on a sustainable path?

Several indicators suggest that Comoros’ finances are sliding into an increasingly unsustainable position:

The debt position remains fragile. Comoros’ level of indebtedness fell from 68.8 percent in 2008 to 17.5 percent of GDP in 2014 after HIPC completion. Its risk of debt distress was subsequently upgraded from high to moderate as private remittances were included in the denominator of the debt and debt service indicators for the first time. However, the debt position continues to be fragile. Although private remittances represent a large and reliable source of foreign exchange, currently estimated to be in excess of 25 percent of GDP, their contribution to debt sustainability is limited in the Comoros context. The main channels through which remittances would support the government’s repayment capacity are absent or incomplete due to underdeveloped domestic financial markets, a small tax base and weak tax management capacity. When remittances are excluded from the analysis, the alternative DSA scenarios (that exclude remittances) suggest an ongoing high risk of debt distress. In addition, the country’s large financing gap, and its access to external loans from international development partners have been driving the steady accumulation of new liabilities.
The domestic fiscal deficit has been deepening. The overall balance before grants is in a structural deficit that has been deepening since 2005 (figure 22). Moreover, the ratio of recurrent spending to domestic resources has been worsening. This ratio improved temporarily between 2008 and 2012, shrinking from 133 percent of revenues to 91 percent in a space of four years. However, the improvement was fleeting. As the deficit before grants deepened, the ratio of recurrent expenditure to revenue increased once more, reaching 113 percent in 2014 (figure 23). These trends reveal an increasing dependence on grants, and in particular, for financing the government’s recurrent costs.

The revenue envelope is increasingly vulnerable to external shocks. The recent growth in revenues has increased their share to almost half (49 percent) of the revenue envelope. This has increased the vulnerability of revenues to exchange rate and commodity price shocks. Moreover, the small-size the economy, the generous exemption regime and the limited coverage of taxes limit the size of the tax base. These factors provide the conditions for increasingly volatile revenues in the future.

Revenues are more volatile than expenditures. The growing share of recurrent spending in the budget has increased the rigidity of the spending mix, especially at the island level where salaries are the largest cost center. At the same time, revenues are becoming increasingly volatile due to the large share of import-related revenues and the unpredictability of non-tax revenue flows, placing a strain on the budget to cover the basic running costs of government at times of revenue decline (figure 24).

Limited fiscal buffers. Lastly, Comoros’ fragile debt position, shallow banking systems and its inability to access international capital markets place it on a fragile fiscal footing. These factors, taken together with the non-existence of savings place the burden of adjustment on development spending. The investment budget has typically been reduced at times of scarcity to accommodate recurrent spending needs, as occurred most recently in 2014 when the domestic investment budget contracted by 58 percent. In this context, limited fiscal buffers are directly related to the deteriorating composition expenditure and diminishing role of the public sector to invest for growth.
4. OUTLOOK: IMPROVING FISCAL OUTCOMES

This note has highlighted the recent deterioration in Comoros’ fiscal framework, and the increasing risks that need to be navigated in the medium-term before returning to a stable fiscal footing. Having reviewed recent trends and identified the sources of vulnerability so far, this section of the note presents a forward looking analysis of the likely fiscal position under two scenarios, status quo and consolidation reforms:

1. **Status quo: no reform.** This scenario assumes no reforms. The wage bill and non-salary recurrent spending are assumed to grow annually at 6 percent and 7 percent respectively on average. This is the average growth rate recorded between 2008 and 2014. Revenue growth is predicted to slow down compared to the period average due to the slow pace reform in revenue administration, slackening economic growth and the depreciation of the Comorian franc. External funding (grants and loans) are assumed to remain constant at current levels, with identified, yet, unimplemented projects taken into account. Domestic investments are held steady at 1 percent of GDP.

2. **Consolidation reforms.** This scenario assumes that reforms to increase revenues and restrain recurrent spending are implemented. Revenues are assumed to grow by one percent of GDP annually; the wage bill is held constant in real terms; non-salary overheads in the administrative agencies are held constant in real terms; reductions in electricity subsidies are incorporated based on estimates of the MA-MWE financing gap. External funding and domestic investment assumptions are as in the status quo scenario.

The consolidation reforms have the potential of yielding up to 6.2 percent of GDP in fiscal space in 2018, whereas under the status quo, a financing gap of up to 1.6 percent of GDP may emerge. Comoros’ financing gap would continue to grow under the status quo, reaching an estimated 1.6 percent of GDP by 2018. The expanding recurrent budget would be the largest contributor to growing deficit. In contrast, the cumulative effect of the consolidation reforms described above would yield an estimated 6.2 percent in fiscal space in 2018 compared to the status quo for that year (figure 25). Measures that augment revenues, limit the growth of recurrent spending and that support the recovery of the electricity sector would be at the core of these reforms.

Redistributing the fiscal space to investment and service delivery could increase their share from 13 to 23 percent of the budget by 2018. Figure 26 presents the potential for reorienting the composition of public expenditure towards increased allocations to investment and service delivery. The estimates assume that 60 percent of the additional fiscal space is allocated to domestic investment and that the remaining 40 percent is allocated to non-salary service delivery funding to the health and education sectors. Based on these parameters, the share of these expenditures would increase from 13 to 23 percent of the budget by 2018. This indicative scenario demonstrated the potential to sharply increase funding to hitherto under-funded essential expenditures and the significant gains that could be achieved in the next three to four years.

Figure 25: Financing gap/fiscal space by scenario

Figure 26: Budget composition by scenario
Reforms to widen the tax base and strengthen revenue administration are urgent. Measures to reduce the volume of exemptions and to increase the capacity of the tax and customs agencies are critical. Policy measures that widen the tax base and that diversify it would also strengthen revenue management. The adoption of a medium-term revenue effort target would guide these reforms.

Revival of salary control efforts to curb the persistent pressures on the wage bill. Wage bill management would benefit from a twin-track approach that balances overarching instruments such as the new GISE with specific solutions to tackle the underlying sectoral drivers, particularly in the education sector.

Savings in the non-salary budgets are needed, especially in the administrative agencies. Non-salary recurrent spending has been the main contributor to the expanding budget. There is scope for savings therein, especially to reduce costs such as mission travel and fuel benefits for civil servants and to rationalize running costs in non-service delivery sectors.

Adopt a medium-term fiscal plan as part of the national budget to lay out a path for reorienting the composition of spending. The plan would be based on targets for savings and for increasing allocations to underfunded priority areas. It would also include medium-term targets for revenue growth. Such a plan would be adopted through a national consultation process, and reviewed annually through the annual budget cycle.

Strengthen the budget classification and reporting framework. Implementing the improved budget classification framework (adopted in 2013) is a priority reform area. Improving budget classification would go in hand with a targeted reduction in the share of spending classified as "other", and clarify the composition of both the recurrent and development budgets. Given the complexity of these reforms, a phased approach, commencing with improved economic classification followed by broad program/functional information, would be practical. These reforms would also benefit from coordination with the process for introducing the integrated financial management system.

Maintain prudent debt management. The lack of fiscal space and the scarcity of private investments place pressure on the authorities to borrow in order to fill the gap. Ensuring that the debt position remains sustainable while the country’s development needs are addressed will require prudence in debt management, access to concessional financing and an exclusive focus on projects of high economic value. The legal and strategic framework for debt management must also be strengthened through the adoption of the debt management bill and the medium-term debt management strategy.
<table>
<thead>
<tr>
<th>Budget Frame (KMF current)</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditure</td>
<td>46,338</td>
<td>43,179</td>
<td>44,703</td>
<td>47,493</td>
<td>57,342</td>
<td>60,005</td>
<td>61,788</td>
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<td>Recurrent expenditure</td>
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<td>35,785</td>
<td>41,898</td>
<td>36,101</td>
<td>41,511</td>
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<td>Compensation of employees</td>
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<td>17,034</td>
<td>18,500</td>
<td>18,409</td>
<td>18,278</td>
<td>18,582</td>
<td>21,423</td>
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<td>Transfers</td>
<td>2,678</td>
<td>5,325</td>
<td>3,578</td>
<td>3,889</td>
<td>4,394</td>
<td>5,227</td>
<td>5,087</td>
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<tr>
<td>Other recurrent</td>
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<td>11,881</td>
<td>11,037</td>
<td>13,488</td>
<td>19,227</td>
<td>12,292</td>
<td>15,001</td>
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<tr>
<td>of which Goods and services</td>
<td>8,122</td>
<td>7,447</td>
<td>7,553</td>
<td>7,662</td>
<td>8,932</td>
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<td>of which Interest payments</td>
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<td>of which Other</td>
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<td>4,874</td>
<td>9,317</td>
<td>2,787</td>
<td>2,994</td>
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<tr>
<td>Development expenditure (domestic)</td>
<td>1,758</td>
<td>1,563</td>
<td>2,515</td>
<td>1,417</td>
<td>5,747</td>
<td>8,261</td>
<td>3,470</td>
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<td>Development expenditure (foreign project)</td>
<td>14,725</td>
<td>7,376</td>
<td>9,073</td>
<td>10,291</td>
<td>9,696</td>
<td>15,643</td>
<td>16,807</td>
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<td>Net lending</td>
<td>-</td>
<td>448</td>
<td>-</td>
<td>300</td>
<td>461</td>
<td>1,300</td>
<td>-</td>
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<tr>
<td>Domestic revenue</td>
<td>22,486</td>
<td>26,401</td>
<td>29,049</td>
<td>34,693</td>
<td>45,988</td>
<td>37,416</td>
<td>36,752</td>
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<td>Change in net arrears</td>
<td>309</td>
<td>430</td>
<td>(12,430)</td>
<td>(7,281)</td>
<td>(1,544)</td>
<td>(2,146)</td>
<td>(630)</td>
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<tr>
<td>Adjustments, errors &amp; omissions</td>
<td>(752)</td>
<td>(324)</td>
<td>(3,930)</td>
<td>3,481</td>
<td>624</td>
<td>(75)</td>
<td>-</td>
</tr>
<tr>
<td>Deficit before grants</td>
<td>(24,295)</td>
<td>(17,119)</td>
<td>(32,013)</td>
<td>(16,899)</td>
<td>(12,734)</td>
<td>(26,109)</td>
<td>(25,666)</td>
</tr>
<tr>
<td>Grants</td>
<td>18,586</td>
<td>18,374</td>
<td>29,994</td>
<td>16,114</td>
<td>20,944</td>
<td>17,645</td>
<td>23,698</td>
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<tr>
<td>Surplus/ (deficit) after grants</td>
<td>(5,709)</td>
<td>1,255</td>
<td>(2,019)</td>
<td>(785)</td>
<td>8,210</td>
<td>(8,464)</td>
<td>(1,968)</td>
</tr>
<tr>
<td>Domestic financing</td>
<td>2,710</td>
<td>1,131</td>
<td>(719)</td>
<td>1,089</td>
<td>(3,854)</td>
<td>3,902</td>
<td>3,250</td>
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<tr>
<td>External financing</td>
<td>2,218</td>
<td>(2,387)</td>
<td>2,913</td>
<td>(404)</td>
<td>(2,504)</td>
<td>(39,308)</td>
<td>(40)</td>
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<tr>
<td>Surplus/ (deficit) after financing</td>
<td>(781)</td>
<td>0</td>
<td>175</td>
<td>(100)</td>
<td>1,852</td>
<td>(43,871)</td>
<td>1,242</td>
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</table>
### Table 2

**Budget Frame (% GDP)**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditure</td>
<td>26%</td>
<td>23%</td>
<td>23%</td>
<td>23%</td>
<td>26%</td>
<td>26%</td>
<td>26%</td>
</tr>
<tr>
<td>Recurrent expenditure</td>
<td>17%</td>
<td>18%</td>
<td>17%</td>
<td>17%</td>
<td>19%</td>
<td>16%</td>
<td>17%</td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>9%</td>
<td>9%</td>
<td>9%</td>
<td>9%</td>
<td>8%</td>
<td>8%</td>
<td>9%</td>
</tr>
<tr>
<td>Transfers</td>
<td>2%</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Other recurrent expenditure</td>
<td>7%</td>
<td>6%</td>
<td>6%</td>
<td>7%</td>
<td>9%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>of which Goods and services</td>
<td>5%</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
<td>4%</td>
<td>5%</td>
</tr>
<tr>
<td>of which Interest payments</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>of which Other</td>
<td>1%</td>
<td>2%</td>
<td>1%</td>
<td>2%</td>
<td>4%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Development expenditure (domestic)</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>3%</td>
<td>4%</td>
<td>1%</td>
</tr>
<tr>
<td>Development expenditure (foreign project)</td>
<td>8%</td>
<td>4%</td>
<td>5%</td>
<td>5%</td>
<td>4%</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Domestic revenue</td>
<td>13%</td>
<td>14%</td>
<td>15%</td>
<td>17%</td>
<td>21%</td>
<td>16%</td>
<td>15%</td>
</tr>
<tr>
<td>Deficit before grants</td>
<td>-14%</td>
<td>-9%</td>
<td>-16%</td>
<td>-8%</td>
<td>-6%</td>
<td>-11%</td>
<td>-11%</td>
</tr>
<tr>
<td>Grants</td>
<td>-11%</td>
<td>10%</td>
<td>15%</td>
<td>8%</td>
<td>10%</td>
<td>8%</td>
<td>10%</td>
</tr>
<tr>
<td>Surplus/ (deficit) after grants</td>
<td>-3%</td>
<td>1%</td>
<td>-1%</td>
<td>0%</td>
<td>4%</td>
<td>-4%</td>
<td>-1%</td>
</tr>
<tr>
<td>Domestic financing</td>
<td>2%</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
<td>-2%</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>External financing</td>
<td>1%</td>
<td>-1%</td>
<td>1%</td>
<td>0%</td>
<td>-1%</td>
<td>-17%</td>
<td>0%</td>
</tr>
<tr>
<td>Surplus/ (deficit) after financing</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>0%</td>
<td>1%</td>
<td>-19%</td>
<td>1%</td>
</tr>
</tbody>
</table>

### Table 3

**Budget Frame (KMF constant)**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenditure</td>
<td>46,338</td>
<td>44,476</td>
<td>44,436</td>
<td>46,260</td>
<td>52,537</td>
<td>56,811</td>
<td>58,455</td>
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<tr>
<td>Recurrent expenditure</td>
<td>29,855</td>
<td>35,269</td>
<td>32,851</td>
<td>34,856</td>
<td>38,387</td>
<td>34,179</td>
<td>39,272</td>
</tr>
<tr>
<td>Compensation of employees</td>
<td>15,690</td>
<td>17,546</td>
<td>18,353</td>
<td>17,931</td>
<td>16,746</td>
<td>17,593</td>
<td>20,267</td>
</tr>
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<td>Transfers</td>
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<td>5,484</td>
<td>3,550</td>
<td>3,788</td>
<td>4,026</td>
<td>4,949</td>
<td>4,813</td>
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<tr>
<td>Other recurrent</td>
<td>11,487</td>
<td>12,238</td>
<td>10,949</td>
<td>13,138</td>
<td>17,616</td>
<td>11,637</td>
<td>14,192</td>
</tr>
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<td>of which Goods and services</td>
<td>8,122</td>
<td>7,671</td>
<td>7,492</td>
<td>7,463</td>
<td>8,184</td>
<td>8,566</td>
<td>11,171</td>
</tr>
<tr>
<td>of which Interest payments</td>
<td>1,273</td>
<td>1,102</td>
<td>1,028</td>
<td>927</td>
<td>896</td>
<td>433</td>
<td>188</td>
</tr>
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<td>of which Other</td>
<td>2,092</td>
<td>3,466</td>
<td>2,428</td>
<td>4,748</td>
<td>8,536</td>
<td>2,639</td>
<td>2,833</td>
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<td>Development expenditure (domestic)</td>
<td>1,758</td>
<td>1,610</td>
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<td>1,380</td>
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<td>Development expenditure (foreign project)</td>
<td>14,725</td>
<td>7,598</td>
<td>9,000</td>
<td>10,024</td>
<td>8,884</td>
<td>14,810</td>
<td>15,900</td>
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<tr>
<td>Domestic revenue</td>
<td>22,486</td>
<td>27,195</td>
<td>28,817</td>
<td>33,793</td>
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<td>34,770</td>
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<td>Grants</td>
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<td>18,926</td>
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<td>19,189</td>
<td>16,706</td>
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<td>Surplus/ (deficit) after grants</td>
<td>(5,709)</td>
<td>1,293</td>
<td>(2,003)</td>
<td>765</td>
<td>7,522</td>
<td>(8,013)</td>
<td>(1,862)</td>
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<td>Domestic financing</td>
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<td>1,165</td>
<td>(713)</td>
<td>1,061</td>
<td>(3,531)</td>
<td>3,694</td>
<td>3,075</td>
</tr>
<tr>
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<td>2,218</td>
<td>(2,458)</td>
<td>2,889</td>
<td>(393)</td>
<td>(2,294)</td>
<td>(37,216)</td>
<td>(38)</td>
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<tr>
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<td>173</td>
<td>(97)</td>
<td>1,697</td>
<td>(41,536)</td>
<td>1,175</td>
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</table>
Issues in Budget Execution and Credibility
1. OVERVIEW

Budget credibility is the major constraint for budget execution in Comoros. The last PEFA evaluation conducted in 2013 revealed some notable weaknesses in the budget execution process. One of the major constraints highlighted by the report was the lack of budget credibility. This issue not only undermined the budget execution process but also had its toll on critical public service delivery. The consequences of such weak budgetary settings were manifested by the accumulation of arrears, the disregard for certain budgetary allocations and arbitrage disfavoring sectoral ministries during the budget execution process.

