August 2006
IMF Country Report No. 06/306

Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Republic of Madagascar

In the context of the request for a three-year arrangement under the Poverty Reduction and Growth Facility and activation of the trade integration mechanism, the following documents have been released and are included in this package:

- the staff report for the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism, prepared by a staff team of the IMF, following discussions that ended on May 31, 2006, with the officials of Republic of Madagascar on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 6, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of July 21, 2006 updating information on recent developments.
- a Press Release summarizing the views of the Executive Board as expressed during its July 21, 2006 discussion of the staff report that completed the request.
- a statement by the Executive Director for Republic of Madagascar.

The documents listed below have been or will be separately released.

Joint Staff Advisory Note of the Poverty Reduction Strategy Paper Progress Report Annual Progress Report
Letter of Intent sent to the IMF by the authorities of Republic of Madagascar*
Memorandum of Economic and Financial Policies by the authorities of Republic of Madagascar*
Poverty Reduction Strategy Paper Annual Progress Report
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

Request for a Three-Year Arrangement
Under the Poverty Reduction and Growth Facility
And Activation of the Trade Integration Mechanism

Prepared by the African Department
(In consultation with other Departments)

Approved by Thomas Krueger and Anthony Boote

July 6, 2006

- Discussions on a medium-term economic program that could be supported by a new three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) were held in Antananarivo during June 27–July 8, 2005, October 5–14, 2005, December 8–15, 2005, February 16–28, 2006, and May 22–31, 2006.

- The Malagasy representatives included Mr. Radavidson, Minister of Economy, Finance, and Budget; Mr. Ravelojaona, Governor of the Central Bank of Madagascar; and other ministers and senior government officials in charge of economic and social affairs. The mission also met with members of Parliament and representatives of the donor community, the private sector, non-governmental organizations, and the press.

- Madagascar's outstanding use of Fund resources through April 2006 amounted to SDR 11.35 million (9.29 percent of quota). Madagascar reached the Completion Point under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative in October 2004. In January 2006, it also received debt relief from the Fund under the Multilateral Debt Relief Initiative (MDRI). Effective September 18, 1996, Madagascar accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the Fund's Articles of Agreement.

- The Letter of Intent (LOI), Memorandum of Economic and Financial Policies (MEFP), and the Technical Memorandum of Understanding (TMU) are in Appendix I, and relations with the Fund in Appendix II and with the World Bank Group in Appendix III. Appendix IV presents a debt sustainability analysis and Appendix V discusses statistical issues.

Contents Page

Figures

Text Boxes

Text Tables

Tables

Appendices

EXECUTIVE SUMMARY AND KEY ISSUES FOR DISCUSSION

Although Madagascar faces difficult challenges, the authorities are committed to reform and are taking strong measures to accelerate the country's economic development. Madagascar is among the poorest countries in sub-Saharan Africa, has one of the lowest tax revenue-to-GDP ratios in the world, faces persistent weaknesses in public financial management (PFM), has a shallow financial sector, and is vulnerable to shocks. To address these challenges and make progress in meeting the Millennium Development Goals (MDGs), the authorities are requesting a new three-year arrangement under the Poverty Reduction and Growth Facility (PRGF). The authorities' program aims to sustain economic growth, promote fiscal consolidation, broaden and deepen the financial sector, and alleviate poverty, while reducing vulnerability to shocks. The authorities are also requesting activation of the Trade Integration Mechanism (TIM) to assist the country in dealing with the possible impact of shocks in the textile sector.

Do Directors agree with the macroeconomic policy stance envisaged under the authorities' program?

The authorities intend to maintain a prudent monetary and exchange rate policy with a view to bringing inflation down to single digits and limiting central bank intervention in the foreign exchange market to smoothing large fluctuations and meeting the reserve target. Their overall fiscal deficit target is broadly consistent with their inflation and debt sustainability objectives. Do Directors concur that the program is sufficiently ambitious?

Do Directors agree that sustained progress toward achieving the MDGs will require raising domestic revenue?

The authorities' objective is to raise the tax revenue-to-GDP ratio from 10.1 percent in 2005 to 12 percent by 2008 through a concerted effort to simplify the tax system, broaden the tax base, and strengthen revenue collection and enforcement. Do Directors consider the strategy as broadly appropriate and the targets as sufficiently ambitious?

Do Directors agree that improving PFM should also be one of the pillars of the PRGF-supported program?

The authorities have revised their medium-term PFM action plan, are carrying out an audit of the expenditure commitment process, and are putting in place a system of monthly ministerial expenditure commitment plans. Do Directors agree with these priority areas?

Do Directors agree that Madagascar should rely mainly on grants and highly concessional debt for foreign financing?

While the country's debt is low, particularly in the aftermath of the Multilateral Debt Relief Initiative (MDRI), the level of investment needed to halve poverty by 2015 could require substantial increases in foreign grants and other resources. Do Directors agree that if sufficient levels of grants are not forthcoming, Madagascar should finance needed investment with debt on highly concessional terms?

I. BACKGROUND

1. **Madagascar is one of the poorest countries in sub-Saharan Africa, ranking 146 out of 177 on the United Nations Human Development Index**. Economic development has been hampered by such factors as low domestic savings, poor social and economic infrastructure, uneven application of government regulations, and most recently, power outages owing to a financial crisis at the national public utility company (JIRAMA).

2. **The country has one of the lowest tax revenue-to-GDP ratios in the world** (10.1 percent in 2005). This impedes the authorities' ability to finance critical development expenditure and mobilize donor assistance. These problems, combined with persistent weaknesses in PFM, exacerbate an already tenuous fiscal situation.

3. **Madagascar's economy is vulnerable to exogenous shocks,** such as intermittent cyclones and drought, volatility in key commodity prices (notably for oil and vanilla), the termination of the Agreement of Textiles and Clothing (ATC) in early 2005, and the expected termination in 2007 of the third party provision under the U.S. African Growth and Opportunity Act (AGOA).

4. **To address these challenges, the authorities are requesting a new three-year arrangement under the PRGF to support their economic program for 2006-08**. The goals of the program are to sustain economic growth, promote fiscal consolidation, and alleviate poverty, while reducing vulnerability to shocks. Access requested is an amount equivalent to SDR 54.99 million (45 percent of quota), reflecting the strength of the program and the balance of payments need. Seven disbursements would be phased uniformly over the three-year period (Table 1).

5. **The authorities also request activation of the TIM** to help the country deal with expected shocks in the textile sector such as those from the ATC and AGOA terminations. Should the impact of these shocks during the arrangement be worse than anticipated in the base case scenario (see Table 12), the authorities would like to reserve the possibility of augmenting access of up to 10 percent of quota under TIM's deviation feature (LOI para. 4).

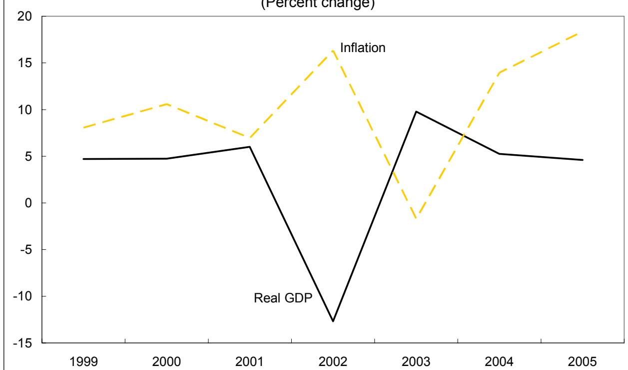
6. **The authorities response to past Fund policy advice has been mixed.** As the 2005 ex-post assessment (EPA) noted, this is principally because there have been persistent weaknesses in PFM and limited institutional capacity. Since 2005, the country has benefited from Fund technical assistance in the areas of revenue administration, PFM, and a Financial Systems Assessment Program (FSAP). In addition, the central bank has benefited from a Safeguards Assessment. The authorities have incorporated the main recommendations in each of these areas into their economic program and hope to benefit from additional technical assistance.

7. **Political stability has been restored, following the 2001 political crisis.** Presidential elections are scheduled for December 2006 and parliamentary, regional, and municipal elections for 2007.

II. Recent Economic Developments

8. **Economic growth slowed in 2005.** Despite a strong performance from the agriculture, tourism, construction, and (to a lesser extent) export sectors, real GDP grew by 4.6 percent in 2005 compared to 5.3 percent in 2004 (Figure 1). The drop was largely due to increases in oil and electricity prices and periodic electricity blackouts owing to the financial crisis at JIRAMA. By early 2006, power outages had subsided.

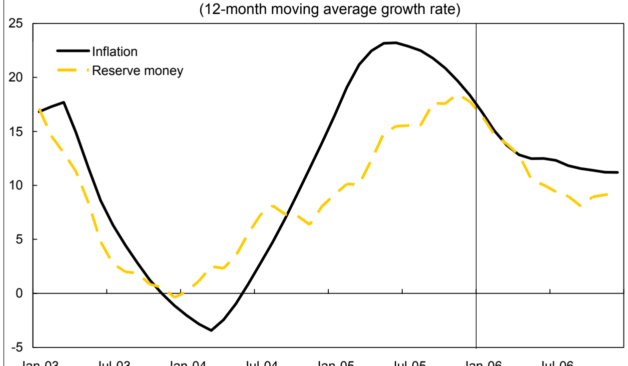
Figure 1. Madagascar: Real GDP and Inflation, 1999-2005
(Percent change)



Source: Malagasy authorities.

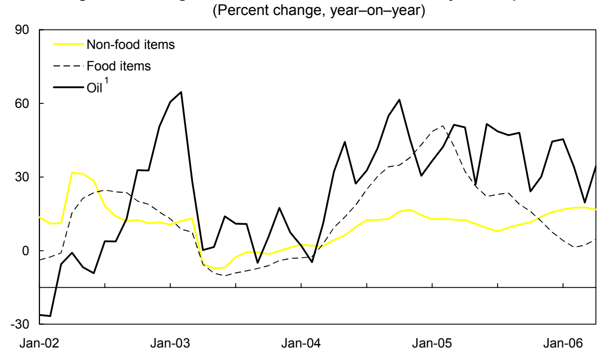
9. **Though headline inflation has declined since early 2005, rates remain in double digits.** Inflation (12-month moving average) fell from 18.4 percent in 2005 to 14 percent at the end of the first quarter of 2006 (Figure 2a). This reflected a sharp decline in food prices (Figure 2b), while nonfood price inflation was affected by a rise in world oil prices and domestic electricity tariffs and by the depreciation of the ariary. By the end of the first quarter, the nominal effective exchange rate depreciated by about 9 percent over the previous 12 months, leaving the real effective exchange rate fairly flat and well below the level it had reached before the 2004 devaluation. (Figure 3).

Figure 2a. Madagascar: Inflation and Reserve Money, 2003-2006
(12-month moving average growth rate)



Source: Malagasy authorities.

Figure 2b. Madagascar: Consumer Price Index, January 2002–April 2006
(Percent change, year–on–year)

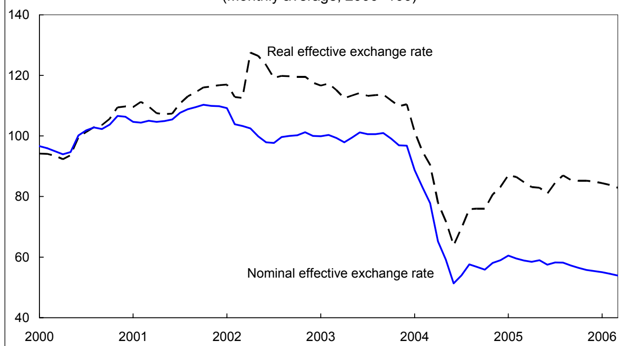


Source: Malagasy authorities.
[1] Simple average of three spot prices; Dated Brent, West Texas Intermediate, and the Dubai Fateh.

10. **Broad money growth declined sharply in 2005, but credit to the private sector was strong** (Figure 4**).** The central bank tightened monetary policy in early 2005, and by end-December broad money growth had decelerated to 3 percent (year-on-year), while real interest rates rose. The share of treasury bills held by the nonbank sector increased owing to their higher interest rates relative to commercial bank deposit rates and because treasury bills were issued in smaller denominations, which attracted more nonbank buyers (Figure 5).[1] The corresponding decline in commercial banks' holdings of treasury bills, combined with an increase in bank earnings and paid-in capital, allowed credit to the private sector to increase by 22 percent, which went principally to petroleum importers. Financial markets remained tight in the first quarter of 2006, with broad money growing at an annual rate of only 6 percent compared to annualized inflation rate of about 10 percent. Nominal treasury bill yields rose 2 percentage points owing to exceptionally high domestic financing of the budget. There were signs of increased liquidity in May, however, as treasury bill holdings declined and bank deposits increased.

Figure 3. Madagascar: Real and Nominal Exchange Rates, January 2000–March 2006

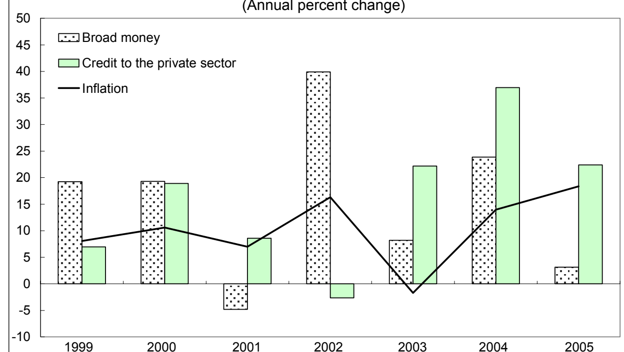
(Monthly average, 2000=100)



Source: INS: *Information Notification System*.

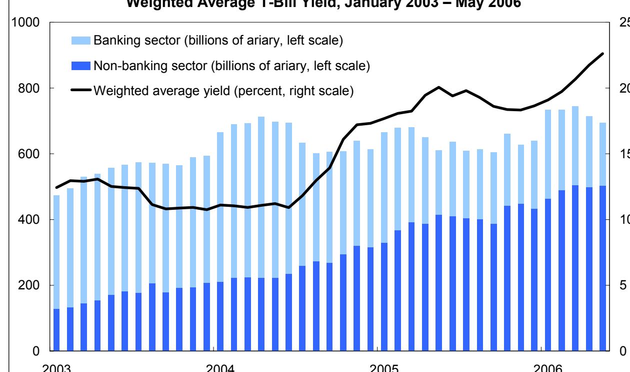
Figure 4. Madagascar: Broad Money, Average Inflation and Credit to the Private Sector, 1999-2005

(Annual percent change)



Source: Malagasy authorities.

Figure 5. Madagascar: Total Stock of Outstanding T-Bills and the Weighted Average T-Bill Yield, January 2003 – May 2006



Source: Malagasy authorities.

11. **The banking system is profitable and well-capitalized** (Text Table 1). Soundness indicators generally improved in 2005 and into the first quarter of 2006; capital adequacy and liquidity ratios rose and the share of nonperforming loans declined.

[1] The nonbank share of total treasury bills rose from 52 percent in December 2004 to 69 percent in December 2005.