The execution analysis shows that while budget execution was robust on an aggregate level, the budget plan itself lacks credibility given the high volume of reallocations with the year. A high volume of reallocations occurred between economic categories and between ministries/institutions. The arbitrage during the budget execution cycle seems to have happened in a way that disfavors economic and social sectors, and created an expenditure bias towards non-priority administrative and remuneration spending. Moreover, this trend was accompanied by a heavy reliance on both discretionary spending such as the "dépenses communes" and undefined budgetary line items.

Bottlenecks in the budget execution process and environment explain largely the spending outcome observed above. The note highlights some of these weaknesses and links it with the observed out-turn. Major weaknesses impacting budget credibility can be identified such as the linkages between preparation and execution phases of the budget, the concentration of execution authority with the ministry of finance and the weak treasury planning and internal controls.

Fiscal data availability remains weak and does not allow for a comprehensive analysis of expenditures. In the absence of an integrated public financial management system, and an internationally accepted chart of accounts and budget classification, the statistical data obtained on budget execution from various sources, at both Union and Island levels, remain weak and incoherent. As a result, findings related to budget indicators and trends account for such a reality in the rest of the note.

The above issues constitute the focus of this note and are presented in subsequent sections. The note first analyses the budget out-turn for most recent data available and delves into spending execution trends at both economic budget line items and ministerial level. It then describes the bottlenecks in the budget execution process and control environment that explain the out-turn findings. Finally, it highlights the issue of civil service reform and its implications on the management of the wage bill.

2. BUDGET OUT-TURN ANALYSIS

To investigate budget execution trends, the note uses data from Comoros’ successive budget laws, also known as “Lois de Finance” and from budget execution reports. Such data is compiled by the Directorate General of Budget (DGB) at the MoF. The data is consolidated for both Union and Island levels and is available for the period between 2009 - 2014. The quality of the data remains a concern, though, as data recording systems remain weak and do not adhere to international standards. The trends for domestic revenues are briefly discussed first before dwelling on the execution of expenditure using broad economic classification.

REVENUE OUT-TURNS

Revenue execution has been largely determined by out-turns of non-fiscal revenues. The execution rate of domestic revenues compared to the original budget, averaged a 110 percent during the period of 2009-2014. A breakdown of those revenues reveals that this trend was driven by non-tax revenues, which recorded a 180 percent out-turn (figure 1). In contrast, tax revenues have been relatively predictable with an average out-turn of 92 percent over the same period. This volatility is linked to the unpredictable nature of the Economic Citizenship Program (ECP) [30], which has been an unstable source of revenues and consequently undermined the budget execution process.
Issues in Budget and Credibility

EXPENDITURE OUT-TURNS

Expenditure Out-turns At The Aggregate Level

Despite a tendency to overspend, the aggregate expenditure out-turn remained modest on average over the last 6 years, with regular under-spends at the island level moderating overspends in the union budget. Aggregate expenditures (Union and Island), deviated by an average of 3.9 percent over the period 2009-2014 (figure 2). The largest deviations occurred in 2009 (8.4 percent) and in 2012 (8.9 percent). The overspending is in part attributed to the surge in commodity prices in 2009 and the sharp increase in ECP proceeds in 2012. A disaggregation of trends by entity reveals that between 2011 and 2014 the Union had a general tendency to over-execute its budget, while islands tended to underspend (figure 3). Indeed, the deviation between the budgeted and actual expenditures averaged 10.9 and -5.9 percent for Union and Islands respectively. This suggests a potential reallocation between the two entities.
The largest source of deviation in budget execution has been the reallocation of resources between ministries. Despite robust realization rates at an aggregate level, large resources reallocations within the overall envelope and between spending categories during the year could also undermine the credibility of the budget as a policy statement. This is notably the case in Comoros. Results show that the deviation due to reallocations between economic categories averaged 9.2 percent while that between ministries reached 18.4 percent (figure 4).

Comoros adopts a revised budget each year, but the revisions do not seem to increase the likelihood of improved budget execution. The difference between the original budget voted in December and the revised one - also known as “Loi rectificatif” – approved in February/March, is a mere 0.6 percent (figure 5). Such outcome suggests that revisions were most probably undertaken at the margins and did not account for changes in spending priorities between economic line items. This opens the door for more discretionary arbitrage during the budget execution phase notably for investments and transfers.

Note: ministries spending is at the level of the union only.
Source: Direction General du Budget (DGB): Lois de Finances, Rapport d’Exécution du Budget; World Bank Staff Calculations.

EXPENDITURE OUT-TURNS BY ECONOMIC CLASSIFICATION

Expenditure On Salaries

Out-turn analysis of the wage bill shows robust execution on aggregate except in 2014. Figure 6 indicates that variation of the wage bill has remained broadly subdued below the 5 percent. This reflects i) GoC commitment to divert resources to the wage bill as a priority spending item, and ii) partial success of the wage bill containment policy under the IMF program, which rendered this budget line item relatively more predictable. This was not the case though in 2014 where the out-turn was impacted by the unbudgeted teachers’ salary increase following large scale national strikes.

Recruitment mostly occurs in the security and education sectors. Recruitment within the civil service, by ministry or commission, is somewhat different between the Union and Island Governments. At the Union level, recruitment is centered on the Ministry of Interior, which mainly employs police officers. Island administrations on the other hand primarily chose to recruit civil servants in the education sector. Significant hiring took place, nevertheless, in the commissions of interior and finance as well.
Issues in Budget and Credibility

The hiring authority is fragmented with the Union and the Islands each having sole recruitment rights at their respective administrative level. As a result recruitment has notably increased, especially at island level where seemingly limited controls were exerted. Indeed, 61 percent of the 2014 increase came from Islands' wage bill (figure 7) \(^36\).

<table>
<thead>
<tr>
<th>National</th>
<th>Union</th>
<th>Island</th>
</tr>
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<tr>
<td>Source: Direction General du Budget (DGB): Lois de Finances, Rapport d’Exécution du Budget; World Bank Staff Calculations.</td>
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Figure 6: Salary spending out-turn (%)  
Figure 7: Magnitude of wage bill deviation (%)

Expenditures On Goods And Services

The goods and services budget has had a tendency to be over-executed, with an overspend of 8.4 percent between 2009 and 2014 on average. The union budget is the primary driver of this trend, given that the execution rates have exceeded the allocation on a regular basis (average overspend of 16.8 percent). In contrast, island authorities have had a tendency to underspend against their planned allocations for goods and services (average underspend of 11.2 percent). In order to present a more detailed analysis of these trends, figure 8 displays the original budgetary allocations for goods and services under the Loi des Finance (LF) in 2013 \(^37\) and the executed spending for each line item. Findings identify three trends: prioritization of remuneration related spending, underspending on public services and large undefined goods and services allocations that are also prioritized.

In the Union’s 2013 budget, public spending that boosts government officials’ remunerations has execution rates exceeding 95 percent. For some items, spending exceeded the allocated budget (refer to Table 1 in Annex 1 for details). This is the case for “charges for within country, transport and missions” that registered an execution rate of 210 percent, “purchases of fuel and lubricants” \(^38\) with 111 percent and “costs of outside country missions” with 99.7 percent. These items alone amounted to 25 percent of total allocations for goods and services (equivalent to KMF1.4 billion or 0.6 percent of GDP) \(^39\). This is a large allocation and execution rate for non-priority spending.

In the same year, the execution rate for spending on public services operations was weak. In contrast to spending on travel, mission and fuel, the Union under-spends on line items contributing directly to the improvement in the performance of public services. This is the case for budget line items like training, IT equipment, and maintenance, where expenditures execution rates remain low at respectively 16, 19 and 39 percent \(^40\) (Table 1 in Annex 1). Moreover, the GoC has been delaying payments for services utilized, notably those provided by public utilities for telecommunications, water and electricity. These items have recorded an execution rate of 0 and 37.8 percent in 2013 respectively. Despite having specific budgetary allocations, the GoC seems to abstain from paying for those services \(^41\).
Lastly, over half of the goods and services budget is designated as “other”, and this undefined category is executed at a high rate. The 2013 budget law features 3 sub-headings titled “Others”: “Other Services Allowances”, “Other Goods and Services Procured for Security”, and “other goods and services procured for civil services”. No further details or breakdown on the nature of such spending exists. In total, budget allocations under those sub-headings represent a staggering 50 percent (KMF2.9 billion) of all allocations made under goods and services. The combined budget execution rate for the 3 sub-headings mentioned above was 104 percent (refer to table 1 in Annex 1 for the breakdown by line item). As a result, this raises the share of expenditures on the “others” line-items to 53 percent of total goods and services when computed on actual spending (or execution) basis.

Public Investment

The public investment program is a large source of deviation in budget execution, with level of high volatility from year to year. Public investments accounted for 46 percent of total deviations between 2009 and 2014 (figure 9). Such volatility is expected as investments are often treated as residual spending, and tend to be closely correlated with the availability of fiscal space. They are the first to be cut or increased depending on the fiscal constraints. This is confirmed when examining yearly trends (figure 10). The positive peaks (re-allocations towards investments) observed in 2011, 2012, 2013 are tied with the years of ECP receipts, while the drop in 2014 (re-allocation away from investments) coincide with the stop of those revenues and the increase in the wage bill and the subsidies for electricity sector.
Islands have consistently under-spent on investments while the union saw large increases in 2012 and 2013. Another notable trend is a high execution rate for road maintenance at 100 percent execution (45) (refer to table 2 in Annex 1). This contrasts with items such as construction, maintenance and acquisition of materials with an execution rate of 19 and 15 percent respectively. This difference is largely due to the fact that expenditures on road maintenance, which is financed exclusively from domestic sources, are often conducted in advance and before the delivery of the service. Such conditionality is often imposed by road maintenance contractors as a guarantee against the GoC’s track record for arrears accumulation. Such payment procedures are not adopted for the other budget line items.

Expenditure Out-turns – Ministries and Institutions Levels

A high volume of reallocations between ministries indicate a lack of budget credibility. Data at the union level revealed that maintaining a robust execution rate at an aggregate level came at the expense of substantial reallocations between ministries, exceeding 18 percent. This reallocation came primarily in operational budgets and at the expense of social ministries. Such imbalances neutralize budgetary allocations and virtually eliminate sectoral operational funding. Average execution rates in 2011-2013 varied significantly between ministries/institutions; from as low as 40 percent to a staggering 285 percent in certain instances (Table 3 in Annex 1). Moreover, findings reveal that such swings are more noticeable when considering operational budgets such as goods and services (47) (Table 4 in Annex 1). Numbers suggest that sectoral ministries fared on the lower end of the spectrum with ministries such as health, tourism/telecom and transport, and education all underspending throughout this period. Again, the bias is more acute when considering spending on goods and services (48).

Expenditure bias towards the administrative institutions at the expense of economic and social sectors, and the investment program, is observed. In contrast to line ministries, the budget execution rate of the Presidency of the Union and Courts (49) all exceed 110 percent (Table 3). The utilization of the full allocations is primarily due to the authority these institutions possess in administering and liquidating spending (49) an authority that is concentrated with the budget department when line ministries are concerned. On the other hand, the Parliament’s spending in excess of their budgetary allocations for goods and services (G&S) (51) seems unjustifiable and sends wrong signals for the credibility of the budget process and for adhering to a much needed fiscal discipline.
3. FISCAL DISCIPLINE AND EXECUTION ISSUES
– EXPLAINING THE OUT-TURN FINDINGS

Bottlenecks in the budget execution process explain largely the trends observed in spending out-turn. This note has outlined the main areas of weakness in budget execution and highlighted three main findings:
(i) unpredictable non-tax revenues that cause fluctuations from the planned levels of spending;
(ii) a high volume of expenditure reallocations within the year reducing budget credibility;
(iii) irregular but large overspends on civil service salaries.

Unpredictable non-tax revenues and their impact on spending

The macro framework guiding the overall allocations remains highly uncertain. Despite notable improvements under the IMF program, the MoF still faces capacity problems in forecasting macro parameters, including growth, revenue and deficit targets. The consistent over-estimation of tax revenues, the volatility in the non-tax receipts, and the uncertainty in identifying subsidies and transfers for sectoral ministries and state enterprises exacerbate this constraint. Taken together, these factors reduce the credible budgetary ceilings and create an impetus for frequent changes to allocations during execution.
The unpredictability of non-fiscal revenues has impacted spending levels and created uncertainty in the budget execution process. This volatility is linked to the irregular nature of the ECP proceeds. The ECP has indeed been a highly unpredictable source of revenues. Revenues from state enterprises have also been unpredictable due to a tendency for late payments and the accumulation of tax arrears. Historically severe fluctuations have been observed from one year to another, leading the out-turn of non-fiscal revenues to vary from as low as 65 percent in 2010 to 347 percent in 2012 (refer to figure 1). Due to the magnitude of these revenues flows (4.1 percent of GDP) 33, spending levels and priorities were altered within the fiscal year as these revenues unfolded, further undermining the budget execution process. A strong correlation exists between non-tax revenues and public investment. In 2014 when the ECP was suspended, public investment was under-spent by 45 percent compared to an overspending of 53 percent in 2012 - the record year for these receipts.

**LOW BUDGET CREDIBILITY AND A HIGH VOLUME OF EXPENDITURE REALLOCATIONS WITHIN THE YEAR**

A gap between sector strategies and the budget plan

Sector specific plans are often not reflected in the budget, diminishing the credibility of the budget. Underspending in line ministries, especially in economic and social sectors, is linked to the poor integration of sector plans in the budget. Although most sectors in Comoros, such as health and education, have formulated national strategies and they are not translated in to effective budget plans. The mismatch stems, in part, from the weak deliberation process between the budget department and sector ministries on one hand, and between sector ministries at the union level and their island counterparts from the other.

The budget calendar exacerbates the problem. Public finance laws mandate that the Comorian Parliament approves the national budget in December (of year t-1) and sets with it global ceilings for the respective Island budgets. Island Assemblies do not convene to vote on their respective budgets until February (of year t). Under tight fiscal conditions and with pre-set global ceilings, there is little room left for Islands to incorporate any sectoral priorities. Hence arbitrage, if it needs to occur, is only possible during the execution phase. A more bottom-up approach that enhances deliberations between Union and Island stakeholders before the December vote can help produce better informed ceilings reflecting development priorities.

Weak budget classification framework

The budget classification framework in use is narrow and lacking in transparency, allowing significant levels of discretion to deviate from planned expenditures. In 2009, new charts of accounts that conforms to the IMF’s GFS 2001 classification, were adopted in Comoros 33. The new chart covers the general budget, the annexed budget, the special treasury accounts, and the islands budgets. However, this classification has never been implemented. Currently the budget still uses a narrow, domestically defined classification that does not adhere to international standards and that does not extend to the investment account. Adhering to the GFS 2001 will enable Comoros to increase transparency and reduce the currently undefined spending items. It also permits the introduction of a functional classification that would enable improved collection of information for policy planning and monitoring purposes.

The large share of the budget categorized as "other" or "dépenses communes" further increases room for discretionary spending. Approximately 41.2 percent of the budget is classified as "dépenses communes". These unclassified budget lines, along with those recorded as "other expenses", are in part a result of Comoros’ underdeveloped budget classification framework. They are also a manifestation of a planning system that prioritized discretionary allocation power over sound planning and preparation. These practices have an impact on overall budget implementation. First because "dépenses communes" are MoF controlled spending made on a union level and not depicted in budgetary line items of other ministries (figure 11). Although “dépenses commune” - notably its investment sub-item - was devised as a mechanism to channel funds away from weak disbursement ministries and allow MoF to liquidate commitments more rapidly; it increased the level of discretion without specific guidance or rules for such spending. Second, resorting to undefined sub-headings such as “other expenses” in a frequent fashion reduces budget transparency. This calls for a reclassification of the “others” funds under more defined line items and bringing their proportion to less than 10 percent.
A concentration of discretionary power to reallocate at the Ministry of Finance

The concentration of the reallocation procedures at the ministry of finance opens the door for increased discretion in spending. Budget execution is highly concentrated at the level of the director general of budget. Line ministries can as such find themselves constrained due to unavailability of budgetary resources despite allocations made in the budget law. The public finance law of 2005, currently applied, allows for considerable discretion for funds reallocation. The 2012 revised law corrects for this. However it remains to be fully implemented. Transfers of credits between programs and ministries do not require parliamentary approval but could be conducted through decrees from the council of ministers or inter-ministerial decision. The law stipulates that such transfers cannot exceed 10 percent of voted allocations per program. However as the out-turn analysis reveals, this is not adhered to in many instances. The law also allows the budget directorates to reallocate funds from personnel credits to goods and services, transfers or investments by solely a minister’s decision. While some flexibility is merited, the nature of some line-items within goods and services and within investments, be it undefined or geared toward remunerations, raises concerns over the development impact of such redeployment and the potential abuse of such discretionary spending authority. Under tight fiscal environments, reallocations have tended to disfavor sectoral line ministries during the budget execution cycle. The latter are often the first to suffer from spending cuts, hence leaving a negative implication on public service delivery.