Text Table 1. Madagascar: Bank Soundness Indicators, end-of-period 2001 - 2006Q1

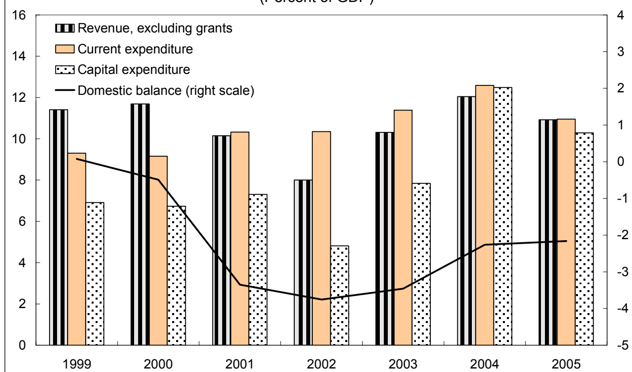
	2000	2001	2002	2003	2004	2005	2006 Q1
Capital adequacy				(Ratio; percent)			
Regulatory capital to risk-weighted assets							
Lowest ratio	10.1	12.0	11.4	10.7	7.2	8.8	10.3
Highest ratio	32.2	34.1	38.7	38.5	31.3	197.8	273.1
Asset quality							
Nonperforming loans to total gross loans	8.4	10.3	19.6	16.7	11.5	9.5	8.6
Earnings and profitability							
Return on assets	4.0	2.8	1.1	3.2	4.0	5.0	4.7
Return on equity	47.0	39.0	16.0	54.7	62.3	89.1	77.6
Noninterest expenses to gross income	45.4	48.9	52.2	46.9	44.8	42.2	45.2
Personnel expenses to noninterest expenses	38.4	35.3	38.3	38.9	35.4	36.4	36.4
Liquidity							
Liquid assets to total assets	36.9	44.2	52.1	50.5	47.4	43.4	43.7
Liquid assets to short-term liabilities	62.2	70.0	77.8	73.2	67.6	61.3	62.8
				(Billions of ariary)			
Memorandum items:							
Total assets	1,133.6	1,344.6	1,393.0	1,537.2	2,006.6	2,209.2	2319.6
Total profits before tax	45.3	37.3	15.9	49.9	80.2	111.3	27.3
Foreign exchange exposure limit (highest ratio)	...	17.2	19.6	58.3	127.2	16.8	10.0

Source: Banking and Financial Supervision Commission, Central Bank of Madagascar (BCM).

12. **Revenue shortfalls persisted throughout 2005 and into the first quarter of 2006.** The authorities did step up their efforts to improve revenue collection following a poor performance in the first half of 2005 and after the exoneration scheme for capital goods imports was phased out in September. However, revenue fell well below budget because of ad hoc exemptions from customs taxes, exonerations from pre- and post-shipment inspection, and shortfalls in collection of taxes on government-sponsored emergency rice imports. Customs revenue shortfalls continued into early 2006, although this was principally due to lower capital goods imports as private operators drew down the sizable stocks they had accumulated before the exoneration scheme was terminated. Similarly, in the third quarter of 2005 domestic tax collection fell because of slippages in tax administration, but rebounded in the first four months of 2006 and were on track by May.

13. **Inadequate PFM resulted in spending overruns in the second half of 2005.** The authorities were unable to reduce spending in line with the revenue shortfalls owing to lack of institutional capacity to control expenditure commitments. Expenditure overruns in the second half of 2005 were equivalent to 1 percent of GDP and the domestic fiscal deficit[2] was more than double the agreed target (Figure 6). In the first quarter of 2006, expenditure commitments were lower than projected because there were continued difficulties in adopting the new program budget classification scheme. Yet, in spite of the revenue shortfalls, the domestic fiscal deficit at end-March 2006 was lower than targeted (Table 5).

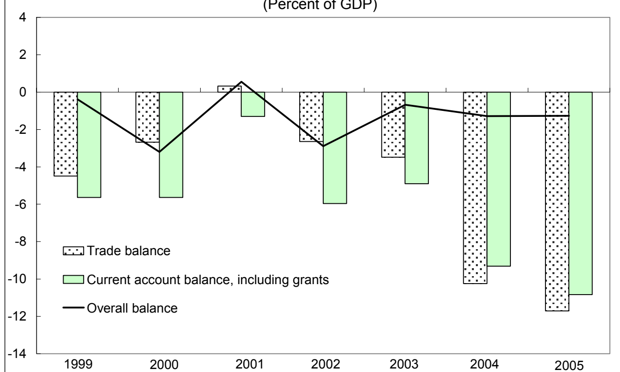
Figure 6. Madagascar: Fiscal Developments, 1999-2005
(Percent of GDP)



Source: Malagasy authorities.

14. **The external current account deficit including grants (as a share of GDP) widened in 2005, in part because the terms of trade deteriorated** (Figure 7). A sharp fall in vanilla prices and a decline in shrimp exports attributed principally to over fishing resulted in a substantial decline in merchandise export receipts. A further drop in export prices and a reduction in export volumes seem likely in 2006. Import volumes also fell in 2005, consistent with the slowdown in economic activity. Capital goods imports, which had risen steadily in 2004 and most of 2005, declined sharply toward the end of the year and into the first quarter of 2006 because the duty exoneration scheme was terminated. As prices of energy-related imports leaped, the terms of trade deteriorated further. A strong performance in tourism, however, helped the current account balance despite concerns early in 2006 over an outbreak of *Chikunguya* (a sometimes fatal mosquito-borne disease). External grants declined during 2005, as the composition of the World Bank assistance shifted away from grants towards loans. The overall balance deteriorated slightly in 2005; foreign assistance inflows (loans and

Figure 7. Madagascar: External Balance, 1999-2005
(Percent of GDP)



Source: Malagasy authorities.

[2] The domestic fiscal balance is defined as total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure. The staff believe that this indicator best captures the authorities' fiscal effort.

grants) were lower relative to the peak levels of 2004 (Table 6). Gross foreign reserves rose slightly to an estimated 2.9 months of imports of goods and services at the end of April 2006.

15. **Madagascar is eligible for debt relief under the MDRI amounting to an expected US$2.4 billion (43 percent of GDP).** The IMF granted US$197 million in debt relief in January 2006. MDRI relief from the African Development Fund (US$327 million) and from the International Development Agency (US$1,878 million) is expected to be approved in July 2006.[3]

III. Medium-Term Outlook and Policies

16. **The authorities' medium-term economic strategy is grounded in their Poverty Reduction Strategy Paper (PRSP), which was updated in June 2006**.[4] They believe that attaining the MDGs will depend critically on strong real GDP growth and good economic management. To this end, they have built their strategy on three key pillars: (i) reducing fiscal imbalances; (ii) strengthening PFM; and (iii) broadening and deepening the financial sector. They are also harmonizing business procedures and regulations with a view to improving investor confidence.

A. Medium-Term Outlook

17. **The authorities' baseline scenario foresees strong economic growth, but is insufficient to achieve the MDGs**.[5] Real GDP is projected to increase by 5.6 percent annually over the medium term, supported by strong performance in construction, mining, and tourism. After an initial rise in spending on social and economic infrastructure, public investment is expected to decline to sustainable levels. Private investment is assumed to rise over the medium term as the investment climate improves and macroeconomic policies stabilize. Inflation is projected to decline gradually to 5 percent by 2009.

18. **The fiscal outlook is expected to improve in the medium term** (Text Table 2 and Table 4). Total revenue should grow by 1.5 percent of GDP during the program period (2006-08) owing to tax administration reforms and the termination of ad hoc tax and duty exemptions. Domestically-financed expenditures are targeted to increase by about 0.5 percentage point of GDP during the same period, resulting in an improvement of the

---

[3] The large stock adjustments resulting from the MDRI distort many of the annual indicators for 2006.

[4] The authorities are working on their second-generation PRSP, the Madagascar Action Plan (MAP), which will be finalized by the end of this year.

[5] See alternative scenario in Section B below and the Joint Staff Assessment Note (forthcoming).

domestic fiscal balance by almost 1 percent of GDP. Interest payments on foreign debt and foreign-financed capital expenditure should together decrease by 1 percent of GDP over the same period owing to MDRI relief and a gradual return of foreign assistance to historical averages after the post crisis peak in 2004. Therefore, the overall fiscal deficit (on a commitment basis, excluding grants) is expected to decline from 10.4 percent of GDP in 2005 to 8.5 percent in 2008. This is consistent with the authorities' inflation and debt sustainability objectives. The deficit is expected to be financed principally by foreign grants and loans on IDA terms.

Text Table 2. Madagascar: Fiscal Indicators, 2005-08
(Percent of GDP) [1]

	2005 (a)	2008 (b)	(b) - (a)
Total revenue	10.9	12.4	1.5
Domestically financed expenditures [2]	13.1	13.6	0.5
Domestic balance	-2.2	-1.2	0.9
Foreign interest	1.0	0.4	-0.6
Foreign-financed capital expenditure	7.3	6.9	-0.4
Overall balance (commitment basis, excluding grants)	-10.4	-8.5	1.9
Grants	5.7	3.9	-1.8
Overall balance (commitment basis, including grants)	-4.7	-4.6	0.1

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections; see Table 4.

[1] Aggregates may differ from the sum of components due to rounding.

[2] Includes current expenditure with the exception of foreign interest obligations, domestically financed capital expenditure, and net cost of structural reforms.

19. **The external outlook is also expected to improve**. Exports of key goods (mining, agro-industry, shrimps, and gems) and services (mainly tourism) are projected to rise given the low base and planned activities in the mining sector. Some projects in these sectors are being financed by the U.S. Millennium Challenge Corporation (agro-industry) and the World Bank (tourism and mining). Exports from export processing zones (EPZs), however, will remain sluggish, in large part because the third party provisions of the AGOA will expire in 2007. After declining in 2006 because of the elimination of the capital goods duty

exoneration scheme, import volume should pick up sharply in 2007 and 2008. Thereafter, growth in import volume is expected to slow somewhat though imports should grow at a rate higher than real GDP, given robust investment spending and the associated imports of capital goods and raw materials. Though the capital account is likely to be weaker over the medium term compared to recent years, when there were exceptionally high grants and concessional loans, foreign reserves would be maintained at the equivalent of at least 3 months of goods and services throughout the medium term.

20. **Madagascar's debt profile is sustainable.** A joint Bank/Fund debt sustainability analysis (DSA) based on the low-income debt sustainability framework (Appendix IV) reveals that the key debt indicators, which were already below the thresholds in 2005, will fall sharply in 2006 as MDRI debt relief is delivered. They are then expected to pick up, given the borrowing (assumed to be largely on IDA equivalent terms) needed to support investment and growth, but over the long term remain well below the debt sustainability thresholds. The analysis, however, identifies certain vulnerabilities. If borrowing occurs at unfavorable rates (200 basis points above the base case), the NPV of debt-to-exports ratio would breach the 150 percent threshold. Similarly, the same indicator would breach the threshold should there be large shocks to exports. These results underscore the fact that the program's trade-facilitating policies (para. 27) will be important to enhance competitiveness and that borrowing must be only on highly concessional terms.

B. "Scaling-Up" Scenario

21. **Madagascar's economy would need to grow annually by about 7.6 percent if it is to achieve the MDG target of reducing income poverty by half by 2015**. Such growth is attainable only if there is a large increase in private investment and a substantial scaling-up of donor assistance to finance infrastructure and other social spending. The authorities, with support from the IMF, World Bank, and UNDP staff, are developing a "scaling-up" scenario within the context of their MAP for the period 2007–2012. In the meantime, staff has assessed the investment levels and growth rates that would be required to halve extreme poverty by 2015 (Text Box 1, Text Table 3 and Table 13). Based on this preliminary analysis, to attain the average 7.6 percent GDP growth rate, real investment would need to grow at over twice the pace of real GDP and foreign inflows would need to increase to above 12 percent of GDP.

Text Box 1. Madagascar: "Scaling-Up" Scenario

The staff conducted a preliminary scaling-up exercise in order to estimate the GDP growth rates and aggregate levels of investment that would be required to achieve the income poverty MDG. Based on the 1990 extreme poverty benchmark of 59 percent and the 2004 benchmark of 56 percent, if Madagascar is to reach this MDG by 2015, extreme poverty would need to be reduced by about 27 percentage points. Using the estimated elasticity of poverty with respect to growth of -0.45, cumulative real per capita income would therefore need to grow by 59 percent over the next decade and overall real GDP by 107 percent (7.6 percent a year). Using a Cobb-Douglas production function that assumes constant shares of capital and labor, the staff estimated the average contributions of capital and labor to growth and found that the contribution of total factor productivity (TFP) has been highly variable in the recent past:

Percentage change in output = 0.46 * (Percentage change in capital) + 0.54 * (Percentage change in labor) + Growth in TFP

For the projection period, estimates of annual TFP growth of between 0.6 to 1.4 were used, based on recently observed behavior and expectations that better policies and more technology-based investment would raise and sustain TFP. The above long-run relationship was used to deduce the real investment levels needed to sustain the required growth rate.

A comparison of this scaling-up scenario with the base case scenario is shown in Text Table 2 and Table 13. To sustain an average annual real GDP growth rate of 7.6 percent, investment would need to increase by 16 percent a year in real terms so that the investment-to-GDP ratio rises to 35 percent by the end of the period. It is assumed that most of this investment would come from the domestic private sector, but foreign capital flows (foreign assistance and foreign direct investment) would need to rise to the equivalent of at least 12.5 percent of GDP, which would mean an annual increase of about SDR 275 million above the base case by the end of the period. To keep debt sustainable, such flows should ideally be in the form of grants and foreign direct investment, and there should be careful consideration of the institutional and economic capacity to absorb them.

Text Table 3. Madagascar: Long-Term Economic and Financial Indicators, 1996-2015					
	1996-2005 (Avg.)	2006-15 (Avg.)		2015	
		Base Case	High Case	Base Case	High Case
	(Percentage unless otherwise specified)				
Real GDP growth	3.2	5.6	7.6	5.8	8.9
Real GDP per capita, cumulative growth [1]	1.1	32.8	61.0	38,806	46,875
Poverty ratio (percent of population) [2]	58.3	49.5	44.7	41.9	29.1
Investment (share of GDP)	16.8	23.0	27.9	23.9	34.8
Foreign inflows (SDR millions) [3]	247	624	731	850	1,126

Source: Staff projections; see Table 13.

[1] 2015 value is in constant 1984 MGA per capita.
[2] Percentage of population in extreme poverty.
[3] External grants and loans and foreign direct investment.

C. Sustainable Public Finance

22. **The authorities recognize the need for fiscal discipline throughout the medium-term to keep debt sustainable and inflation expectations at bay.** To do this, they intend to mobilize domestic resources, strengthen PFM, seek grant and concessional financing, and improve debt management.

23. **Domestic resources will be mobilized.** The authorities' objective is to raise the tax revenue-to-GDP ratio from 10.1 percent in 2005 to 12 percent by 2008 through a concerted effort to simplify the tax system, broaden the tax base, and strengthen revenue collection and enforcement. They have already taken major strides by adopting a value-added tax (VAT) with a single rate for both local and imported goods and by streamlining the number of customs tariffs, excise taxes, and royalties. They intend to consolidate the tax system further by reducing the number of excise duties and by eliminating exemptions on the taxation of earnings. To broaden the tax base, the authorities will eliminate ad hoc tax and custom duty exemptions, phase out direct tax incentives under the EPZ regime (with grandfathering), take measures to capture the mining and tourism sectors in the tax net, and reallocate human resources in line with the revenue potential of the different taxpayer categories. To raise the quality of management, the authorities plan to put in place a more efficient human resource management system, with support from the Fund's Fiscal Affairs Department (FAD) and other development partners.

24. **PFM will also be strengthened** (Text Box 2). The authorities have revised their medium-term PFM action plan, in consultation with Fund staff and interested donors. The plan includes specific measures to strengthen budget preparation and execution, enhance public procurement laws and practices, improve accounting and reporting, and strengthen cash management so that domestic arrears do not accumulate. The authorities are committed

to strictly limiting the use of emergency spending procedures. Progress on the PFM action plan will be monitored through an annual Public Expenditure Financial Assessment (PEFA), undertaken with the assistance of development partners; the objective is to increase Madagascar's score by one grade letter for at least 5 of the 28 PEFA criteria by 2008. The authorities will strengthen the link between merit and pay increases while keeping the wage bill within the programmed envelope (MEFP para. 52).