Weak treasury processes and missing internal controls

Treasury management and internal control systems are severely underdeveloped, making credible and timely budget execution difficult. The key amongst these weaknesses is cash planning procedures and commitment controls that are carried out solely against budgetary allocations and not against the availability of resources. As a result, many commitments are admitted in the absence of sufficient budget funds. This results in the downstream reprioritization, mostly at the discretion of the ministry of finance, of expenditures during the payment stage where large reallocations are made.

Moreover, exceptional payment procedures are frequently used to bypass expenditure controls, allowing for payments against overspent budget line items. This procedure, "paiement par anticipation", which has been highlighted by both the PEFA (2103) and IMF technical assistance, is used by the MoF to fast-track certain payments by overriding core expenditure procedures and controls, including the budget ceiling against the line item. This exceptional payment procedure is frequently used and is likely to have contributed to volume of reallocations experienced within the year.

Finally, the mistrust with goods and services contractors have led to a distorted payment procedures in which services are paid for prior to delivery and controls. When the commitment is submitted for the financial controller’s clearance it is often accompanied by the invoice, the delivery note, the term of payment and the liquidation slip, all while the service has not necessarily been provided. Such practices limit the usefulness of the internal controls process. Despite being in violation with the budgetary and procurement codes of the country, these practices set precedence and became the modus operandi. This forces further unaccounted reallocations within the fiscal year and exacerbates further the arrears problems. It also increases the risks for goods and services not to be supplied and/or the risks of corruption.
Overspending in the wage bill

The separation between hiring and payment authority creates a mismatch that places an upward pressure on the wage bill. The civil service hiring authority is fragmented with the Union and the Islands each having sole recruitment rights at their respective administrative level. In contrast to the recruitment decision, salary payment is a centralized process assumed by the Union's ministries for finance and public service. This creates misalignment of incentives between Union and Islands leading to budgetary tensions and a mismatch between recruitment and payment obligations. As a result, wage bill pressures such as a call for teacher pay rises stemming from tight controls over the 2011-2013 period and the 2014/15 election season had intensified, leading to the expansion in 2014. These pressures have further complicated cash management and, coupled with constrained domestic resources, have led to delays in salary payments. Indeed, the GoC has an average delay of 2 to 3 months salaries, contributing to additional arrears build-up every year.

Despite a series of reforms steps, implementation delays prolong the weak controls features of the current salary payment system. The GoC undertook three key actions: a census of all civil servants, installing a new human resources information system (GISE) and defining the organizational structure for civil services at all administrative levels. Despite such advances, strict adherence to civil service management reforms proved to be a challenge amidst a politically charged environment and delays in the implementation of the new GISE. Moreover, the treasury currently lacks a robust process and sufficient information to exert controls over incoming salary payment requests. As a result, they are confined to a systemic transaction processing role. These gaps contributed to a weak control environment for salary payments. More recently, the GoC imposed a hiring freeze policy that: i) limits the hiring in public service at least at the central government level, ii) halts salary increases, iii) relies on attrition to control the number of personnel. Moreover the MoF imposed monthly ceilings on salary payments for which any excess is deducted from the Island’s revenue sharing formula. Results have been mixed. The wage bill declined from 9 percent of GDP in 2009 to 7.6 in 2013 before increasing to 8.2 in 2014, partly following a teacher salary increase and a projected 8.4 percent in the 2015 budget law. The reversal of the trend threatens to undo the fiscal progress made on the wage bill.

Broadly speaking, the implementation of the organic civil service framework can eliminate all of these mismatches. The organic framework for civil servants has been elaborated and the number of personnel has thus been determined at both Union and Island levels. However the plan remains to be executed. The implementation of the plan aligns the incentives as it determines the real staffing needs at all administrative levels taking into account efficiency parameters and cost savings measures. Once these needs are clearly identified it is easier to cost and set proper allocations during budget preparation, and avoid payment delays and unexpected/unfunded increases during budget execution.

4. RECOMMENDATIONS

Faced with all these challenges, the note recommends to implement the public financial management reform plan, originally formulated in 2009 and updated in 2013. Immediate set of actions can be executed in short to medium run. These include:

Actions to enhance the budget credibility:

i) Adopt a more credible macro framework to guide overall allocations and decouple core spending from exceptional non-tax revenues.

ii) Integrate cost sector specific plans, both at national and island level, into the budget.

iii) Review the budget preparation calendar and foster more deliberation between sectoral ministries and commissions from one hand, and sectoral ministries and MoF.

iv) Implement the 2001 GFS charts of accounts and budget classification.

v) Re-classify the undefined budgetary items and reduce allocations of line items denominated as “others” to less than 10 percent.

vi) Re-classify the “dépenses communes” under their related ministerial classification when applied. This is particularly the case for sub-categories, “prestations de services” and “investments”.

Deconcentrate the budget execution authorities while maintaining fiscal discipline:

i) Accelerate the implementation of the 2012 public finance law, which, among other things, decentralizes the
payment order process to ministry level.

ii) Allow each minister to dispose fully of the ministry’s budgetary allocations to enable them to execute their budgets in an optimized fashion.

iii) Reduce the recourse to exceptional payment procedures “paiement par anticipation” to no more than 5 percent of total expenditures.

Improve Treasury and Internal Controls and uphold their conformity to existing rules:

i) Improve treasury planning functions by adopting monthly and quarterly cash plans in coordination with the treasury single account, to help reduce and avoid arrears.

ii) Strictly enforce the existing internal controls regulations, especially for procurement and payment orders procedures and eliminate practices of payment before services delivery.

Tackling civil service as to increase its efficiency and manage the wage bill:

i) Centralize the recruitment process within the FoP.

ii) Fast-track the implementation of the new GISE, which should bring all salary payments together in an integrated system.

iii) Design and adopt a control process for managing the salary payment chain, including regular reconciliations and audits of the nominal roll.

iv) Seek political and technical consensus of all stakeholders at Union and Island levels for the limits on salary expenditures, preferably in the medium term. This could happen by strengthening deliberation early in the budget process.
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<th>Ordonnancé</th>
<th>Exécution Rate (%)</th>
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<td>487</td>
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<td><strong>Total Biens et Services</strong></td>
<td>5743</td>
<td>5653</td>
<td>98.4</td>
</tr>
</tbody>
</table>

Source: DGB: Compte Administratif de l’Union 2013; World Bank Staff Calculations.
Table 2: Execution of public investments financed from domestic sources

<table>
<thead>
<tr>
<th>Désignation</th>
<th>LFR 2013 Mln KMF</th>
<th>Exécution Mln KMF</th>
<th>Taux %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entretien des routes</td>
<td>800</td>
<td>799</td>
<td>99.9</td>
</tr>
<tr>
<td>Acquisitions, constructions et réparations des</td>
<td>1570</td>
<td>303</td>
<td>19.3</td>
</tr>
<tr>
<td>immeubles</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Acquisitions et grosses réparations du matériel et du mobilier</td>
<td>440</td>
<td>66</td>
<td>15.0</td>
</tr>
<tr>
<td>Total Investissements</td>
<td>2810</td>
<td>1168</td>
<td>41.6</td>
</tr>
</tbody>
</table>

Source: DGB: Compte Administrative de l’Union 2013; World Bank Staff Calculations.
### Table 3: Expenditure execution (actual/original budget) - administrative level (union) (%)

<table>
<thead>
<tr>
<th>Ministère</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>Avg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Santé, Solidarité, Cohésion sociale et Promotion du Genre</td>
<td>39.3</td>
<td>41.2</td>
<td>99.4</td>
<td>60.0</td>
</tr>
<tr>
<td>Assemblée de l’Union</td>
<td>64.5</td>
<td>62.8</td>
<td>95.7</td>
<td>74.3</td>
</tr>
<tr>
<td>Dépenses communes - Ministère du Budget*</td>
<td>81.4</td>
<td>90.1</td>
<td>61.3</td>
<td>77.6</td>
</tr>
<tr>
<td>Postes et Télécommunications, Promotion des nouvelles technologies de l’Information, Transport, Tourisme</td>
<td>77.8</td>
<td>91.5</td>
<td>88.8</td>
<td>86.0</td>
</tr>
<tr>
<td>Education Nationale, Recherche, Culture et Arts</td>
<td>92.9</td>
<td>93.9</td>
<td>105.6</td>
<td>97.5</td>
</tr>
<tr>
<td>Production, Environnement, Energie, Industrie et Artisanat</td>
<td>95.7</td>
<td>150.8</td>
<td>49.7</td>
<td>98.7</td>
</tr>
<tr>
<td>Garde des Sceau, Justice, Fonction Publique, Réforme administrative, Droits de l’Homme, Affaires Islamiques</td>
<td>107.2</td>
<td>101.5</td>
<td>98.5</td>
<td>102.4</td>
</tr>
<tr>
<td>Aménagement du Territoire, Infrastructures, Urbanisme et Habitat</td>
<td>107.5</td>
<td>106.0</td>
<td>102.4</td>
<td>105.3</td>
</tr>
<tr>
<td>Relations extérieures et Coopération, Diaspora, Francophonie, Monde Arabe</td>
<td>101.7</td>
<td>103.5</td>
<td>118.5</td>
<td>107.9</td>
</tr>
<tr>
<td>Cour Constitutionnelle</td>
<td>102.5</td>
<td>122.8</td>
<td>106.2</td>
<td>110.5</td>
</tr>
<tr>
<td>Présidence de l’Union, Défense</td>
<td>119.8</td>
<td>109.9</td>
<td>103.5</td>
<td>111.1</td>
</tr>
<tr>
<td>Finances, Economie, Budget et investissements, Commerce extérieur, Privatisation</td>
<td>137.2</td>
<td>106.3</td>
<td>95.7</td>
<td>113.1</td>
</tr>
<tr>
<td>Intérieur, Information, Décentralisation, Relations avec les institutions</td>
<td>75.6</td>
<td>215.4</td>
<td>87.3</td>
<td>126.1</td>
</tr>
<tr>
<td>Contingence</td>
<td>144.3</td>
<td>153.9</td>
<td>92.6</td>
<td>130.3</td>
</tr>
<tr>
<td>Cour Suprême</td>
<td>169.6</td>
<td>169.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emploi, Travail, Formation professionnelle, Entreprenariat féminin</td>
<td>658.1</td>
<td>91.4</td>
<td>103.9</td>
<td>284.5</td>
</tr>
</tbody>
</table>

* “Dépenses Communes” comprise all spending under this administrative category such as domestic investments, and international obligations; but excluding contingencies.

Source: Direction General du Budget (DGB): Lois de Finances, Rapport d’Exécution du Budget ; World Bank Staff Calculations.
### Table 4: Budget allocations and execution – operational budget (union)

<table>
<thead>
<tr>
<th>Désignation</th>
<th>LF 2013</th>
<th></th>
<th>Execution</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mln KMF</td>
<td>%</td>
<td>Mln KMF</td>
<td>%</td>
</tr>
<tr>
<td>Dépenses Communes*</td>
<td>3175</td>
<td>55.3</td>
<td>3367</td>
<td>106.1</td>
</tr>
<tr>
<td>Présidence de l’Union</td>
<td>1583</td>
<td>27.6</td>
<td>1569</td>
<td>99.1</td>
</tr>
<tr>
<td>Assemblée de l’Union</td>
<td>248</td>
<td>4.3</td>
<td>297</td>
<td>119.7</td>
</tr>
<tr>
<td>Intérieur, Information, Décentralisation, Relations avec les institutions</td>
<td>151</td>
<td>2.6</td>
<td>41</td>
<td>27.4</td>
</tr>
<tr>
<td>Education Nationale, Recherche, Culture et Arts</td>
<td>125</td>
<td>2.2</td>
<td>99</td>
<td>79.1</td>
</tr>
<tr>
<td>Relations extérieures et Coopération, Diaspora, Francophonie, Monde Arabe</td>
<td>89</td>
<td>1.6</td>
<td>86</td>
<td>95.8</td>
</tr>
<tr>
<td>Production, Environnement, Energie, Industrie et Artisanat</td>
<td>88</td>
<td>1.5</td>
<td>28</td>
<td>32.0</td>
</tr>
<tr>
<td>Finances, Economie, Budget et investissements, Commerce extérieur, Privatisation</td>
<td>65</td>
<td>1.1</td>
<td>42</td>
<td>63.8</td>
</tr>
<tr>
<td>Garde des Sceau, Justice, FOP, Droits de l’Homme, Affaires Islamiques</td>
<td>62</td>
<td>1.1</td>
<td>51</td>
<td>81.2</td>
</tr>
<tr>
<td>Postes et Télécommunications, NTIC, Transport, Tourisme</td>
<td>57</td>
<td>1.0</td>
<td>2</td>
<td>3.9</td>
</tr>
<tr>
<td>Cour Constitutionnelle</td>
<td>33</td>
<td>0.6</td>
<td>33</td>
<td>100.0</td>
</tr>
<tr>
<td>Cour Suprême</td>
<td>31</td>
<td>0.5</td>
<td>31</td>
<td>100.0</td>
</tr>
<tr>
<td>Santé, Solidarité, Cohésion sociale et Promotion du Genre</td>
<td>21</td>
<td>0.4</td>
<td>4</td>
<td>21.3</td>
</tr>
<tr>
<td>Emploi, Travail, Formation professionnelle, Entreprenariat féminin - Porte-parole</td>
<td>8</td>
<td>0.1</td>
<td>2</td>
<td>32.7</td>
</tr>
<tr>
<td>Aménagement du Territoire, Infrastructures, Urbanisme et Habitat</td>
<td>7</td>
<td>0.1</td>
<td>1</td>
<td>12.8</td>
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</tbody>
</table>
## Table 4 (continued): Budget Allocations and Execution - Operational Budget (Union)

<table>
<thead>
<tr>
<th>Désignation</th>
<th>LF 2013</th>
<th></th>
<th>Execution</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mln KMF</td>
<td>%</td>
<td>Mln KMF</td>
<td>%</td>
</tr>
<tr>
<td><strong>Dépenses Communes</strong></td>
<td>5743</td>
<td>100</td>
<td>5653</td>
<td>98.4</td>
</tr>
<tr>
<td>Biens et Services</td>
<td>959</td>
<td>34.5</td>
<td>954</td>
<td>99.5</td>
</tr>
<tr>
<td>Santé, Solidarité, Cohésion sociale et Promotion du Genre</td>
<td>913</td>
<td>32.8</td>
<td>966</td>
<td>105.9</td>
</tr>
<tr>
<td>Education Nationale, Recherche, Culture et Arts</td>
<td>394</td>
<td>14.2</td>
<td>432</td>
<td>109.5</td>
</tr>
<tr>
<td>Dépenses Communes*</td>
<td>300</td>
<td>10.8</td>
<td>300</td>
<td>100.0</td>
</tr>
<tr>
<td>Intérieur, Information, Décentralisation, Relations avec les institutions</td>
<td>173</td>
<td>6.2</td>
<td>79</td>
<td>45.5</td>
</tr>
<tr>
<td>Production, Environnement, Energie, Industrie et Artisanat</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finances, Economie, Budget et investissements, Commerce</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>extérieur, Privatisation</td>
<td>22</td>
<td>0.8</td>
<td>22</td>
<td>100.0</td>
</tr>
<tr>
<td>Garde des Sceau, Justice, FOP, Droits de l’Homme, Affaires Islamiques</td>
<td>21</td>
<td>0.7</td>
<td>21</td>
<td>100.0</td>
</tr>
<tr>
<td><strong>Subventions</strong></td>
<td>2781</td>
<td>100</td>
<td>2773</td>
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</tr>
<tr>
<td>31 - Dépenses Communes*</td>
<td>472</td>
<td>73.6</td>
<td>470</td>
<td>99.8</td>
</tr>
<tr>
<td>04 - Présidence de l'Union</td>
<td>87</td>
<td>13.6</td>
<td>87</td>
<td>100.0</td>
</tr>
<tr>
<td>01 - Assemblée de l’Union</td>
<td>30</td>
<td>4.7</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>14 - Education Nationale, Recherche, Culture et Arts</td>
<td>30</td>
<td>4.7</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>05 - Santé, Solidarité, Cohésion sociale et Promotion du Genre</td>
<td>18</td>
<td>2.8</td>
<td>18</td>
<td>99.3</td>
</tr>
<tr>
<td>02 - Cour Suprême</td>
<td>4</td>
<td>0.5</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Transferts</td>
<td>640</td>
<td>100</td>
<td>576</td>
<td>89.9</td>
</tr>
<tr>
<td><strong>Dépenses Communes</strong></td>
<td>931</td>
<td>100</td>
<td>862</td>
<td>92.6</td>
</tr>
<tr>
<td><strong>Imprévus</strong></td>
<td>931</td>
<td>100</td>
<td>862</td>
<td>92.6</td>
</tr>
<tr>
<td><strong>Total Général</strong></td>
<td>10095</td>
<td>100</td>
<td>9864</td>
<td>97.7</td>
</tr>
</tbody>
</table>

*Dépenses Communes* In this table does not include all expenditures under this administrative line items. It relates to only spending under ‘dépenses communes’ for the respective economic categories (goods and services, subsidy, transfers and contingency).