Text Box 2. Madagascar: Public Financial Management

The Madagascar authorities adopted a new budget law in July 2004 that introduced three major innovations. First, the budget is drawn up and executed through programs linked to the country's poverty reduction objectives. Second, ministries benefit from increased flexibility in the management of their budgets. Third, budget controls are strengthened. But the switch to performance budgeting has been plagued with implementation problems; ministries were unprepared and had difficulty applying the new budget structure. Over the medium term, however, the new system should improve PFM because it is more flexible and facilitates allocation of resources according to priority programs and performance.

Madagascar suffers from persistent weaknesses in PFM. The main deficiencies are: (i) late budgetary preparation; (ii) consistent overestimation of tax revenue; (iii) inability to implement spending cuts; (iv) cash management based on incomplete information (this is owing to slow and incomplete reporting by public entities and decentralized government bodies, and the absence of monthly commitment plans by line ministries); and (v) a burdensome expenditure execution process with too many ex-ante administrative controls and no timely ex-post independent assessment by the audit court.

These weaknesses are being progressively addressed using an ambitious medium-term PFM action plan with support from development partners, including the IMF. The first PFM action plan was adopted in 2004/05 and updated in May 2006. It builds upon a PEFA that was completed in April and a donors' meeting in May (MEFP para. 33).

25. **Debt management will be strengthened**. Although its debt is sustainable, particularly in the aftermath of the MDRI, Madagascar will continue to need foreign assistance if it is to achieve the MDGs. While the authorities would like to benefit from foreign grants to the greatest extent possible, reliance on debt appears unavoidable. In the context of the MAP, the authorities will develop a debt strategy based on their contracting external debt on highly concessional terms, maintain low levels of domestic debt, and include contingent liabilities (MEFP para. 17). They will also strengthen capacity of the Ministry of Finance and the central bank to assess debt sustainability and efficiently manage the country's external obligations.

D. Monetary and Financial Sector Reforms

26. **To improve the investment climate and promote domestic savings, the authorities are implementing medium-term financial sector reforms**. Drawing on the recommendations of the 2005 FSAP and with support from the World Bank and the Millennium Challenge Corporation, the authorities intend to: promote regulatory reforms that will increase competition in the banking sector; align accounting and business reporting standards with best practices; modernize the national savings bank (the main way to access the banking system in rural areas); develop a credit bureau that is accessible to all credit institutions; and enhance the payments system to reduce delays and to attract more participants into the formal financial sector (MEFP paras. 40-42). They are also taking measures to deepen financial savings by expanding the government securities market. They will continue to decentralize the issuance of treasury bills to other major cities, reduce the minimum denomination, and consider issuing small-savers certificates. The monetary authorities plan to introduce additional instruments of indirect monetary control by securitizing government debt.

E. External Sector Policies

27. **The authorities will consolidate recent progress in trade liberalization.** They have recently simplified the tariff regime by reducing the number of non-zero tariff bands from four to three (5, 10, and 20 percent), thereby marginally reducing the average tariff rate. During the program period, the authorities will seek to address constraints impeding diversification of the country's export base, explore regional trade opportunities, adopt further trade facilitating measures such as significant customs administration reform (Text Box 3 below), additional simplification of the tariff code (MEFP paras. 25 and 45), and improved efficiency of the foreign exchange market (MEFP paras. 43). They also intend to assess the benefits of moving to a single (non-zero) unified tariff rate during the program period and determine whether such a measure could be revenue neutral. Madagascar recently joined the Southern African Development Community (SADC) and will seek to exploit export opportunities in the agriculture and textile sectors there. It is also a member of the Common Market for Eastern and Southern Africa (COMESA). COMESA members are negotiating a common external tariff while SADC has yet to initiate such negotiations. Should either of these tariff structures be more restrictive, Madagascar will need to choose between achieving its own more liberal and uniform tariff policy objective and remaining in the regional trade agreements. Madagascar is also playing a lead role in negotiating European partnership agreements related to the fishing sector, where it expects to gain better market access. The authorities are committed to maintaining a competitive managed floating exchange rate with no predetermined path that moves in line with economic fundamentals.

IV. Economic and Financial Policies for 2006

28. **For 2006, the authorities have set realistic, though ambitious, macroeconomic objectives.** Real GDP is targeted to grow at 4.7 percent, average inflation to hold at 11.2 percent in spite of the recent price shocks, and official reserves to remain at the equivalent to 2.9 months of imports of goods and services. The goal is to promote fiscal consolidation while aligning expenditure with Madagascar's PRSP objectives.[6] Despite the shortfalls in revenue and budgetary assistance in the first half of the year, the authorities intend to achieve an overall deficit (on a cash basis, excluding grants) equivalent to 10.8 percent of GDP, consistent with their macroeconomic objectives. To do so, they have had to reduce domestically financed spending across the board by the equivalent of about 1.7 percent of GDP. However, thanks to the resources freed up by the MDRI (equivalent to 0.6 percent of GDP), the authorities were able to reduce the planned cuts in priority sector spending. A supplementary budget with these changes will be submitted to Parliament in early July.[7] The overall fiscal deficit will be fully financed by grants and highly concessional loans from development partners. Achieving the program's objectives for 2006 will require a concerted effort on revenue mobilization, PFM, monetary and exchange rate management, and reform of JIRAMA.

A. Revenue Mobilization

29. **The authorities expect to use tax policy and administrative measures to increase the tax-to-GDP ratio by 0.9 percentage points of GDP** (MEFP paras. 24-29 and Text Box 3). In January 2006 they increased excise duties on gasoline by 66 percent and on diesel by 178 percent, bringing them in line with regional norms. They are also working hard to prevent revenue leakages by ceasing ad hoc exemptions and exonerations, and installing the ASYCUDA++ information system to minimize human discretion in customs clearance and valuation. The authorities are taking measures to improve VAT administration and will draw up an action plan to reorganize tax administration in line with the recommendations of the March 2006 FAD technical assistance mission.

---

[6] See Republic of Madagascar, Poverty Reduction Strategy Paper—Annual Progress Report and the related Joint Staff Advisory Note (forthcoming).

[7] Given that the government holds a majority in Parliament, passage in full is expected before end-July.

Text Box 3. Madagascar: Customs and Tax Administration Measures, 2006

Customs administration. The five priority customs administration measures are:

1. Eliminate ad hoc exemptions and exonerations;
2. Terminate exemptions on pre- and post-shipment inspection (PSI) for clearing goods and the valuation of imports by the PSI company;
3. Extend the new ASYCUDA++ software to the next five largest customs bureaus;
4. Track monthly and publish in the press all goods tax-exempted or not inspected by the PSI company; and
5. Use a "watermark" securing system to minimize risks in counterfeit customs documents.

Tax administration. The five priority tax administration measures are:

1. Improve confidence in the VAT system by granting refunds to exporters within 60 days, fully budgeting for government counterpart VAT obligations on foreign-financed projects, and auditing all government VAT-related arrears with a view to regularize them within the 2007 budget law;
2. Give attention to medium-size enterprises, while continuing to improve control over large enterprises;
3. Design and implement selective audits of the most important taxpayers;
4. Establish and monitor monthly performance indicators for tax revenue collectors; and
5. Draw up an action plan and timeline for strengthening domestic tax administration, drawing on recommendations from FAD.

B. Public Financial Management

30. **PFM will improve.** To avoid the spending overruns that occurred in 2005, the authorities are implementing measures to control expenditure commitments and payments (MEFP paras. 30-38). They are carrying out an analytical audit of the expenditure commitment process, to be completed in September. The authorities are putting in place monthly ministerial expenditure commitment plans so that the Treasury can keep spending in line with expected revenue and financial flows. They are also implementing their revised PFM action plan, including early preparation of the 2007 budget, installation of a new information system for tracking expenditure, and implementation of a new Procurement Code. Progress in strengthening PFM will be assessed in the next PEFA, to be conducted in early 2007.