Source: Direction General du Budget (DGB): Lois de Finances, Rapport d’Exécution du Budget; World Bank Staff Calculations.
ANNEX 2: THE STAGES OF BUDGET EXECUTION IN COMOROS

**ENGAGEMENT**

ADMINISTRATEUR DE CREDITS

- Visa ou Rejet
- Fiche d’engagement accompagnée de:
  - I) la facture pro forma
  - II) le bon de commande
- Fait l’état de ses besoins et les transmet

FOURNISSEUR

- Etabli la facture pro forma qu’il retourne

CONTROLLEUR FINANCIER

**LIQUIDATION**

ADMINISTRATEUR DE CREDITS

- Liquide la facture
- Réceptionne la marchandise
- Établit le PV de réception
- Prépare les documents d’ordonnancement
- Fiche visée par le CF et Bon commande

FOURNISSEUR

- Exécute la commande et transmet:
  - Facture définitive
  - Bordereau de livraison
  - Fiche d’engagement

CONTROLLEUR FINANCIER

- Visa ou Rejet

ORDONNATEUR

**ORDONNEMENT**

ORDONNATEUR

- Prise en charge ou Rejet
- Signe la fiche d’ordonnancement
- Émet un mandat de paiement
- Émet les titres de règlement
- Établit le bordereau d’émission

CONTROLLEUR FINANCIER

COMPATIBLE

**PAIEMENT**

ADMINISTRATEUR DE CREDITS

- Controle et Paiement

FOURNISSEUR

L’engagement est l’acte par lequel l’autorité habilitée, crée ou constate à son encontre une obligation de laquelle résultera une charge. Il ne peut être pris que par le représentant qualifié agissant en qualité de ces pouvoirs, notamment l’administrateur des crédits.

La Liquidation a pour objet de vérifier la réalité de la dette et d’arrêter le montant de la dépense. Elle s’appuie sur les titres établissant les droits acquis aux créanciers.

La liquidation comporte deux aspects:
- La constatation du service fait.
- L’arrêté des droits du créancier (fixer le montant exact de sa créance).

L’Ordonnancement est l’acte administratif donnant, conformément aux résultats de la liquidation, l’ordre de payer la dette de l’organisme public. Cet ordre est donné par l’ordonnateur au comptable et se matérialise par l’établissement d’un mandat de paiement.

Le paiement est l’acte par lequel l’État se libère de sa dette. Cette dernière phase de la procédure de la dépense est du ressort du comptable public.
The Fiscal Framework for Service Delivery
1. OVERVIEW

The purpose of this note is to review Comoros’ fiscal framework for funding service delivery. Although “service delivery” is a term that can be applied to the wide range of services offered by a government to its citizens, in this note, the term "service delivery" refers exclusively to the health and education sectors. Using the available budget data at the island level, the note presents service delivery funding trends and finds a large expenditure bias towards salaries, whilst other priority areas remain underfunded. Driven by this finding, the note offers recommendations for re-balancing the framework for funding service delivery. The analysis was complemented by field visits to all three islands where interviews were conducted with both island officials and at service delivery units.

Findings: Comoros’ fiscal framework for service delivery is defined by a highly decentralized framework, whereby islands are assigned large institutional responsibilities, including the delivery of primary and secondary health and education services. The framework provides islands with the fiscal autonomy to allocate resources at their discretion and funds their budget through transfers from the union government. Although the transfers are designed around a revenue sharing formula, in practice, fiscal transfers to the islands fall below their quota. Hence, instead of receiving 62.5 percent of shared revenues as per the formula, island governments were allocated 37 percent of revenues on average between 2011 and 2014.

A review of their budgets suggests that the islands have not been strategic in allocating resources for service delivery. The budgets are characterized by significant expenditure bias towards salary spending as they prioritize staffing and recruitment, even though the indicators show that schools and clinics are already abundantly staffed. They also suffer from a bias towards administrative spending to fund the staffing costs and overheads of the island commissariats. These trends have resulted in severe underfunding of the essentials for improved service delivery, including basic provisions such as teaching materials and medical drugs, school inspection, training, sanitation and infrastructure improvements. The underfunding has caused schools and health centers to rely on fees and charges, effectively transferring the cost burden to families and the community. At the same time, the share of the private sector in service delivery has grown to cover the deficit in public services.

The underfunding of non-salary spending is the result of various factors. As is the case in many small fragile states, high unemployment rates and the scarcity of private sector jobs places pressure on the public sector to absorb excess labor. This reality, combined with a political economy setting that frames jobs as rent, has contributed to the inflated wage bill at the cost of other essential expenditures. Moreover, Comoros operates what can be described as a general purpose intergovernmental transfer system, whereby transfers to the islands are executed without any imposed expenditure ceilings, nor any targeted allocations to priority expenditure areas.

Recommendations: Given these findings, the note offers four main recommendations for re-balancing the service delivery budget: (i) setting firm recruitment caps based on sectoral staffing needs to curb the growth of salary spending; (ii) identifying the main service delivery gaps and under-funded areas to guide more efficient resource allocations; (iii) engaging in policy dialogue with the communities to stimulate their in engagement in this area; and (iv) enhancing the framework for inter-governmental transfers by transitioning from a general purpose transfer system to targeted transfers in order to re-balance service delivery allocations.

2. THE FRAMEWORK: DELIVERING SERVICES IN A DECENTRALIZED CONTEXT

Comoros’ fiscal framework is highly decentralized, providing an elevated level of fiscal autonomy to the island governments. In Comoros, the Island governments have the legal autonomy to plan, allocate and execute these fiscal resources without any restriction from the union government. Although the national budget may present indicative spending thresholds at the island level, it does not supersede the islands’ spending decisions and their own budgets. Islands also have the authority to raise their own revenues that are fully retained and allocated by them. In addition to this, islands have the autonomy to hire civil servants for their assigned areas of responsibility. Given that these include health, education, local police and administration, they hold the responsibility for managing a large share percent of the civil service. Taken together, these factors contribute to the fiscal autonomy enjoyed by the islands within Comoros’ decentralized fiscal framework.
Table 1: Islands overview

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Ngazidja</td>
<td>379,324</td>
<td>1025</td>
<td>66</td>
<td>42.7</td>
</tr>
<tr>
<td>Anjouan</td>
<td>315,108</td>
<td>424</td>
<td>61</td>
<td>46.4</td>
</tr>
<tr>
<td>Mohéli</td>
<td>49,365</td>
<td>211</td>
<td>135</td>
<td>49.1</td>
</tr>
</tbody>
</table>

Sources: INSEED, Ministry of Finance.

The division of Comoros’ fiscal resources is guided by a quota based fiscal transfer formula known as the “quote-part” 67. The mechanism defines the fiscal revenues to be shared between the union and island governments and fixes the revenue share of each entity. Shared revenues represent 95 percent of all government receipts and hence, they are the main source of funding for island governments. Islands’ spending is supported by their own revenues, but only marginally, as these revenues typically finance between 5 – 12 percent of their expenditure. Fiscal transfers under the quote-part are un-earmarked general purpose transfers. The transfer framework does not include a mechanism such as a block grant or a formula to guide allocations to key services or sectors. As such, they have characteristics of a general revenue source that is allocated at the discretion of island authorities.

In practice, island expenditures fall below their quote-part shares. The union government’s expenditure typically exceeds its quote-part share. The union’s domestic funded expenditure was 24 percent higher than the resources it would have been allocated according to the formula on average between 2011 and 2014. In contrast, government spending in all three islands falls below the quota with underspends in the range of 3-7 percent over the same period (figure 2).

The assignment of responsibilities between the Union and the Islands places a large share of the public sector, including service delivery, under the purview of island governments. The assignment is regulated by article nine of the 2001 constitution. The constitution assigned a limited number of responsibilities of national interest to the exclusive competence of the union government such as defense, foreign policy, monetary policy and justice and mandated that every other competence had to be shared between the central government and the governments of the Autonomous Islands. Under these arrangements, island governments are tasked with delivering the bulk of public services, including primary and secondary health and education, the maintenance of local roads and the management of the local economy, which is dominated by agriculture and fisheries 69.
The islands’ assignment of responsibilities gives them a central role in determining the success of service delivery outcomes. Planning, budgeting and implementation at the island level are the primary factors driving the quantity and quality of health and education services.

### Table 2: Division of labor in areas of shared responsibility

<table>
<thead>
<tr>
<th>Islands</th>
<th>Union</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>Universities</td>
</tr>
<tr>
<td>Health</td>
<td>Referral hospitals</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Main roads</td>
</tr>
<tr>
<td>Local economy</td>
<td></td>
</tr>
<tr>
<td>Local governance</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Islands</th>
<th>Union</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary and secondary education, vocational training, scholarships</td>
<td>Universities</td>
</tr>
<tr>
<td>Primary health centers and clinics</td>
<td>Referral hospitals</td>
</tr>
<tr>
<td>Streets and secondary road building and maintenance</td>
<td>Main roads</td>
</tr>
<tr>
<td>Agriculture, coastal fishing and husbandry</td>
<td></td>
</tr>
<tr>
<td>Administrative regulation of local governments, local markets regulations and local police</td>
<td></td>
</tr>
</tbody>
</table>


Although Comoros fiscal framework provides generously for the autonomy of island government, recent reforms have centralized the management of key public finance functions. Most notably, payroll payments are executed by the union treasury on behalf of the island governments. The underlying civil service management system (*GISE* 70), which is operated independently by each entity to date, is being consolidated under one unified framework under the management of an overarching civil service management authority (*Haute Autorité de la Fonction Publique*). Similarly, the recent formation of a coordinating treasury directorate (*Direction Générale de la Comptabilité Publique et du Trésor*) and the adoption of the treasury single account will centralize the oversight over treasury and cash management operations. Revenue administrations reforms are also pursuing measures for increased coordination, such as the integration of customs operations and the consolidation of the large tax payers register at the island and union levels. Overall, these reforms aim to mitigate the tension between a highly decentralized framework on the one hand, and low administrative capacity at the island level on the other. These reforms also seek to strengthen discipline in fiscal management through increased coordination between the Union and Island governments.

### 3. THE TRENDS: (UNDER) FUNDING OF SERVICE DELIVERY

Island service delivery budgets demonstrate expenditure bias towards salaries, especially in education, and the under-funding of non-salary essentials. Island budget allocations are the primary resource for public schools and health centers. These allocations are low. On average, the islands allocated USD 5 per person to non-salary spending in education, and a total of USD 3 to both salary and non-salary spending for health. The exception to this trend appears in the education sector wage bill, where the per capita allocation amounted to USD 79 in 2013. In effect, the full allocative discretion of island governments and their expansive recruitment practices has resulted in a service delivery budget dominated by salary expenditure, especially in the education sector. Moreover, a review of the composition of non-salary spending in health and education shows that a large share of these resources is allocated to funding the running costs of the island commissariats, rather than funding the essential operational spending needs at service delivery units. This spending gap translates to a severe shortage of resources at the facility level, and weak service delivery at public schools and clinics across the country (see boxes one and two for a snapshot of funding gaps at the facility level based on field interviews).
Other than teacher salaries, which are paid directly through the Union treasury, Missiri primary school relies on student contributions to fund almost all other expenditures. It does not receive any direct cash transfers from the island government. The school levies KMF 1000 per student annually (approx. 2.5 US dollars), and uses these limited funds to purchase teaching materials, maintain latrines and ensure the security of the children to the extent possible. Students also pay exam registration fees (KMF 3000 for end of primary exams), but these payments are made directly to the Anjouan Commissariat for Education, and are not retained by the school. The school received textbooks, funded by UNICEF, which are used during classes and stored at the school. Only children from households that can afford to purchase textbooks can have books at home. Overall, the school suffers a shortage of teaching equipment such as chalk and boards and the infrastructure, including the classroom furniture, is in a state of disrepair. Investments in maintaining or upgrading the facilities are unfunded by government.

Source: Interviews and school visit, September 2014.
The medical health center of Wanani district in Mohéli serves a community of 8,000 people spread across seven villages. The center is staffed by 16 persons. Of these, the island authorities have provided a manager, three midwives (one volunteer) and a nurse. The remaining staff, including the doctor, an additional nurse, a lab technician and support staff are paid directly by the center itself from patient medical fees. The costs of medical consultations range from KMF 250 to 500 (USD). Pregnant women pay a fixed fee of KMF 1000 (USD) for child delivery. The center receives 160 people per month for medicine and 60 people for maternity which contribute to a monthly turnover of KMF 200,000 to KMF 300,000 (USD). These resources are used to pay staff, operating expenses, medical products, laboratory reagents equipment and furniture for the accommodation of the doctor. The center receives essential assistance from NGOs and development partners through the Mohéli commissariat for Health to provide consumable supplies, refrigeration, beds, vaccines and medical equipment. Donors also cover the medical fees of some of the patients that cannot pay. The center is generally under-supplied, given the needs of the local community and lacks the means for transporting patients in case of emergency even though they register three to four cases in need of immediate transfer to a health specialist per month.

Source: Interviews and school visit, September 2014.

The dominance of salary spending is most acute in the education sector, where the budget ratio of salary to non-salary spending averaged 16 for all three islands in 2013, compared with 0.8 in the health sector and 0.4 for all other sectors. In other words, for each one Comorian franc allocated to non-salary spending in education, 16 francs were allocated to salaries. A high education wage bill is not unusual, given the labor intensive nature of teaching. Nevertheless, salaries account for 94 percent of education spending on average at the island level, with Anjouan at a peak of 99 percent, suggesting the under-funding of school services, equipment and maintenance. Figure 5 shows that Comoros is one of the countries in the world with the highest share of salaries in its total education budget. Moreover, the modest allocations to non-salary spending on service delivery are dominated by administrative costs.

Islands are prioritizing salaries when staffing levels in health and education are already high. When compared to other small, fragile or neighboring states, Comoros’ staffing levels in the service delivery sectors appear to be high. In the education sector, student-teacher ratios at the primary and secondary levels are relatively low at 30 and 11 students per teacher respectively in 2014 (figures 6 and 7). Similarly, Comoros has a high
The Fiscal Framework for Service Delivery

number of physicians serving the population in the public sector, well above the average for small, fragile or sub-Saharan African states (figure 8) and also above the average for upper and middle income states. These indicative benchmarks point to the need for re-balancing the health and education sectors spending by constraining their respective wage bills and allocating budget increases to funding operational essentials and investments in order to increase access to services and improve their quality. They also suggest that limiting recruitment in these sectors might not impose a drag on service delivery, given the high levels of staffing currently in place.

The underfunding has caused schools and health centers to rely on fees and charges, transferring the cost burden to families and the community. The under-allocation of resources to essential operational spending has led to the reliance on charges and user fees to fund operational essentials in schools and health facilities. Schools charge a combination of enrollment and examination fees and request family contributions to plug their funding gap (see box 1). Similarly, the health sector funds a large share of its operations by levying fees for the use of services. The national health accounts compiled in 2013 demonstrate the magnitude of this effect in the health sector. The accounts estimate that 67 percent of health spending in that year was funded through private resources, with the highest share of private funding having been estimated for Ngazidja. Approximately 90 percent of private resources were used to fund non-salary spending, whilst the remaining share funded the wages of contractual workers.
At the same time, the share of the private sector in service delivery has grown. Private schools and clinics deliver a large share of Comoros’ public services. A third of all primary schools and over 80 percent of secondary schools are privately owned. Similarly, the private sector plays a substantial role in the health sector given that 46 percent health facilities are privately owned. Even by global comparison (annex three), the Comoros’ private sector plays an important role in service delivery. The large size of the private sector suggests decreasing demand for state provided services. The public sector may present a less attractive option for Comorian households if these services are provided at a cost (such as school and medical fees) whilst the quality of teaching and care lags due to severe underfunding. Overall, the private sector is providing a parallel service delivery framework to that of the state. It is attracting a large share of the Comorian population amongst those who are able to afford private services through their own incomes or remittances from the diaspora.

4. THE RECOMMENDATIONS: OPTIONS FOR RE-BALANCING SERVICE DELIVERY FUNDING

The previous section demonstrated the extent to which the islands’ service delivery budgets are dominated by expenditure on salaries, whilst non-salary spending needs remain severely underfunded. This is the case even
though Comoros’ health and education sectors are abundantly staffed, especially when compared with similar or neighboring countries. There is a need to rebalance the allocations to improve performance and capacity in the sector, and to reduce the cost burden borne by households. We present four recommendations to this end. The first three recommendations are applicable within the existing framework for inter-governmental transfers. The fourth recommendation discussed the potential for reforming the transfer system to transition from a general purpose transfer mechanism under the quote-part to a framework that offers more targeted transfers to guide a more balanced allocation of resources to the service delivery sectors.

**Re-balancing with the existing framework for inter-governmental transfers**

**Identify the under-funded service delivery gaps.** Prior to allocating additional resources to non-salary spending, it is essential that island commissariats identify the under-funded priority areas for strengthening service delivery in coordination with the union ministries of health and education. These potentially include areas such as the supply of teaching materials, medical drugs and equipment, teachers and health service providers’ training, maintenance and renovation of infrastructure including access to water, sanitation and electricity and school inspection and supervision. Building institutional capacity for service delivery is also a priority, given that increased budget allocations are unlikely to be effective in the absence of capacity to absorb the resources. Establishing the spending gaps prior to reallocating funds to non-salary spending will guide the more effective distribution of resources.