31. **MDRI resources will principally be allocated to priority poverty-reducing spending and tracked.** The IMF MDRI resulted in a transfer of MGA 361.7 billion from the central bank to a special Treasury account at the central bank. The government plans to draw down these resources in ten equal annual installments and direct them into priority poverty-reducing spending to be specified in the annual budget laws. In the draft 2006 supplementary

budget, the government is allocating MGA 10 billion of IMF MDRI resources to a new social housing project. The remaining MGA 26.2 billion, along with MGA 37.2 billion of International Development Agency and African Development Fund MDRI relief, will mainly be used to cover the government's domestic counterpart obligations related to donor-financed priority spending in agriculture, education, health, infrastructure, environment, and justice. The use of MDRI resources will be tracked through the new budget execution information system (SIGFP).

C. Monetary and Exchange Rate Policies

32. **Monetary policy discussions centered on the appropriate inflation target for 2006.** While the authorities' medium-term inflation target is still at 5 percent, they said that an inflation rate below 11 percent for 2006 was not feasible. Continued inflationary pressures reflected the impact of: (i) insufficient rain which will effect both hydroelectric production and the next harvest; (ii) JIRAMA utility price increases; (iii) reimposition of tariffs on capital goods imports; and (iv) the continued depreciation of the ariary.

33. **The monetary stance will be kept tight throughout 2006 to prevent a spillover of energy-related price increases into general inflation.** The authorities intend to keep the rate of growth in broad money below that of nominal GDP growth. The program calls for growth in reserve money of about 12 percent (year-on-year) compared with a target growth in nominal GDP of 17 percent. In light of the higher inflation, interest rates are expected to rise, thereby increasing the money multiplier. The authorities will continue to use their current indirect monetary instruments (appel d'offre, reserve requirement ratio, and central bank rate) to better manage banking sector liquidity.[8] The government's borrowing needs during the third quarter could rise sharply if there are delays in the disbursement of donor budget assistance and could create a shortage of liquidity in the banking system that may require central bank intervention. Central bank credit to the government will be limited to: (i) providing statutory advances to the government equivalent to 10 percent of last year's fiscal revenues, and (ii) disbursing annual flow relief from the IMF MDRI account (MGA 36.2 billion). In addition, government repayment of consolidated debt to the central bank will effectively limit net credit to government to about zero throughout the medium term.

34. **The authorities will continue to maintain a managed floating exchange rate regime with no predetermined path.** Because the interbank foreign exchange

---

[8] Liquidity management is largely done through the appel d'offre (buying and selling of commercial bank deposits), although the monetary authorities also can use the reserve requirement (presently 15 percent) and the central bank rate (presently at 16 percent).

market (MID) is shallow and is dominated by a few large banks with no outside players, it does not always function based on market fundamentals. The authorities are committed to: (i) enforcing commercial bank compliance with the MID's operating guidelines; (ii) publishing the rate and volume of each transaction, along with the average weighted rate, to improve transparency; (iii) enforcing two-way quotation of prices by all banks; and (iv) developing forward markets. The central bank will limit its interventions to smoothing large variations in the exchange rate and meeting its foreign reserve target. Additional technical support from the IMF to address market imperfections and to improve the functioning of the MID is planned.

35. **The authorities have accepted the main recommendations of the Safeguards Assessment Report**. Specifically, they will: (i) strictly limit all transactions between the government and the central bank to those permitted by the Central Bank Statute; (ii) arrange for the internal auditor to verify quarterly monetary program data submitted to the Fund; (iii) adopt the use of international financial reporting standards (IFRS) to be phased in over the next two years, with the assistance of an experienced international audit firm; and (iv) retain all profits for 2005. The authorities were considering staff's suggestions to distinguish between realized and non-realized foreign exchange gains for the purpose of paying dividends to the government.

D. Reform of JIRAMA

36. **The authorities have taken action to address the financial and structural problems facing JIRAMA.** They put in place a private management contract with support from the World Bank, and have increased electricity prices by 93 percent in the past year (MEFP para. 54). They have also finalized a comprehensive restructuring plan, which was presented to donors in early 2006. The authorities have received financing assurances for JIRAMA's investment program which is aimed at rehabilitating and modernizing the utility's production technologies away from reliance on fuel oil and toward hydro-electricity. The authorities have taken a decision to grant a long-term private concession for JIRAMA, where remuneration will be linked to operating profits once the current flat-fee management contract expires early next year. The private operator would not, however, be responsible for underwriting the investment program, which is being financed by donors. Together, these actions are expected to eliminate the frequent power outages that have hampered economic activity over the past years and to place JIRAMA on a sustainable financial path.

V. Program Monitoring and Targets

37. **Madagascar's capacity to repay the Fund is good.** Debt service to the Fund is projected to remain modest at 0.1 percent of exports of goods and services for the foreseeable future, following the cancellation of obligations owed to the Fund under the MDRI.

Implementation of the Safeguards Assessment recommendations will improve the financial position and institutional capacity of the central bank.

38. **Program reviews will be semi annual.** The reviews will be linked to the end-July and end-December test dates in 2006 and to the end-June and end-December test dates in 2007 and 2008. Indicative targets will be established each year for end-March and end-September to allow quarterly assessment of progress under the program.

39. **Quantitative performance criteria (PCs)** apply to: (a) a ceiling on external payments arrears; (b) a ceiling on nonconcessional external borrowing; (c) a floor on the accumulation of net foreign assets by the central bank; (d) a ceiling on the accumulation of net domestic assets of the central bank; (e) a ceiling on domestic financing of the budget; (f) a floor on tax revenue of the central government; and (g) a ceiling on the accumulation of domestic arrears (MEFP Table 1).

40. **Structural performance criteria and benchmarks apply to the priority areas of the program.** The authorities have committed to: (a) eliminate ad hoc tax and custom duty exonerations; (b) abolish exoneration from valuation of imported goods by the custom inspection company; (c) limit transactions with the central bank to those authorized by its charter (all continuous PCs); (d) impose monthly ministerial spending aligned to the latest Treasury cash flow projections; and (e) audit VAT arrears of the government on capital expenditure so that they can be regularized (both PCs for end-September). Given the need to address persistent problems at JIRAMA, in revenue mobilization, and in PFM, as well as the fact that this is a presidential election year, the program has been front-loaded with prior actions (MEFP Table 2). The first review will attach particular importance to progress in tax administration (MEFP paras. 24-29).

VI. Risks

41. **There are risks to program implementation as illustrated by the lengthy discussions required to negotiate the PRGF arrangement**. Inadequate institutional capacity in macroeconomic and financial management could jeopardize the program reforms. Weather-related shocks, volatility in key commodity prices, and possible trade shocks could also disrupt the reform effort. There is uncertainty about the projected level and profile of tax revenue, donor support (especially grants), and private investment that would be required to achieve the growth envisaged under the program. Finally, while the authorities have indicated that they are committed to improving domestic revenue collection and keeping spending at levels consistent with achieving their macroeconomic objectives, there may be pressures for them to do otherwise during the period leading up to, and immediately after, the presidential elections.

VII. Staff Appraisal

42. **The authorities have improved policy implementation in preparation for a new PRGF arrangement.** They have taken measures to remedy policy slippages due to weak institutional capacity. Notably, the authorities have incorporated Fund technical assistance recommendations and policy advice, as well as recommendations of other stakeholders, into their program. As an indication of their political commitment, they have created a monitoring committee to facilitate program implementation in the wake of the MDRI.

43. **The government's economic program is appropriately aligned with its poverty reduction and growth strategy**. Staff welcomes the authorities' intention to develop a "scaling-up" scenario within the context of the MAP, and concurs that the baseline scenario should serve as the basis for economic planning until such additional concessional resources materialize.

44. **Recent efforts to improve domestic resource mobilization are appropriate.** The focus is rightfully on raising oil excise duties to regional norms, broadening the tax net, (including through the elimination of ad hoc tax and duty exemptions), making revenue collection more efficient, and strengthening monitoring and control, particularly regarding large and medium-size taxpayers.

45. **There has been good progress in strengthening PFM.** The PFM action plan provides a prioritized agenda for addressing key deficiencies and the PEFA provides a firm foundation for monitoring progress in this area. The issuance of monthly spending commitment ceilings during the remainder of 2006 and the accelerated budget preparation process for 2007 should facilitate budget design and execution.