**Set recruitment caps guided by sectoral staffing ratios and competencies.** The high share of spending on salaries reflects the underlying recruitment trends, especially the expansion of teacher recruitment over the past year. To curb this trend, the authorities would benefit from setting firm staffing limits based on a minimum student-teacher ratio per school and maximum number of physicians per health facility. The ratios would be based on parameters that are agreed on by the sectoral union and island authorities. In addition to this, minimum qualification standards would need to be established to ensure that new recruits are qualified for their positions. This approach would ensure that staffing decisions are consistent with service delivery needs and that the growth of the wage bill is automatically limited by these constraints to allow room for non-salary essential spending needs.

**Evidence based policy dialogue with communities and island authorities.** Lastly, further analysis of the service delivery funding gap and its impact on both the quality of outcomes and services, would strengthen the basis for policy dialogue with island governments in this area. It would also provide a basis for stimulating community awareness and engagement in this area. The key questions to be addressed include (1) the types of expenditures that would yield the highest health and learning returns to the community; (2) the sources of potential savings in island expenditure to open space for funding improved services; and (3) the potential role of the community in strengthening service delivery. Such evidence-based policy dialogue and increased citizen engagement may influence decision making at the island level to re-balance the service delivery budget and increase allocations to cover operational and investment costs.

**Enhancing the framework for inter-governmental transfers**

**Transitioning from a general purpose transfer system to targeted transfers to re-balance service delivery allocations.** Without a mechanism to directly channel resources to services, it is likely that island budgets would continue to over-provide for salaries and administrative costs, whilst other priorities remain under-funded. Reforms that pursue the evolution of the existing transfer system from all-purpose transfers to a more targeted framework would serve to reverse the existing imbalance by providing constraints (e.g. budget ceilings) and/or by providing additional resources to underfunded priority areas. In essence these mechanisms provide a means for signal and commitment to improve the targeting of resources for service delivery. More balanced funding for service delivery would also ease the burden of service fees and contributions on households. Targeted transfer frameworks are used widely in both developed and developing countries and also in both unitary and decentralized administrations. These frameworks range from basic sectoral block grants to more sophisticated output driven formula-based transfers. Box three below provides an overview of the main mechanisms. Despite the diversity of approaches, targeted transfer mechanisms typically share the objectives of increasing efficiency, equity and transparency in resource allocations.

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**BOX 3: INSTRUMENTS OF INTER-GOVERNMENTAL FINANCE**

**General-Purpose Transfers (Comoros System):** General-purpose transfers are provided as general budget...
support, with no strings attached. These transfers are typically mandated by law. Such transfers simply augment the recipient’s resources and are intended to preserve local autonomy and enhance inter-jurisdictional equity.

**Targeted Transfers:** Targeted transfers are intended to provide incentives for governments to undertake expenditures in specific programs or activities. They are best suited for subsidizing activities considered high-priority by a higher-level government but low-priority by local governments. In their simplest form, they are grants for general areas of subnational expenditures (such as education) with no strings attached, allowing recipients discretion in allocating the funds among specific uses within the sector (block grants). Targeted transfers can also specify the type of expenditures that can be financed by pre-setting shares to expenditure categories such as salaries, capital expenditures, or operating expenditures (Input-based targeted transfers). Alternatively, targeted transfers may be output-based by requiring the attainment of certain results in service delivery (output-based targeted transfers). Targeted transfers may also incorporate matching provisions, requiring grant recipients to finance a specified percentage of expenditures using their own resources. Matching requirements encourage greater scrutiny and local ownership of grant-financed expenditures. However, they represent a greater burden for a recipient jurisdiction with limited fiscal capacity.

**Capitation Grants:** Capitation grants are resources allocated directly to service delivery units based on a per capita financing formula. For schools, the formula is typically based on the number of pupils enrolled and is hence directly linked to school enrollments in such a way that enrollment of each additional student results increased funding to the school. For health centers, the size of the grant is typically linked to the size of the local population and local demand for health services. The formulae adopted by different countries vary widely, but in general, they share the objectives of pursuing equity, efficiency and transparency in resource allocation.

The under-funding of non-salary expenditures and the low-capacity context suggest that a targeted transfer mechanism that is transparent and simple to execute would be most suited in the Comoros context (figure 12). Two approaches that may be relevant in Comoros context are simple input-based targeted transfers or capitation grants:

- **Input-based targeted transfers - setting sectoral ceilings for salary spending:** An approach that builds on the existing framework would be to assign a service delivery component within the quote-part that includes an agreed ceiling for salary expenditure. Given that the most acute imbalances appear to be in education, this sector could be selected as the pilot initiative. This approach has the advantage of being simple and transparent to execute, whilst maintaining much of the flexibility of the island authorities to allocate most of their resources at their discretion. However, it requires fiscal discipline of island authorities, without offering budget resources that are additional to their quote-part allocation. Moreover, setting sectoral ceilings for salary spending is an input-based approach that may not necessarily result in more strategic allocations by itself. At a minimum, it would require that the recommendations discussed above in are implemented to ensure that the salary ceiling is backed by recruitment constraints (and caps where necessary), so that the key non-salary spending gaps are identified and that island authorities (and the communities) fully recognize the importance of re-balancing their service delivery expenditure to engender consensus and sustainability of the reforms.

- **Capitation grants - funding schools and clinics directly:** An alternative approach is to allocate a share of the service-delivery budget as capitation grants directly to service-delivery units. This could be accomplished separately or in parallel with reforms to the quote-part model along the lines described above. The advantage of the capitation grant is that it provides a predictable and transparent funding to the facility itself and allows service providers to take the lead in managing the needs of their respective school or health center. When combined with community awareness and engagement initiatives such as school management committees, it may increase oversight over the use of these resources.

Comoros’ constitution provides the islands with a level of fiscal autonomy that is not readily compatible with a top-down reform of the transfer system; coordination and consensus through the budget cycle would be essential. Although consensus may be achieved for the need to re-balance funding to core services at the island level, a top-down reform of the transfer system is unlikely to be successful. Any reform to the transfer system will inevitably rely on buy-in by all levels of government and coordination between the entities around the...
The Fiscal Framework for Service Delivery

budget cycle. This implies the adoption of a service-delivery compact at the national level that is implemented by both levels of government through the budget process. Currently, the budget cycles of the union and the islands are not calibrated to pursue policy priorities in a coordinated way. Under a coordinated arrangement, a framework for targeted transfers would be adopted and benchmarks for the levels of funding would be set on an annual basis in the union and island budgets. Since the islands adopt their budgets after the Union, the budget cycle would need to make space for a consultation phase between the union and islands to facilitate the process, with inputs from the relevant sector ministries.

Figure 12: Inter-governmental transfer options

<table>
<thead>
<tr>
<th>SERVICE DELIVERY FUNDING RE-BALANCING</th>
<th>CAPACITY REQUIREMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td>Output based targeted transfers</td>
<td>Input-based targeted transfers</td>
</tr>
<tr>
<td></td>
<td>Capitation grants</td>
</tr>
<tr>
<td>General Purpose Transfer</td>
<td>Block grant without ceilings</td>
</tr>
<tr>
<td>(the status quo)</td>
<td></td>
</tr>
</tbody>
</table>

This note seeks to introduce the theme of targeted transfers in the Comoros context; a more detailed options analysis would be next the step if there is demand from the authorities. As opposed to being a simple choice amongst a list of possible modalities, the reform of an inter-governmental transfer system is an intricate process that must fully take the country context into account in its design, including the political economy context, fiscal positions and technical capacity at the various levels of government. Rather than providing a full analysis of the potential modalities, this note seeks to present a brief overview of some of the options for strengthening Comoros’ intergovernmental transfer framework for funding service delivery as a basis for launching dialogue in this area and gauging the authorities’ interest in this theme of reform. A more specific design options paper could be prepared if there is interest and demand from the authorities.
ANNEX 1: COMOROS COMPARATIVE HEALTH INDICATORS

Malnutrition, maternal and infant mortality rates are above the world and small state average. There is a relatively high level of access to maternal health services.

**Malnutrition prevalence, weight for age - % of children under 5 (2013)**

**Births attended by skilled health staff - % of total (2011)**

**Life expectancy at birth, total - years (2013)**

**Maternal mortality ratio - modeled estimate, per 100,000 live births (2013)**

**Mortality rate, infant - per 1,000 live births (2013)**

**Immunization, DPT - % of children ages 12-23 months (2013)**
ANNEX 2: COMOROS COMPARATIVE EDUCATION INDICATORS

Education indicators are consistently below the world and small state average with a notably large gap in secondary enrollment and completion rates.
ANNEX 3: PRIVATE SECTOR SHARES IN SERVICE DELIVERY

Comoros has private sector enrollment rates in education that are well above the SSA and world average. Private spending on health is comparable to the world average, but exceeds the levels for SSA and other small states.

Private school enrollment - % of total primary (2013)

Private school enrollment - % of total secondary (2013)

Private health expenditure - % of GDP (2013)
The Fiscal Framework for The Recovery of the Electricity Sector
Comoros has a poorly performing and financially unviable electricity sector that has become a significant burden on public finances. A strong dependence on expensive imported diesel for generation, a degraded infrastructure, poor commercial practices, high losses and a constraining financial relationship with the public sector have all contributed to rapidly deteriorating services resulting in widespread and prolonged outages and blackouts. Structural bottlenecks have put MA-MWE (the electricity utility) in a commercially non-viable financial position, rendering it heavily dependent on government subsidies. Maintaining MA-MWE’s operations has come at a very high fiscal cost as direct transfers and accumulated arrears for the public sector reached 1.5 and 9.3 percent of GDP respectively. In a fiscally constrained environment like Comoros, this situation is not sustainable.

Linked to donor related efforts, the Government of Comoros (GoC) has started implementing a comprehensive program of reforms in the electricity sector. The program, funded through a number of coordinated projects, focuses on upgrading generation, distribution and storage infrastructure and on improving the commercial performance of the utility. The GoC is also pursuing the diversification of the fuel mix by investing in heavy fuel generation facilities. Given the high financial dependence of the sector on the state, the program of reforms is expected to have significant fiscal implications.

This note reports the outputs of a simulation tool developed to investigate the fiscal implications of the planned reforms. The objective of the report is to provide the Government of Comoros with a tool for analyzing the fiscal impact of the electricity sector reforms and for generating estimates MA-MWEs subsidy needs under various reform scenarios. It also allows authorities to examine the overall financial position of the utility and its links with the budget. The tool is expected to contribute to budgetary discussions with stakeholders in the energy sector.

The results indicate that MA-MWE will continue to face a financing gap in the first two years of reform implementation, causing it to require a subsidy allocation through the budget. Implementing the program of reforms is the fastest option to relieve fiscal pressures caused by MA-MWE and eventually help boosting the much needed fiscal space in Comoros. Doing so is expected to eliminate the subsidy over a period of two years. It is hence critical for the MoF to account for these transfers, estimated at respectively 1.1 and 0.5 percent of GDP, in the upcoming national budgets to ensure smoother operations at MA-MWE through the early phase of the reforms. These results are sensitive to achieving the plan’s outcome targets namely in terms of reducing technical losses and boosting collection rates. A weaker implementation of the reforms is projected to extend the subsidy needs for two additional years.

MA-MWE’s financing gap and subsidy needs would be reduced in the short term through cost cutting reforms, especially those aimed at reducing the price of diesel. An immediate downwards diesel price adjustment would ease MA-MWE’s cost pressures and reduce its financing gap. The model simulations show that a 25 percent reduction from KMF 400 to KMF 300 per liter of diesel would reduce the financing gap by xx percent, and that a 50 percent reduction to KMF 200 would further reduce the gap to xx percent, virtually eliminating the need for a subsidy in the first two years of reform implementation. In the medium term, addressing these constraints and liberalizing the price of diesel can have a notable and quick impact on the profitability of the utility.

Overall, the successful implementation of the reform package is expected to yield a small operational profit for the utility, nevertheless overall losses will still be incurred in the absence of maintenance in the long term. The overall net losses in the long term are a result of the additional financial obligations borne by the company with the new infrastructure and the expanded operations. The sustainability of such expansion will require conducting periodic and timely maintenance as to reduce the costs of capital depreciation. Sustaining net losses drains further the company’s equity and reserves, causing MA-MWE to continue being a source of fiscal risk if not addressed over the long term.

Reforms should also be accompanied by policy efforts to ensure a normalized financial relation within the sector stakeholders. Decisions related to normalizing financial flows between the company and the public sector need to be considered. These include repayment of taxes and arrears, elimination of exemptions on customs and fees and collection of government receivables from electricity services provided. Such decisions further enhance MA-MWE’s financial position and reduce fiscal pressures and risks.
2. CONTEXT: THE ELECTRICITY SECTOR AND MA-MWE’S STRUCTURAL BOTTLENECKS

The public sector in Comoros has an interdependent role in the energy sector as owner, operator and regulator. The electricity service provision is divided between two State-Owned Enterprises: MA-MWE, which provides electricity supply services to the islands of Ngazidja and Mohéli and EDA serving exclusively the island of Anjouan. The two utilities are vertically integrated with responsibility for generation, transmission and distribution assigned in their respective service areas. The utilities supply over two levels of voltage: low and medium voltage. In the absence of a large industrial sector in the Comoros, low voltage provision remains the dominant service.

All petroleum products and lubricants for electricity and for commercial usages are solely imported by a public enterprise. The state-owned company SCH procures, imports, stores and distributes wholesale petroleum products and has a national monopoly over the entire Comorian territory. SCH operates two storages facilities in Anjouan and Ngazidja. The total storage capacity is estimated at 7,918 cubic meters and provides the country with around 30 days of fuel supply when utilized in its entirety. The largest customers for SCH are the domestic market for vehicle gasoline and MA-MWE.

SCH procures petroleum products on the international market but is often constrained by the lack of economies of scale. Large and established oil companies opt out from SCH’s tenders due to the small quantities to be supplied (limited storage and port facilities) and the elevated risks (political and counter-party credit) in the absence of credible banking guarantees. As a result, SCH is left with a limited choice of small suppliers that charge larger premiums on deliverables.

Electricity tariffs in Comoros are set by the cabinet of ministers, often on non-commercial basis as they do not cover operational costs. Tariffs are not adjusted automatically to reflect the true cost of providing the service nor changes in input costs such as oil price fluctuations. They are also not subject to a defined process of periodic review. Furthermore, the ministry of energy, the ministry of finance and the public electricity utilities all lack analytical capabilities to design and implement a pricing policy on the basis of economic rationale. Therefore socio-political considerations tend to prevail and prices are only adjusted upward in extreme financial constraints cases. This adds considerable pressure on the profitability of the service providers.

However tariffs remain high when compared to other African countries. Current tariffs stand at 90-100 KMF/kWh for medium voltage, 120 KMF/kWh for low voltage fixed meters users, and 132 KMF/kWh for low voltage pre-paid meters clients. While these prices do not cover operational costs of an all diesel-based production system, the average tariff in Comoros is higher than most Sub-Saharan African countries (Figure 2). This is typical of small countries with limited economies of scale and expensive imported diesel oil. Such relatively high rate coupled with poor services raise the political stakes of any discussion on tariff adjustments.

Figure 1: Electricity Tariffs Comparison in Africa

Service delivery bottlenecks rose from administrative weaknesses and both supply and demand-side constraints. High operational and administrative costs, poor financial and accounting practices (Box 1), absence of strategic budgeting and investment planning are all administrative constraints currently hindering MA-MWE’s operations. Moreover, the company faces severe supply bottlenecks as poor maintenance and lack of investments lead to a degradation in generation capacity and outdated distribution networks that translate into high technical losses. The dependency on expensive diesel-based production along with rigid pricing mechanisms has also exacerbated operational losses and hence aggravated supply constraints. Finally demand side bottlenecks are also a constraint to better services. This comes namely from low electrification levels and high level of fraud (through illegal connections and non-payment) linked to both poor quality of the service and relatively high tariffs.

BOX 1: DATA LIMITATIONS

Major data gaps in the electricity sector exist in Comoros. This is primarily due to the weak accounting and recording functions at MA-MWE, and the limited availability of official figures at the Ministries of Finance and Energy. MA-MWE has never had a certified financial or audit statement. The last organization and strategic audit was performed by the firm Mazars-Fivorana in 2013. However, the report produced was not certified as the auditors could not conclude on the reliability of the data. A long disclaimer in that report has been introduced for this issue.

Therefore, the data exploited in this note, including that used to populate the simulation model thereafter, is fragmented and should be considered with caution. In effect, the note relies on external data sources namely the audit report Mazars-Fivorana (2013) and project documents from Donors. Nevertheless, this is the only information currently available on the sector.

As such, the simulation model remains a ‘high level’ tool that is highly dependent on the quality of existing data. The results should be treated as providing indication of size and direction of impacts of reform programs to help the MoF with decision making. The outcomes of the tool will be enhanced as existing data is revisited and improved as part of the recovery plan. In addition to current efforts for reforming the accounting and recording functions at MA-MWE, other efforts to improve the data quality are also underway. One of them is the upcoming World Bank financed study on cross-subsidies in the electricity sector. The latter should provide more accurate information on the exact size of these flows.

Note:* Despite commended cooperation from all authorities, official figures remain limited.
** Namely the World Bank (2015, 2013, 2012), the AfDB (2014, 2013a&b) and the EU (2013). Documents from Donors depict the technical parameters from various infrastructure and reform projects currently in the pipeline.

The mechanisms of fuel supplies are burdensome and impose additional operational constraints and costs. As a result of its financial difficulties, MA-MWE has been consistently defaulting on payments to SCH for purchases of diesel and lubricants since 2004. By 2013, the arrears towards SCH reached KMF19.8 billion. This situation has pushed SCH to take measures that i) require MA-MWE to pay in advance prior to delivering the fuel, and ii) limit the quantities of fuel delivered to those paid for, as opposed to the contractual agreement. Moreover since SCH is the sole fuel provider and is bound by non-competitive contracts with small suppliers, the additional “monopoly” cost is transferred to MA-MWE with diesel purchased at prices much higher than the international market. These raises further the operational costs of the utility.

MA-MWE also faces a delicate but constraining financial arrangement with the government. Overall, the energy sector represents a high burden on public finance. While the fiscal impact and fiscal risks are discussed thoroughly in a later section, it should be noted that MA-MWE’s losses are borne either through receiving budgetary transfers from the Ministry of Finance (MoF) or through accumulating arrears towards the public sector and notably SCH. This creates distortive arrangements between the stakeholders, government and state-owned enterprises, notably those of non-transparent cross-subsidies. Moreover, the non-payments of electricity bills by the public sector consumers exacerbate the problem.
3. MA-MWE’S FINANCIAL SITUATION, ITS IMPLICATIONS AND FISCAL RISKS

As a result of all the structural deficiencies described earlier, MA-MWE has suffered from weak sales streams and high operational costs (figure 2). In the past 3 years, sales declined by a yearly average of 12 percent. This decline came as the company’s technical losses continue to worsen and collection efforts stalled with clients increasingly refusing to pay their bills as outages became longer and more frequent. Furthermore, operating costs witnessed a surge starting in 2010. This follows:

i) the rise in international oil prices and consequently the increase in cost of diesel purchased

ii) the government decision to increase staff hiring and salaries in MA-MWE.

This came while maintaining a freeze on electricity tariffs. As a result, MA-MWE incurred significant losses that placed the company in a difficult financial position.

MA-MWE’s net losses depleted the company’s equity and reserves, and imposed further contingent liabilities on the government. Operational losses have been sustained by the company for several years (Figure 5). Consequently net earnings turned into net losses for the most part of the decade despite direct government subsidies. The most acute losses started, though, in 2010 and continued for 3 successive years. This had depleted the company’s capital, which started recording negative equity and reserves since 2011. In commercial terms, such situation reflects a state of bankruptcy for the company. However, since this is a public utility and electricity provision cannot be ceased, the government will have to eventually bear such contingent liabilities and guarantee the company’s debts. In 2013, this utility’s negative equity amounted to KMF2.4 billion, which is equivalent to around 1 percent of GDP.

In light of this difficult financial position, MA-MWE has seen other worrying signs on its balance sheet notably those of accumulating receivables and arrears. Figure 4 indicates that receivables from clients have increased significantly reaching KMF14.6 billion in 2013. This comes as a 7 fold rise from a decade ago in 2004. Such rapid escalation reflects the growing amount of unpaid bills for services delivered by the utility to clients in both the private and the public sector including the central government. This inability to collect the proceeds from sales has also been coupled by an increase in arrears, notably to the fuel supplier SCH. The latter reached a staggering KMF19.8 billion, from KMF1.5 billion over the same period. It became a practice to indirectly recover the receivables from clients by accumulating arrears towards SCH. Such arrangements have been used in the past to write-off some of MA-MWE’s debt by eliminating receivables notably those from the public sector. Accounting practices are often non-transparent and should be discouraged.
The structural problems of MA-MWE and the sector are a considerable source of fiscal vulnerability for Comoros. The financial position of MA-MWE is of great concern to the Ministry of Finance (MoF) due to the budgetary repercussions and fiscal risks it generates. Such fiscal impact takes explicit forms through direct budgetary transfers and government debt guarantees provided by the MoF to MA-MWE and implicit forms through unpaid corporate taxes and fees and the accumulation of arrears towards other State-Owned Enterprises (SOEs).

**DIRECT TRANSFERS**

Direct transfers to MA-MWE have been on a continuous rise in the past decade, contributing substantially to the budget deficit (Figure 5). To avoid prolonged shedding and outages the MoF has been providing explicit support to MA-MWE in the forms of direct budgetary transfers. These transfers are defined as “explicit fuel subsidy” and “investment transfers”. Combined, they account for KMF3.7 billion in 2013, equivalent to 1.5 percent of GDP, a 100 times surge from their 2004 level **4. These transfers have increased public spending and have put further
pressure on the budget deficit notably in the past 2 years. On average during that period (2012-2013), direct transfers accounted for 8.1 percent of domestic spending and have contributed to more than 20 percent of the overall fiscal deficit excluding grants. These have reduced the fiscal space available for public investment and spending on social sectors. Details on the mechanisms of this explicit assistance are elaborated below.

**• Direct Fuel Subsidy:** a notable part of MA-MWE’s diesel and lubricants input for electricity production is purchased by the GoC. The MoF conducts direct payments to SCH based on pre-agreed delivery schedule and prices. These purchases mostly occur during the month of Ramadan to insure the continuity of services during that holy period. However, payments are not provided on regular basis due to lack of forward budgeting, limited financing options and cash management inefficiencies. This leads to arrear accumulation for SCH and in more dire instances fuel shortages causing wide-range load shedding and prolonged service interruptions. Fuel subsidies have been gradually increasing since 2004 and have reached KMF3.1 billion, or 1.3 percent of GDP, by 2013 (Table 1).

**• Investment Transfers:** the government also provides transfers to finance maintenance, retrofitting, and equipment purchases. These transfers are necessary for sustaining the services and are often linked with donor project financing or in-kind grants. In 2013, investment transfers reached KMF642 million, equivalent to 0.3 percent of GDP. These transfers are recorded in MA-MWE’s balance sheet as equity, hence do not appear in the income statement under maintenance costs.

**OUTSTANDING TAXES AND FEES**

MA-MWE also benefits from an implicit financial assistance namely through unpaid tax payments repeatedly over several years. MA-MWE has been accumulating tax arrears since 2004. These arrears include: i) income taxes, notably on years where positive earnings were reported, ii) patents, and iii) customs, excises, and fees on fuel and equipment imports. The MoF has not provided MA-MWE with an official and explicit tax exemption. Instead, these arrears have been formally registered as current liabilities in the balance sheet of the company. Between 2004 and 2013, these accumulated arrears have grown by a multiple of 21. They have gone from 0.1 percent of GDP to an estimated 1 percent of GDP by 2013 - or KMF2.3 billion (Figure 8).

From a fiscal perspective, these unpaid taxes and fees can be viewed as forgone domestic revenues. The financial position and solvency of the electricity utility combined with the absence of reforms in the sector both drastically reduce MA-MWE’s repayment capabilities. Under such a situation, these arrears represent an opportunity cost for unrealized taxes and hence can be looked at as forgone domestic revenues. In a fiscally constrained environment like Comoros where taxes to GDP do not exceed 12 percent, such outstanding taxes could contribute to alleviate pressure on the budget deficit. This form of implicit subsidy tolerated by the ministry of finance increases the fiscal risks of the country and consequently deepens its vulnerability to macroeconomic shocks.
ACCUMULATED ARREARS FOR STATE-OWNED ENTERPRISES

Accumulating arrears to SOEs are an important risk resulting from MA-MWE’s financial practices. In addition to outstanding taxes, arrears towards SOEs have been accruing (Figure 7 and Table 1):

- **Outstanding Payments for Fuel Purchases:** 88 percent of MA-MAWE’s arrears to the public sector is due to outstanding payments for fuel purchases from SCH. Such arrears have significantly accumulated in the past decade and have gone from KMF1.5 billion (1 percent of GDP) in 2004 to KMF19.8 billion (8.1 percent of GDP) in 2013. As a result, SCH has stopped supplying MA-MWE with fuel without advance payments.

- **Outstanding Social Contributions:** MA-MWE’s financial losses resulted in unpaid social contributions namely to the Comoros’s pension fund, the health insurance cooperative, and the social security. By 2013, these arrears reached KMF228 million (0.1 percent of GDP).

- **Retained Audiovisual Royalties** MA-MWE has been tasked to collect audiovisual royalties on behalf of the Office of Radio and Television of the Comoros (ORTC). This arrangement was made to reduce fixed costs by including the fee within the electricity bill and utilizing the wide reaching network of electricity collectors employed by MA-MWE. Since May 2010 however, part of the receipts have been continuously withheld by the utility and not transferred to ORTC. Arrears owed to ORTC have also been increasing and have reached KMF137 million (0.1 percent of GDP) in 2013, from KMF 3 million in 2010.
The speedy accumulation and the magnitude of these arrears entail significant contingent liabilities risk on the government. In total, arrears to SOE have risen substantially in the past decade from KMF1.6 billion (or 1.1 percent of GDP) in 2004 to KMF20.1 billion (or 8.3 percent of GDP) in 2013 (Figure 9). While these arrears have no direct effect on the budget deficit itself, the resulting contingent liabilities do raise the country’s overall fiscal risks. As SOE’s financial losses accentuate, the probability of those liabilities materializing increase, hence potentially forcing the government to cross-subsidize or guarantee the SOE’s debt.

### Table 1: Summary of Magnitude and Trend of Fiscal Costs and Risks

<table>
<thead>
<tr>
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<td>8.3</td>
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<td>9.2</td>
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</tbody>
</table>

Source: Mazars-Fivorana 2013 and World Bank Staff Calculation.

## 4. DESCRIPTION OF THE SIMULATION TOOL

This note presents a simulation tool to analyze the fiscal implications of the reform scenarios on MA-MWE’s operational and financial position. The objective of the model is to provide the MoF with a tool to support budgetary discussions with stakeholders in the energy sector. In addition to estimating MA-MWE’s funding gap, the model allows government officials to examine the overall financial position of the utility and the link of the proposed sectoral reforms with the budget.

The tool is designed to project simplified versions of MA-MWE’s financial statements and related budgetary flows of central government, notably the fuel subsidy. The model is built on three levels of analysis: i) projecting MA-MWE’s income statement to determine operational and net earnings and consequently determining the oil subsidy, ii) constructing the utility’s balance sheet, iii) depicting the budgetary flows between the Central Government and MA-MWE. The tool is tailored to project outcome indicators for each level of analysis under different reform scenarios, and then devises financial inter-linkages. The projection period for this exercise is set for 2014-2022.

The model is populated by 4 sets of assumption parameters. These assumptions relate to: i) the macroeconomic framework in Comoros namely GDP growth, the budget deficit, inflation and exchange rate; ii) the determinants of revenues from sales of electricity including assumptions on production, technical and commercial losses, tariffs and the client base; iii) the costs of production and delivery of electricity including volumes and prices of various input costs along with infrastructure investments and maintenance; and iv) policy decisions with direct implications on both financial and operational performance of the utility such as tariff changes, recovery of receivables and arrears payments among others. A detailed description of the simulation tools and the assumption parameters used is found in Annex 1.
5. THE REFORM SIMULATIONS

The report presents four scenarios based on the status quo and three different reform paths. These reform scenarios are conceived around the three main interventions of the government’s electricity sector program: (1) commercial, governance and regulatory reforms to improve the management of the sector, (2) Investments in infrastructure to upgrade the existing generation and distribution facilities; (3) diversification of fuel sources through the establishment of heavy fuel generation facilities (HFO). Reforms under each area are accompanied and financed by a donor project (see annex one). The interventions are scheduled for completion in the next 2 to 4 years. The aim of the simulations is to present the likely outcomes of various reform scenarios and their budgetary implications. Since the tool allows to control for all these options, it gives government officials the opportunity to examine different angles of sectoral reforms and hence enables them to conduct a more thorough and comprehensive analysis. The four scenarios are briefly summarized below:

Scenario 1 (S1) represents the status-quo. This non-reform scenario assumes no capital investments in the company’s generation capacity or its transmission and distribution networks, no reforms on the commercial functions such as billing and collection, no tariffs adjustment and no policy action on normalization of the utility’s financial flows through payments of accumulated arrears and collection of long-due receivables. As a result, S1 simulates the financial and budgetary implications of a case of continued and deepened operational and financial deterioration of MA-MWE.

Scenario 2 (S2) simulates a full reforms situation through the simultaneous implementation of both commercial and infrastructure investment initiatives. The scenario simulates the expected outcomes of the reforms on the utility’s commercial capacities and the infrastructure investments. Assumptions are derived from the Recovery and Development Plan adopted by MA-MWE (the recovery plan) and approved by the GoC. Two sensitivity variations have been added to this scenario to simulate the effects of a slower pace of reform implementation (S2a) and the likely outcomes if infrastructure upgrades are pursued without progress in commercial reforms (S2b). Further variations have been added to this scenario to present the potential impact of introducing cost saving at MA-MWE by reducing the SCH diesel price (S2c) and realizing administrative cost savings within the utility (S2d).

Scenario (S3) integrates long-term reforms that focus on diversifying the fuel mix for production. This scenario aims to examine the implications of introducing additional HFO generation capacity. Such big investments, if proven viable, may change the level and cost structure of production and help meet long-term electricity demands in Comoros. However, as the analysis shows, these are very sensitive to internal oil prices and tariff assumptions.

<table>
<thead>
<tr>
<th>Performance Indicators &amp; Scenario Parameters</th>
<th>S1: No Reforms</th>
<th>S2: Full Reforms</th>
<th>S3: Heavy Fuel</th>
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<tr>
<td>Technical Losses %</td>
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<td>18</td>
<td>18</td>
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<tr>
<td>Billing Rate (%)</td>
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<td>73</td>
<td>73</td>
</tr>
<tr>
<td>Collection Rate (%)</td>
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<td>30</td>
<td>55</td>
</tr>
<tr>
<td>Avg. Tariff (KMF/KwH)</td>
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<tr>
<td>Policy Options</td>
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</tr>
</tbody>
</table>

Source: Mazars-Fivorana 2013 and World Bank Staff Calculation.
6. SIMULATION RESULTS

The Impact on MA-MWE financing Gap and Subsidy Need

Under the status-quo scenario, the need to subsidize the operational costs of MA-MWE endures through the projection period (2015-2022). In this baseline scenario the needed subsidy ranges from KMF2.8 billion in 2015 to KMF3.1 billion in 2022 (figure 8) or an annual average of 0.8 percent of GDP. As infrastructure severely depreciates over time, generation capacity weakens and fuel consumption declines, pushing electricity production costs down. However, this is outweighed by the deterioration in collected revenues as commercial losses and non-payments rise. The result is a continuous increase in MA-MWE’s financing gap and the need for a government subsidy over time. This scenario reflects the unsustainable path of the current situation. A degradation of such magnitude could lead to a complete stop of electricity supply and hence, a severe blackout.

The implementation of the commercial reforms and the infrastructure upgrades (scenario 2) would eliminate the need for a subsidy in 2 years. Under the full reform scenario (S2), a direct subsidy would still be needed during the plan’s implementation period. If no delays occurred this could take up to 2 years. During this period, the subsidy is estimated at KMF3 and 1.5 billion successively (figure 10). This is equivalent to 1.1 and 0.5 percent of GDP. These results show that there is no quick-win solution for the subsidy requirement in the short-term. To avoid fuel procurement problems, arrears accumulation, and services disruption, it will be critical for the MoF to account for subsidy support through the national budget.

The simulations show that the subsidy needs are highly dependent on the speed and quality of implementation. Projections are largely dependent on technical losses and collection rates assumptions. Sensitivity analysis reveals that under a slower pace of reform implementation (scenario S2a), subsidy needs would be extended up to 2019. Therefore, delays in the execution of the reforms and investments entail direct budgetary costs.

Similarly, implementing infrastructure projects without commercial and administrative reforms has severe fiscal implications (scenario 2b). Doing so leads to a substantive rise in the subsidy needed to maintain the operational balance at MA-MWE. In such a scenario, further costs will be imposed on the utility coming from: i) the additional costly diesel-based electricity supply arising from added production capacity and from reduction in technical losses; ii) the maintenance costs incurred for the new investments. To match these costs, additional

The key assumptions for the 3 scenarios are summarized in table 2. The target performance indicators and the scenarios parameters are all figures adopted from the government program of reform and specified in the various Donors’ project documents.

Figure 8: Subsidy projections under reforms scenarios

Source: Simulation Tool.
revenues need to be raised. These can only come through commercial reforms and/or tariffs increase. In the absence of such measures, the subsidy is expected to widen reaching KMF5 and 5.7 billion in 2016 and 2017 respectively (1.6 and 1.7 percent of GDP).