46. **The authorities have taken difficult measures to reduce spending, so as to ensure that their macroeconomic objectives will be achieved.** They should endeavor to base the 2007 and subsequent budgets on realistic revenue and financing assumptions and include contingent spending plans in the event that resources are higher or lower than envisaged.

47. **Monetary policy is appropriately tight in the face of the recent exogenous shocks.** The program's inflation objectives are realistic and the authorities should remain vigilant in bringing inflation down to single digits. While nonperforming loans are low relative to other countries in the region, the authorities should ensure that growth in credit does not result in a deterioration in the quality of loans.

48. **The managed float with no predetermined path exchange rate regime is also appropriate, particularly given the economy's vulnerability to shocks**. The central bank

should continue to limit interventions to smoothing large variations in the exchange rate and achieving the reserve target.

49. **Reducing both the number and levels of tariffs has brought substantial progress in trade liberalization.** Movement toward a revenue-neutral, single non-zero tariff should be carefully studied, taking into consideration regional arrangements.

50. **The authorities have taken appropriate action to address the financial and structural problems facing JIRAMA.** Announcing and staggering power blackouts should minimize economic disruptions until the new technologies are in place.

51. **The debt situation is sustainable, especially in the aftermath of the MDRI.** Capital inflows are needed to reach the MDGs. Debt-creating capital inflows will be monitored carefully using the low-income DSA. The authorities' policy of contracting debt only on highly concessional terms is appropriate.

52. **There are significant risks to program implementation.** Institutional capacity constraints, exogenous shocks, uncertainty over donor assistance, and political pressures emanating from the presidential elections could delay program implementation.

53. **Staff recommends approval of the authorities' request for an arrangement under the PRGF and supports the activation of the TIM**. The program, though ambitious, is achievable. The authorities are taking appropriate actions to ensure satisfactory implementation of their program, including through additional technical assistance and training.

Table 1. Madagascar: Tentative Work Program Under the New Three-Year PRGF Arrangement, 2006–08

Date	Action	Disbursement
July 2006	Executive Board consideration of the request for a new three-year PRGF arrangement	SDR 7.856 million
On or after November 30, 2006	Board consideration of the first review	SDR 7.856 million
On or after April 30, 2007	Board consideration of the second review	SDR 7.856 million
On or after October 31, 2007	Board consideration of the third review	SDR 7.856 million
On or after April 30, 2008	Board consideration of the fourth review	SDR 7.856 million
On or after October 31, 2008	Board consideration of the fifth review	SDR 7.856 million
On or after April 30, 2009	Board consideration of the sixth review	SDR 7.854 million

Table 2. Madagascar: Selected Economic and Financial Indicators, 2004-11

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
	(Percentage change, unless otherwise indicated)							
National income and prices								
Nominal GDP growth	20.3	23.8	16.8	16.0	13.2	11.5	11.0	11.0
Real GDP growth	5.3	4.6	4.7	5.6	5.6	5.6	5.6	5.6
GDP deflator	14.3	18.3	11.5	9.9	7.2	5.6	5.1	5.1
Consumer price index (period average)	13.9	18.4	11.2	9.6	7.0	5.5	5.0	5.0
Consumer price index (end of period)	27.3	11.4	11.3	8.0	6.0	5.0	5.0	5.0
External sector								
Export, f.o.b	0.1	-15.3	1.7	7.5	6.6	6.4	6.5	6.6
Imports, c.i.f.	20.7	-0.7	0.5	8.4	5.6	6.1	5.6	5.9
Export volume	5.6	13.4	-1.6	4.1	5.2	6.2	6.2	6.5
Import volume	7.4	-11.6	-9.7	6.6	6.6	6.1	6.2	6.3
Terms of trade (deterioration -)	-15.7	-33.5	-7.1	1.5	2.3	0.2	0.8	0.4
Public finance								
Revenue (excluding grants)	40.6	12.3	24.8	18.2	18.0	16.0	15.3	14.3
Total expenditure	54.6	4.9	20.1	11.9	11.8	12.9	13.0	12.6
Current expenditure	33.6	7.7	10.0	16.4	15.8	14.5	14.4	14.3
Investment expenditure and net lending	84.2	2.0	30.9	7.9	7.8	11.3	11.6	10.6
Money and credit [1]								
Broad money	23.8	3.1	15.6	16.0	13.2	11.5	11.3	11.3
Net foreign assets	23.3	1.9	22.8	8.8	5.9	4.7	5.0	5.1
Net domestic assets	0.6	1.2	-7.2	6.6	7.1	6.9	6.4	6.2
Credit to government	-12.3	-5.3	-16.8	-1.0	-0.6	-1.0	-0.8	-1.1
Credit to the private sector [2]	36.9	22.4	24.5	24.3	22.5	19.0	18.5	17.0
Velocity of money (M3; average)	3.9	4.6	4.7	4.7	4.7	4.7	4.7	4.7
TB weighted-average auction rates								
(in percent; end of period)	17.4	18.6	...	...	...	...	...	...
	(Percent of GDP)							
Public finance								
Total revenue (excluding grants)	12.0	10.9	11.7	11.9	12.4	12.9	13.4	13.8
Of which : tax revenue	10.9	10.1	11.0	11.5	12.0	12.5	13.0	13.4
Total grants	8.2	5.7	49.5	4.2	3.9	3.9	3.8	3.7
Current expenditure	12.6	11.0	10.4	10.4	10.7	11.0	11.3	11.6
Capital expenditure	12.5	10.3	11.5	10.7	10.2	10.2	10.2	10.2
Total expenditure	25.1	21.2	21.9	21.2	20.9	21.1	21.5	21.8
Domestic balance	-2.3	-2.2	-0.9	-1.3	-1.2	-1.1	-1.1	-1.1
Overall balance (cash basis, incl. grants)	-5.7	-4.3	38.7	-5.1	-4.6	-4.4	-4.3	-4.3
Overall balance (cash basis, excl. grants)	-13.9	-10.1	-10.8	-9.3	-8.5	-8.3	-8.1	-8.0
Domestic financing	-1.0	0.5	-3.1	0.1	0.1	0.0	0.0	0.0

continued

Table 2. Madagascar: Selected Economic and Financial Indicators, 2004-11 (concluded)

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
	(Percent of GDP, unless otherwise indicated)							
Money and credit								
Broad money (M3)	25.9	21.6	21.3	21.3	21.3	21.3	21.4	21.4
Net foreign assets	10.9	9.2	12.1	12.1	11.8	11.4	11.3	11.1
Net domestic assets	14.9	12.3	9.2	9.2	9.4	9.8	10.0	10.2
Credit to government	5.0	2.9	-0.6	-0.7	-0.7	-0.8	-0.9	-1.0
Credit to the private sector	10.0	9.9	10.5	11.3	12.2	13.0	13.9	14.6
Savings and investment								
Resource gap	-15.1	-14.1	-13.7	-13.5	-13.2	-13.0	-12.7	-12.5
Investment	24.3	22.5	21.8	22.3	22.5	22.7	23.0	23.2
Government	12.5	10.3	11.5	10.7	10.2	10.2	10.2	10.2
Nongovernment	11.8	12.3	10.3	11.5	12.3	12.5	12.7	13.0
Gross domestic savings	9.2	8.5	8.1	8.7	9.3	9.7	10.3	10.7
Gross national savings	15.0	11.7	11.4	11.5	12.0	12.3	12.7	13.1
External sector and public debt								
Export, f.o.b	22.9	16.7	15.4	15.3	15.2	15.0	14.8	14.7
Imports, c.i.f.	39.0	33.4	30.4	30.6	30.0	29.6	29.0	28.5
Current account balance (excluding grants)	-13.1	-12.1	-11.6	-11.4	-11.1	-11.0	-10.8	-10.6
Current account balance (including grants)	-9.3	-10.8	-10.5	-10.7	-10.5	-10.4	-10.2	-10.1
Public debt	92.3	80.2	34.2	35.8	37.1	38.4	39.6	40.8
External	80.0	69.7	25.6	28.8	31.1	33.2	35.0	36.8
Domestic	12.4	10.4	8.5	7.0	6.0	5.2	4.6	3.9
Net present value (NPV) of external debt								
NPV of debt-to-GDP ratio	...	35.8	14.5	16.4	17.9	19.3	20.6	21.7
NPV of debt-to-exports ratio	...	134.3	58.8	67.1	74.3	81.3	87.6	93.8
NPV of debt-to-revenue ratio	...	215.0	83.5	102.2	110.0	115.5	119.5	123.8
	(Units as indicated)							
Gross official reserves (millions of SDRs)	330.4	337.4	348.7	381.8	406.7	430.1	463.2	503.0
Months of imports of goods and nonfactor services	2.8	2.9	2.9	3.0	3.0	3.0	3.0	3.1
Residual Financing Gap (millions SDR)	0.0	0.0	9.2	48.9	42.7	32.4	12.5	8.4
Exchange rate: Ariary per SDR (period average)	2,772.1	2,958.3	...	...	...	...	...	...
Exchange rate: Ariary per U.S. dollar (period average)	1,871.8	2,005.5	...	...	...	...	...	...
GDP per capita (U.S. dollars)	251	282	294	310	326	342	360	379
Nominal GDP (billions of ariary)	8,156	10,095	11,795	13,687	15,495	17,282	19,182	21,297