Overall, MA-MWE will continue to have an important financing gap in the first two years even if the full reform initiatives are implemented at a full pace. During the first year, the subsidy is expected to be slightly higher than the status-quo option since additional electricity production is added with no immediate improvements in the sales numbers. Nevertheless, as commercial reforms start to take effect, the fiscal gains become more pronounced. This is reflected by the drop in subsidy in year 2 (figure 8). This outcome highlights the importance of implementing infrastructure and commercial reforms in tandem.

**Impact on Net Budgetary Flows and Financial Position**

The comprehensive set of reforms reduces the pressure on the budget deficit. The previous findings are echoed when examining the overall budget implications of the reforms. Figure 11 illustrates the trends of net budget flows under various scenarios. In the status-quo, payments made by MoF to MA-MWE will continue to outpace budgetary receipts from the utility for the next decade. This situation exacerbates Comoros’s budget deficit. Nevertheless, implementing the full reforms plan within the proposed timeline is the fastest option to relieve fiscal pressures and revert to positive net budget flows. Again, this is projected to occur in 2 years’ time under the optimistic scenario (S2). A less desirable outcome is depicted under the conservative performance scenario (S2a) and the infrastructure-only scenario (S2b).

![Figure 9: Net budgetary flows under reforms scenarios](image_url)

Source: Simulation Tool.

The positive budget flows created under the reforms remain small and could be boosted if MA-MWE’s taxation issues are tackled. The positive fiscal outcome is primarily driven by the widening of MA-MWE’s client base, boosting collections, and tackling technical losses in generation and distribution. All of which reduce the subsidy allocated by MoF. However, the magnitude of the inflows generated will remain small. Under S2 assumptions, net flows continue to be positive but gradually decline from KMF85 million in 2017 to KMF74 million in 2022. This is equivalent to a mere 0.03 and 0.02 percent of GDP. Such outcome is achieved though without settling MA-MWE’s outstanding taxes. Repaying unpaid taxes and eliminating the implicit customs and fees exemptions on the utility’s imports is expected to increase budgetary inflows and consequently boost the much needed fiscal space. It also means normalizing the institutional financial arrangements between stakeholders.

The reforms in consideration are expected to transform MA-MWE into an operationally viable company. In the scenario S2, the company is projected to start making profits on its core operations by 2017 (figure 10). Such profits are estimated at KMF54 million and are projected to grow gradually to KMF379 billion by 2022. Again, a weaker execution of the Recovery Plan delays the utility’s financial recovery by an additional 2 years. Going ahead
with infrastructure projects alone will have, on the other hand, severe detrimental effects that outweigh the losses sustained under the non-reform scenario \(^{114}\).

Despite operational profits, the company is expected to run overall net losses in the long term even if the full reform initiatives are implemented (figure 10). This discrepancy primarily arises since the infrastructure projects entail additional maintenance costs and financial counterpart that is borne by the utility when it is running operational profits \(^{115} 116\). The subsidy provided by the MoF assumes these costs only in the years when the utility is running an operational loss \(^{117}\). Moreover, policy makers should take into account the costs of capital depreciation, which can become significant if maintenance requirements are not met. Sustaining net losses drains further the company’s equity and reserves further, and hence maintains the fiscal risks coming from potential contingent liabilities.

**Figure 10: MA-MWE financial position under reforms scenarios**

![Figure 10: MA-MWE financial position under reforms scenarios](image)

Source: Simulation Tool.

**Introducing Oil Price and Policy Reform Parameters**

Further measures to reduce MA-MWE’s financing gap and boost its profitability can come from cost-cutting reforms. Savings in some of the main cost centers would ease the strain on financing the utility’s operations, reduce the need for financial support through the budget and potentially reduce fiscal risks generated by contingent liabilities. Indeed, reducing operational costs allows the company to gradually build its equity and reserves from enhanced retained earnings.

**The first option is to tackle fuel price rigidities to reduce the cost of diesel.** MA-MWE’s fuel purchases from SCH are priced at a fixed rate, set at KMF 400 per liter \(^{31}\). This price has not changed despite the sharp reduction in global oil prices starting mid-2014. An immediate downwards diesel price adjustment would ease MA-MWE’s cost pressures and reduce its financing gap. The model simulations show that a 25 percent reduction to KMF 300 per liter of diesel would reduce the financing gap by xx percent and that a 50 percent reduction to KMF 200 would further reduce the gap to xx percent, virtually eliminating the need for a subsidy in the first two years of reform implementation. Further price rigidities arise from the lack of economies of scale in diesel purchasing, de-facto non-competitive bidding processes for fuel purchases, and MA-MWE’s poor track record of payments. In the medium term, addressing these constraints and liberalizing the price of diesel can have a notable and quick impact on the profitability of the utility as shown in scenario S2d \(^{118}\) in figure 11 \(^{119}\).

**The second option is to address the administrative costs at MA-MWE.** In 2011, non-fuel related operational and administrative costs increased by 32 percent and was maintained at this elevated level. The increase was not accompanied with improvements in performance. On the contrary, the company’s technical and commercial losses continued to rise. To reduce costs, a proposed measure could be to revert to the pre-2011 cost structure levels. To illustrate such option, the note simulates the impact of undertaking an annual 10 percent cut in administrative expenses over a period of 3 years (Scenario S2c) \(^{120}\). Results show a notable boost in profitability with the utility returning to a positive financial position as soon as 2018.
The introduction of an HFO plant to replace the diesel-based generation capacity starting 2019 will have a notable fiscal impact (Scenario S3). This plant is planned to be financed through a US$40.6 million credit line from India-Exim Bank. A major feature of this option is that it doubles the installed capacity in Comoros. Hence electricity production is expected to cover all of the envisaged demand of the country. From a commercial perspective, this enables the utility to sell more electricity to a larger client base. Moreover the price of HFO is projected at 67% of the current price of diesel, bringing significant operational cost savings. As figure 14 illustrates, the introduction of HFO has notable positive budgetary implications. The inflows generated through income taxes outweigh the servicing of the debt. Under S3, net budget inflows are projected to average 0.3 percent of GDP starting 2019.

The HFO has significant potential to change the structure of MA-MWE and can contribute greatly towards its financial recovery. The HFO option could also bring long-term commercial viability to MA-MWE and greatly reduce the contingent liabilities risk on the government. As depicted in figure 13, the increased capacity and the cost savings on fuel brings to the utility significant earnings and transforms it into a commercially viable company over the medium run. Indeed, net earnings are projected to increase from KMF1.7 billion in 2019 to
7. CONCLUSIONS & RECOMMENDATIONS

MA-MWE’s Recovery Plan is the fastest option to turn around the company’s financials and hence relieve fiscal pressures on the GoC. Simulations reveal the absence of a quick-win solution for the subsidy issue. Implementing the Recovery Plan gradually eliminates the subsidy over a period of 2 years. Therefore, it is critical from the MoF to account for these transfers in the budget to ensure smoother operations at MA-MWE as it executes the reforms.

However, the success of the Recovery Plan hinges on two conditions: the implementation of both infrastructure and commercial reforms in tandem and avoiding delays in the execution and adhering to the output/outcome targets set in the plan. The simulation tool shows that a failure to fulfill those conditions only extends the need for subsidy and could, in some cases, worsen the financial situation of the utility.

A review of the broader cost structure is merited to ensure long-term sustainability and reduce fiscal risks. Simulations reveal that tackling administrative costs and liberalizing oil prices could have notable implications in boosting the financial position of MA-MWE and hence reducing potential risks arising from contingent liabilities. Moreover, the introduction of HFO might be a game-changer as it alters the production structure away from costly diesel. However, the latter needs more in-depth sensitivity analysis studies so as to ensure all explicit and implicit costs are taken into consideration.

Recommendations are devised between short and medium-terms action.

a. In the short-term (2015-2016):

- Accelerate the execution of MA-MWE’s Recovery Plan by fast-tracking implementation of both commercial and infrastructure reform projects in tandem.
- Implement an immediate lowering of SCH’s diesel costs in order for MA-MWE to pass on price reductions on global oil prices, and initiate a review of the potential design, as well as impact of the transition to a flexible price mechanism.
- Account for MA-MWE’s subsidy in the budget to avoid fiscal uncertainty during the year, boost transparency and provide the utility with the clarity and support required as it implements the reforms.
- Prepare an up-to-date set of financial reports for MA-MWE and SCH to be submitted for a full financial audit.
- Create a supervision committee from the Ministry of Finance, Ministry of Energy and MA-MWE to oversee the reforms. In addition to technical representation, it is highly advisable to include ministerial membership so
as to boost the efficiency of the committee and push forward decisions on the political level.

b. In the medium to long-term (2016 – 2019):

- Reform the fuel purchasing process with the SCH to introduce flexibility in the diesel price setting mechanism and to increase competition in the bidding contracts, in order to benefit from the lower international oil prices.
- Normalize the flow of funds among the public entities and clear out MA-MWE’s arrears along with the GoC’s outstanding electricity bills. In this regard the upcoming study on cross-subsidies within the sector would be helpful 124.
- Diversify the sources of electricity production. In addition to the introduction of HFO, Comoros might want to press ahead with the renewable energy projects.
- Review MA-MWE’s administrative costs with a view to identifying potential savings.
ANNEX 1: DESCRIPTION OF THE SIMULATION TOOL

The tool is designed to project simplified versions of MA-MWE’s financial statements and related budgetary flows of central government notably the oil subsidy. The model is built on three levels of analysis which are: MA-MWE’s income statement, the utility’s balance sheet, and the budgetary flows between the Central Government and MA-MWE. The tool is tailored to project outcome indicators for each level of analysis under different reform scenarios and then devise financial inter-linkages. The projection period for this exercise is set for 2014-2022. More details on these levels of analysis are presented below:

1. The first level of analysis projects components of MA-MWE’s income statement to determine operational and net earnings and consequently determine the oil subsidy. In the first level of analysis, the tool constructs the electricity utility’s income statement by projecting yearly operational revenues, the cost of goods and services sold and the non-operational revenues and costs. As a result, the tool allows deducing both operating profits or losses and the net earnings of the company. The tool then utilizes these parameters to compute the amount of subsidy to be provided within the year. The model defines the subsidy as the government transfer needed to cover operating losses under various scenarios.

2. The second level of analysis constructs the broad items of the utility’s balance sheet. It projects, on the one hand, current and fixed assets including the important items such as receivables from non-paying clients, inventories, and investments in physical capital. On the other hand, the model estimates MA-MWE’s current and long-term liabilities, notably, the accumulated arrears for the central government and the public sector in general. Those elements enable to determine the company’s equity and reserves and hence design policy simulations that will lift the company from its current financial bankruptcy position.

3. The third level depicts the budgetary flows between the Government and MA-MWE. Using the projection estimates from MA-MWE’s income statement and balance sheet, the third level of analysis depicts i) all inflows to the central government budget coming from potential taxes, dividends, interests on any contracted loans, and re-payments; ii) all outflows or payments made from the budget to the utility, namely, future subsidies and potential investment transfers, equity projections and government credits. Adding up these parameters, the outcome indicator of interest in this tool is, therefore, the net budgetary flows.

The hypotheses needed to populate the model draw on four broad sets of parameters:

i) **The Macroeconomic Framework**: the model takes into account assumptions related to the macroeconomic framework of the Comoros throughout the projection period. These assumptions include both the level and growth of GDP, the budget deficit, inflation and the exchange rate (KMF/US$). For the purpose of the analysis in this note, both World Bank and IMF article IV estimates are used to populate the macro assumptions in the model.

ii) **Revenues from Sales of Electricity**: MA-MWE’s operational revenues are determined on the basis of assumptions related to the quantity of electricity produced, technical losses mainly related to losses incurred on the distribution networks, commercial losses linked to the billing and collection rates, electrification rates and the expansion of the client base, population growth and average tariffs.

iii) **The Costs of Production**: the costs of production and delivery of electricity services are estimated in the tool as a function of the consumption of fuel, domestic and international prices of carburant, costs of lubricants and investments in infrastructure and maintenance. The tool does accommodate for volumes and prices of various sources of fuel such as heavy fuel, gas or others.

iv) **Policy Decisions**: a set of policy parameters are also introduced in the model. These are policy/political decisions beyond MA-MWE’s jurisdiction that the government is expected to take as part of the reforms prospective. These decisions have direct implications on both financial and operational performance of the utility. Such decisions include the tax rates to be paid by MA-MWE, the rate of payments of the company’s arrears for the MoF and for other public enterprises such as the fuel supplier SCH, the percentage of recovery of receivables from client services notably from the government itself and tariff changes that are set by the cabinet of ministers.
ANNEX 2: SUMMARY OF THE GOVERNMENT ELECTRICITY SECTOR PROGRAM OF REFORM

Commercial recovery, governance and regulatory reforms

The components on commercial recovery and improved governance of the sector are accompanied by a US$5 million World Bank project. Under this project, the reforms will restructure MA-MWE’s commercial, financial and administrative directorates and will provide staff training to upgrade administrative capacities including those in the recording of financial information. Moreover, the project will finance a new management information system (MIS) to allow for the proper execution and monitoring of commercial and financial activities in the utility. The efficient use of the MIS is expected to have a strong positive impact on operations transparency and corporate governance. Additionally, both network and fuel metering equipment will be purchased. This will enable the company to improve the current 73 percent billing and 55 percent collection rates and achieve the targeted levels of 97 and 95 percent respectively. Finally, a review of the sector’s governance arrangements and a redesign of its legal and regulatory framework are also envisaged. This is coupled with extensive technical assistance for the development of planning capacity in the sector’s institutions.

Infrastructure upgrade investments

The infrastructure component is financed by the African Development Bank and focuses on upgrading the generation, production and storage facilities. In the area of generation, the project aims to refurbish the existing production units, put in place a new diesel generator and provide maintenance equipment and spare parts. By doing so, MA-MWE will be able to exploit all the currently installed 19 MW capacity, which, if entirely operational, is expected to satisfy demand till 2021. The project is also expected to rehabilitate the distribution networks and install new connections and evacuation posts to reduce technical losses from 18 percent to 10 percent. Moreover, it plans to invest in additional fuel storage capacity that will allow MA-MWE to procure larger quantities and hence reduce the marginal cost for each liter of fuel. Finally, the project will invest in renewable energy notably the installation of solar panels and rehabilitation of micro-hydro plans. While these projects are not expected to have a notable impact on the cost structure of MA-MWE due to their modest scope, they serve to increase access to electricity in rural areas.

Diversification to heavy fuel based generation

The component on diversification of electricity sources is still under discussion. The long run sustainability of the sector is vulnerable to the dependency on expensive imported diesel. Growing awareness of this issue has pushed the government to adopt a two-pronged strategy. First, it moved forward on the existing solar and micro-hydro energy projects financed by the AfDB and the EU. Nevertheless, even with those projects completed, the total capacity of renewable energy will constitute a negligible part, (less than 1 percent), of the overall energy mix. Since substitution of diesel by renewables is possible only in the long run, the authorities decided to turn to heavy fuel (HFO) generation. HFO based generation cost is believed to be significantly less expensive than diesel-based. In this regard, the government signed a US$41.6 million loan agreement with India-Exim Bank for an HFO plant with an 18MW capacity. This investment would double the country’s current installed capacity by 2019 and allow for phasing-out diesel-based generation. Other futuristic plans include tapping into the potential geothermal resources. The exploration phase financed by AfDB, EU and New Zealand begun at the end of 2014. If successful, the ambition is to add 10MW of geothermal component into the country’s energy mix by 2019. At this stage, though, neither the reserves nor the economic viability of the project are confirmed yet.
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Given its limited productive capacity, Comoros’ domestic consumption (both public and private) is heavily import dependent.

As a fragile low income country, Comoros has no access to financial markets. Deficits are typically financed through multilateral and bilateral concessional borrowing.

The IMF Extended Credit Facility ran from 2010 to 2013. Prior to this, the authorities benefited from IMF support under Emergency Post-Conflict Assistance (EPCA) and the Exogenous Shocks Facility-Rapid Access Component (ESF RAC) in 2008.

The ECP allows Comoros to offer citizenship to foreigners who reside in partner countries. The partner government selects the candidates following a background check conducted by the partner government. In exchange, Comoros receives a fee for each passport issued. In recent years revenue from the program has become significant in relation to Comoros’ GDP. The program was suspended in 2013.

Exports are not currently subject to taxation.


A consumption tax is levied on imported goods and is collected at the point of entry by the customs administration.


Data was only made available for 2013.

Tariffs have not been adjusted despite continuous increases in diesel prices purchased by MA-MWE between 2004 and 2013, when prices went from 260 KMF/liter in 2004 to 400 KMF/liter in 2013 (Source: MA-MWE).

On average between 2011 and 2014.

On average between 2011 and 2014.

Assemblée de l'union; Cour constitutionnelle; Cour suprême; Dépenses communes; Garde sceaux, justice, de la FOP; Ministère de l'intérieur, de l'information, de la décentralisation; Présidence de l'union; Vice-présidence Mayotte; Vice-présidence ministère des finances, de l'économie, budget et des investissements; Relation extérieures et de la coopération, de la diaspora, de la francophonie et du monde Arabe. Commissariats et ministères correspondants au niveau des îles.


Expenditure trends disaggregated by entity are available for the 2011 to 2014 period.

Average 2011 to 2014.

Composition estimates are based on the 2013 union and island budgets. This was the only year for which a full dataset representing union and island sectoral allocations were made available.

Assemblée de l'union; Cour constitutionnelle; Cour suprême; Dépenses communes; Garde sceaux, justice, de la FOP; Ministère de l'intérieur, de l'information, de la décentralisation; Présidence de l'union; Vice-présidence Mayotte; Vice-présidence ministère des finances, de l’économie, budget et des investissements; Relation extérieures et de la coopération, de la diaspora, de la francophonie et du monde Arabe. Commissariats et ministères correspondants au niveau des îles.

The cost of military personnel has been separated from the budget of presidency and “dépenses communes” have been separated from the finance budget to be presented separately.

Ministère de l'éducation nationale, de la recherche, de la culture, et des arts; Commissariats de l'éducation des îles. Ministère de santé, solidarité, cohésion sociale, et promotion du genre; Commissariats de santé des îles.

Vice-présidence chargé du ministère de l’aménagement de la terre, des infrastructures, de l’urbanisme et de l’habitat; Vice - présidence, chargé du ministère de la production, de l’environnement, de l’énergie, de l’industrie et de l’artisanat; Ministère de postes et télécom de la promotion des nouvelles technologies, charge des transports et du tourisme; Ministère de l’emploi du travail, formation professionnel et entreprises. Commissariats et ministères correspondants au niveau des îles.
Debt sustainability analysis. 2014.

Both the baseline scenario excluding remittance and the indicators under the probability approach indicate that Comoros’ debt position remains vulnerable.

CoV: coefficient of variation.

Revenue estimates are derived from the revenue forecasting framework developed as part of this review.

These estimates are derived from an electricity sector model developed as part of this review. (See the policy note on the fiscal framework for the recovery of the electricity sector for more details.)

See the policy note on service delivery for a discussion of the funding gap for non-salary service delivery spending.

Several recent technical assistance reports have reviewed Comoros’ tax system and presented a prioritized set of recommendations. See IMF technical assistance reports (i) “Poursuite de la modernisation des administrations fiscale et douanière et mise en place de l’administration générale des impôts et des domaines”, October 2012; (ii) “Développement de l’administration générale des impôts et des domaines et modernisation de l’administration des douanes”, May 2014. (iii) “Réforme du système fiscal: les étapes à franchir”, May 2015.

The GISE (gestion informatisée des structures des effectifs) is the new human resource management system for the public sector.

The note of the fiscal framework for service delivery discusses the large size of the education wage bill and presents recommendations on re-balancing the service delivery budget.

Issues in Budget and Credibility

The ECP program was instituted by the law number 8-14/AU in November 2008. The program grants Comorian citizenship against the payment of KMF1 million for non-resident foreigners. The program has been suspended since 2014, the authorities have been negotiating a renewal over the past year.

Due to data limitations, the analysis of reallocations between ministries is limited to the Union budget in 2013.

Comoros does not use the IMF GFS classification, or any other international recording standard. Hence the terminology economic classification is used with caution to refer to the broader categories of spending namely: wages, goods and services, transfers and investments.

Discussions on the deviation between ministries is discussed later in the next section of the note.

It should be noted that Comoros does not use the IMF GFS classification, or any other international recording standard, and hence the terminology economic classification is used with caution to refer to the broader categories of spending namely: wages, goods and services, transfers and investments.

The IMF program ended in 2013.

Figure 6 shows that deviations in the wage bill mostly come from the islands levels (largest magnitude). However these variations were only large (in value terms) in 2014.

The only detailed budget execution data for goods and services available to the team was for the union budget in 2013. Hence, the trends discussed for this year are referred to on an indicative basis.

This includes fuel awards provided for officials within the administration.

Actual spending reached KMF1.6 billion equivalent to around 0.7 percent of GDP.

The lowest tier in all goods and services line item. Even in terms of magnitude, the amount budgeted for these 3 tasks do not exceed 2 percent of total allocations made for goods and services; a mere KMF118 million (Figure 8).

This comes in part as a mechanism for the MoF to recover part of the subsidies and dividends provided for the electricity and telephone utilities, both of which are public enterprises. This also occurs due to technical problems in metering and billing systems within these utilities and hence failure to determine the amount of services consumed. The budget ought
to specify the financial relationship between the government and public enterprises, and explicitly devise separate budget line items for subsidies and services consumed. This enables MoF to normalize the financial flows within public entities and avoid cross subsidy practices.

This equivalent to around 1.2 percent of GDP.

With the unbudgeted increase in teachers’ salaries during this year.

Hence the peaks observed for categories salaries and goods and services.

Based on detailed execution data for the 2013 union budget only.

Data available is at the Union level for 2011 - 2013.

In 2013 the realization rate ranged from as low as 4 percent to as high as 120 percent.

Ministry of health only spent 21% of its budgetary allocations in 2013, while ministry of education spent 79%.

Both the constitutional court and the Supreme Court.

While Courts and Parliament have a direct authority under public finance regulations in Comoros, the Presidency has notably political influence especially that it also administers the defense budget.

Budget execution rate at 120 percent.

On average over the period 2009-2013.

Decree number 09-084/PR, 20th July 2009.

and directors of budgets for islands level spending.

when reallocation happens within the same entity. In this case the decision is issued from the minister of finance and the concerned minister.

Both the 2005 and 2012 public finance laws.

The minister has the obligation to inform the minister of finance according to the law.

This becomes a viscous circle in which treasury will have to account for these often unbudgeted payments and hence force MoF to cut or delay payments of other transaction in the same budget line items or reallocate from other ones.

Wage bill expansions in Comoros have tended to be correlated with the election cycle. Refer to Rose and Gowthaman (2011).

Except for a public teachers wage adjustment that came in 2014.

The Fiscal Framework for Service Delivery

Health and education are two of the largest expenditure areas in the budget. Other key services such as water and electricity are provided by state owned enterprises.

The objective of this note is not to present a full expenditure analysis for the health and education sectors. Rather, the note selectively focuses on the relative levels of funding for services and the potential policy options for strengthening and re-balancing funding to services.


Comoros’ system of government is composed of three distinct levels of government: the central government (the Union); the regional government (the Autonomous Islands) and the local government (the Municipalities). A third level of government, the Municipality, has been instituted with the conclusion of the local elections in 2015. It represents the most local level of government, and is governed by elected councils and headed by a mayor. The new municipalities will be responsible for the provision of some basic services but their extent of their responsibilities and the fiscal arrangements for this level of government are not fully defined. For the purpose of this note, the analysis will be restricted to the Union and Island levels of government.

The Islands accounted for 42 percent of government spending in 2014.

Based on FY2013 budget data.

The quote-part is defined in article 11 of the constitution of Comoros (2001) and the law on the sharing of revenue (Loi organique n° 05-001/AU –2005).

Average 2011-2014.

Comoros’ electricity and water supply services are managed by public utility enterprises that are regulated by the Union government.
Système de gestion intégrée des structures et des effectifs (GISE).

The education estimates based on school age population. The exchange rate used for 2013 is USD 371 per KMF.

Average for first and second cycles for secondary schooling.

Analysis of the comparative affordability and quality of services offered by the public and private sectors is beyond the scope of this note, but would clarify the factors affecting household choices.

The Fiscal Framework for the Recovery of the Electricity Sector

This section builds on the analysis of the following reports World Bank (2015, 2013, 2012); AfDB (2013) and EU (2013a). This section summarizes some of their main findings regarding bottlenecks in the electricity sector.

“Société d’Eau et de l’Electricité des Comores” which was founded in 2002, emerging out of failed privatization effort with the French company Vivendi. The present note focuses exclusively on MA-MWE since it is the largest service provider in Comoros, faces more severe operational and financial challenges, and financial data for the company are readily available.

“Électricité d’Anjouan”.

There is some supply at medium voltage to commercial clients: the largest clients here are hotels, refrigeration companies, bakeries and some light industries. These have also individual generators that are connected to MA-MWE’s grid.

Industry value added represents 8.5 percent of GDP in Comoros in 2013 (Source: INSEED).

“Société Comorienne des Hydrocarbures”.

The monopoly includes gasoline for vehicles, fuel for both electricity utilities, and fuel for airports and jets.

MA-MWE only buys diesel, the sole fuel type currently used in electricity production. MA-MWE purchases all its needs from SCH.

This situation has been persistent in the last decade. However, the Islamic Development Bank (IDB) has agreed in late 2014 to provide banking guarantees and conduct payments to potential suppliers on behalf of SCH. IDB has also agreed to review the tender process as to widen the competition. This new initiative will be piloted in the first quarter of 2015 and if successful is expected to increase the number of bidders, which will be a first step towards reducing prices. The deal between the IDB and SCH remains a commercial one though. Indemnity agreements and penalties are built into the contractual agreement between the two entities.

Tariffs have not been adjusted despite continuous increases in diesel prices purchased by MA-MWE between 2004 and 2013, when prices went from 260 KMF/liter in 2004 to 400 KMF/liter in 2013 (Source: MA-MWE).

In 2013, MA-MWE’s wage bill reached 13.3 percent of total expenditures.

Refer to Figure 13 for tariffs comparison across Sub-Saharan Africa.

Arrears to SCH account for 89 percent of the company’s total liabilities.

Public Sector is defined as Central Government + State-Owned Enterprises.


In 2010 the cost of fuel purchased increased by 57.8 percent (y.o.y) while in 2011 the wage bill of the company rose by 53.2 percent and both continued to grow in subsequent years.

If the company closed today, the debt it owes to its creditors and suppliers becomes a government debt since the company is publicly owned. Hence these are material contingent liabilities.

Private sector refers here to both businesses and households.

Refer to the next section for a more detailed discussion on arrears to SCH and other State Owned-enterprises.

Debt forgiveness for MA-MWE came in 2009 as part of a cross-subsidy write-off operation.

In 2004, direct transfers were KMF377 million, equivalent to 0.2 percent of GDP.

Domestic spending is defined in this case as public expenditures excluding foreign grants.

The contribution was respectively 26.6 and 15.5 percent in 2012 and 2013.

One of the arrangements adopted was for the government to pay 221.5 KMF/liter out of
the official price of 400 KMF/liter on MA-MWE’s purchases. The rest (178.5 KMF/liter) is borne by the company. In the case MoF refuses to adhere to such arrangement, MA-MWE will go ahead and purchase fuel but at lower quantities to compensate for the difference. This leads to lower generation and hence increases the duration and frequency of service interruptions.

The fuel subsidy is not quantified during the budget preparation process and therefore is not accounted for within the budget law. This creates difficulties during the fiscal year to provide the funds necessary for diesel purchases that are required to run the power plants.

An example of these transfers is the cost for installing generators provided as in-kind grant by China in 2009.

The presentation was decided in MA-MWE’s organizational and strategic audit report Mazars Fivorana (2013).

These liabilities were labelled debt owed to the government.

Public sector in this note is defined as Central Government + SOEs. Outstanding fuel purchases are 98 percent of the outstanding arrears.

The model defines the oil subsidy, or MA-MWE’s funding gap, as the government transfer needed to cover operating losses. Subsidy is defined as equal to revenues from sales – costs of production and maintenance excluding wages and salaries. In the case of operating profits the subsidy is automatically set at zero.

This report only discusses a limited number of reform scenarios. However the tool contains many parameters and therefore a larger choice of simulations. The objective is for the Ministry of Finance officials and technical teams to use the tool and design customized reform scenarios for their specific analysis.

Due to data shortages, the model’s base year was set as 2013. Figures for 2014 are estimates based on similar conditions as 2013.

In brief, the World Bank project tackles administrative and commercial reforms focusing on the restructuring of the company and reducing non-technical losses such as billing and collection. The AfDB project complements these reforms by providing infrastructure namely through refurbishing generation capacities and investing in upgrading the distribution networks. Refer to Annex 2 for details on the two projects.

This scenario remains improbable due to the severity of the deterioration. In such a situation an emergency intervention to tackle the problem becomes a government necessity.

The conservative scenario (S2a) takes in to account two parameters: i) slower improvement in technical losses where these achieve the targeted value of 10% gradually on the 4th year of reform instead of the 2nd, and ii) a longer delay to achieve commercial targets: billing and collection rates achieve targets on the 4th and 7th years of the start of the Recovery Plan, respectively, instead of the 2nd and 5th.

Commercial reforms aim at boosting both billing and collection rates. Tariff increases aim to cover the rise in marginal costs.

From the start of the implementation of reforms.

This also comes as the utility’s sales slightly decline towards the end of the projection period as a result of the depreciation of the current generators. It should be noted the AfDB project does not envisage new power plants only the refurbishment of the existing capacity.

From the start of the implementation of reforms.

In this case operational profits are not expected to before 2019.

By 2022 operational losses will be 56 percent higher under the infrastructure only scenario (S2b) than the no reforms scenario (S2). Indeed these losses will register KMF5.7 bln. in (S2a) compared to KMF3.7 bln. in (S1).

The additional maintenance costs and financial counterpart arising from the project financed by AfDB are considered in the tool as non-operating costs. The rationale is that these payments are extraordinary items that are made on a specific timing (once every two years as per the AfDB estimates). Regular yearly maintenance and other costs incurred, on the other hand, are assumed in the model to grow with inflation (in all scenarios).

Amortization costs are also included as non-operational costs and hence affect net earnings.

Due to the strategic importance of these investments the government will have to step-in and provide this direct financial support as to push forward with these projects. However, since these are physical assets that will be owned and managed by MA-MWE, costs incurred should be born on its financial statements especially when the company is making operational profits.

S2D assumes that prices of diesel purchased by MA-MWE
follow closely the variation in international oil prices, and the company no longer procures its fuel needs at the current fixed price of KMF400/liter. In this scenario the utility benefits from both the steep drop in oil prices starting in 2015 (37.6 percent drop) and the expected lower prices of oil going forward. Average yearly prices projected by the World Bank Commodities Review are used throughout the projection period to track international oil prices (the yearly average throughout the projection period is 6 percent). A 15 percent premium is added to account for additional governance and/or lack of economies of scale costs. Moreover, prices were computed using exchange rate projections from the IMF article IV (January 2015). Although not discussed in this report, the tool does allow for exchange rate shocks.

A new competitive process for fuel procurement is currently being piloted by SCH with support from the Islamic Development Bank. The success of this process enables further liberalization of diesel prices. Hence, Scenario S2d illustrates the trends and impact from such potential action.

In doing so, the share of administrative costs to operating expenses is reduced to an average of 18 percent over the projection period.

The characteristics of the loan are the following. Amount: US$40.6 million; Maturity: 23 years; Grace Period: 11 years; Interest: 1.75 percent (paid in year 1); Grant Element: 36 percent (according to IDA grant element calculator). The cost of construction of the HFO plant is estimated at US$35.4 million. While the use of the remaining credit line remains unclear, the scenario assumes interest payments on the amount withdrawn for the construction of the plant. Source: GoC – India EXIM bank dollar credit line terms contract.

According to World Bank (2012) HFO prices are projected at KMF268 per liter as opposed to the contractual price of Diesel KMF400 per liter.

The scenario assumes that the MoF will enforce payments at the existing corporate tax rate of 35 percent.

This is a World Bank funded study that is part of MA-MWE’s Recovery Plan.

Due to data shortages, the base year in the model is 2013. The 2014 figures are estimates based on similar conditions as 2013.

The subsidy is primarily labelled in the tool as “oil subsidy”. However the tool also allows modeling other types of transfers to MA-MWE such as transfers for investments or equity injections.

Subsidy is defined as equal to revenues from sales – costs of production and maintenance excluding wages and salaries. In the case of operating profits the subsidy is automatically set at zero.

Taxes are identified in the model as income tax and taxes on purchases of goods and services such as excises.

This includes potential loans contracted by MA-MWE from the Government.

This includes transfers from MA-MWE to MoF for repayments of arrears owed to the central Government.

The macro assumptions in this report will be fixed across the various scenarios. However, users of the tool can and may want to simulate macro shocks notably those related to inflation or exchange rate. Many projected indicators are sensitive to changes in these parameters. Examples can be given from costs of fuel, investments and maintenance, growth in services sales, and others.

To simplify the inputs of the tool, average tariffs are considered instead of tariffs per industry or type of users (low vs. medium voltage). The tool could be modified to accommodate for a disaggregation of tariffs, unfortunately data at such level were not available to the report.

For details about the project refer to Project Appraisal Document 553, World Bank, August 2013.

These institutions are the Ministry of energy, the utilities and other relevant stakeholders.

The cost of the project is estimated at US$20 million.


Additional capacity storage is planned in the project to increase reserve of fuel from 4 to 30 days in Ngazidja and from 2 to 30 days in Mohéli.

This will also provide further energy security to the country, given its dependency on imports.

The project is expected to finance the deployment of 50KW of PV panels for households in rural areas.

This is a 0.16 MW of solar energy production in the island of Mohéli.

Further support for development of renewable energy is therefore needed and the planned feasibility studies financed by AfDB on geothermal, hydro and wind power potential will inform future investments.

According to the Recovery Plan for MA-MWE, the cost of...
diesel-based generation is 133 KMF/KWh compared to the expected 56 KMF/KWh for HFO generation in Comoros.

2019 is the working assumption of the government. However due to past experience in project implementation in Comoros, this date is expected to slip further.

This project has a potential to change the landscape of the energy sector in Comoros. However since too many uncertainties are attached to it, this note will not consider it in its simulations.