Sources: Malagasy authorities and Fund staff estimates and projections.

[1] Growth in percent of beginning of period money stock (M3).

[2] Year-on-year growth.

Table 3. Madagascar: Government Financial Operations, 2004-11
(Billions of ariary, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
Total revenue and grants	1,653.5	1,682.3	7,214.3	2,196.4	2,525.5	2,895.9	3,299.1	3,732.8
Total revenue	982.4	1,102.8	1,376.6	1,626.9	1,919.3	2,227.0	2,567.8	2,936.0
Budgetary revenue	982.4	1,102.8	1,376.6	1,626.9	1,919.3	2,227.0	2,567.8	2,936.0
Tax revenue	887.1	1,020.0	1,295.8	1,572.2	1,857.3	2,157.9	2,491.1	2,850.8
Domestic taxes	442.2	529.0	636.2	765.7	897.8	1,035.9	1,188.1	1,351.0
Taxes on foreign trade	444.9	491.0	659.6	806.5	959.5	1,122.0	1,302.9	1,499.8
Nontax revenue	95.2	82.8	80.8	54.7	62.0	69.1	76.7	85.2
Grants	671.1	579.5	5,837.7	569.4	606.2	668.9	731.3	796.8
Current grants	318.7	141.0	182.0	116.6	120.9	131.4	142.1	150.9
Of which: HIPC assistance	7.2	59.8	79.1	13.1	12.1	12.1	12.1	9.1
Capital grants	352.4	438.5	5,655.7	452.8	485.3	537.4	589.1	645.9
Of which: capital transfer, MDRI assistance from IMF via central bank	...	...	361.7	...	...	...	...	...
Of which: MDRI assistance from IDA	...	...	4,094.7	...	...	...	...	...
Of which: MDRI assistance from AfDF	...	...	713.0	...	...	...	...	...
Total expenditure	2,045.3	2,145.5	2,580.5	2,895.3	3,236.0	3,654.9	4,130.3	4,649.7
Current expenditure	1,027.3	1,107.2	1,221.3	1,429.1	1,655.3	1,895.4	2,167.5	2,478.4
Budgetary expenditure	896.9	988.0	1,206.9	1,415.4	1,639.8	1,878.1	2,148.3	2,457.1
Personnel	400.0	456.4	599.8	721.0	831.2	944.2	1,066.2	1,204.7
Of which: HIPC-financed	0.0	35.3	35.4	...	...	...	...	...
Of which: MDRI-financed	...	...	0.0	22.9	25.5	28.3	30.4	33.4
Other noninterest expenditure	257.4	265.0	371.7	474.6	601.2	729.2	873.6	1,033.4
Of which: HIPC-financed	0.0	16.0	22.5	...	...	...	...	...
Of which: MDRI-financed	...	...	0.0	22.9	25.5	28.3	30.4	33.4
Interest obligations	239.5	266.6	235.4	219.8	207.3	204.8	208.5	219.0
Foreign interest obligations [1]	113.9	97.9	50.6	45.4	54.9	64.9	75.6	88.8
Domestic interest obligations	125.5	168.7	184.8	174.4	152.4	139.9	132.9	130.2
Treasury operations (net) [2]	128.6	84.2	12.5	13.7	15.5	17.3	19.2	21.3
Counterpart-funds-financed operations	1.8	1.5	1.9	0.0	0.0	0.0	0.0	0.0
Capital expenditure	1,018.0	1,038.3	1,359.2	1,466.2	1,580.7	1,759.5	1,962.8	2,171.3
Domestically financed	245.4	304.8	304.2	424.7	510.3	585.9	685.8	781.6
Of which: VAT	...	...	102.1	...	...	...	...	...
Of which: HIPC-financed	15.8	43.7	21.6	...	...	...	...	...
Of which: MDRI-financed	...	...	73.4	68.8	76.4	84.8	91.2	100.1
Foreign financed	772.7	733.5	1,055.0	1,041.5	1,070.4	1,173.5	1,277.0	1,389.7
Net cost of structural reforms [3]	-8.8	-8.5	-6.2	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis, including the cost of structural reforms)								
Excluding grants	-1,071.7	-1,051.2	-1,210.1	-1,268.3	-1,316.7	-1,427.9	-1,562.5	-1,713.7
Including grants	-400.6	-471.7	4,627.6	-698.9	-710.5	-759.0	-831.3	-916.8
Domestic balance [4]	-185.1	-219.8	-104.5	-181.4	-191.3	-189.5	-209.9	-235.2
Domestic balance (excluding MDRI-financed spending)	...	...	-31.0	-66.8	-64.0	-48.2	-58.0	-68.4
Float [5]	-63.2	45.2	-40.7	0.0	0.0	0.0	0.0	0.0
Variation of arrears	...	-10.9	-20.0	0.0	0.0	0.0	0.0	0.0
Total overall balance (cash basis, excluding grants)	-1,134.9	-1,016.9	-1,270.8	-1,268.3	-1,316.7	-1,427.9	-1,562.5	-1,713.7
Total overall balance (cash basis, including grants)	-463.8	-437.4	4,566.9	-698.9	-710.5	-759.0	-831.3	-916.8
Total overall balance (cash basis, including grants, excluding MDRI capital transfers)	...	...	-602.5	...	...	...	...	...

continued

Table 3. Madagascar: Government Financial Operations, 2004-11 (concluded)
(Billions of ariary, unless otherwise indicated)

	2004	2005 Est.	2006 Prog.	2007 Projections	2008 Projections	2009 Projections	2010 Projections	2011 Projections
Financing	463.8	437.7	-4,566.9	698.9	710.5	759.0	831.3	916.8
Foreign (net)	518.2	387.8	-4,210.3	691.0	693.2	755.8	824.2	922.7
Drawings	579.3	454.5	710.8	741.4	745.3	811.2	878.3	950.9
Budget	143.2	159.5	142.1	152.7	160.2	175.1	190.4	207.1
Projects	436.1	295.0	568.7	588.7	585.1	636.1	687.9	743.8
Amortization [1]	-188.5	-177.0	-4,921.0	-50.8	-52.7	-55.9	-54.6	-28.3
Of which : MDRI assistance from IDA	...	...	-4,079.2	...	...	...	...	...
Of which : MDRI assistance from AfDF	...	...	-708.6	...	...	...	...	...
Change in external arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt relief	127.4	110.3	0.0	0.4	0.5	0.5	0.5	0.0
Domestic (net)	-84.6	49.4	-362.1	7.9	17.3	3.2	7.1	-5.9
Banking system	-215.6	-111.6	-365.2	-25.1	-16.8	-32.1	-29.5	-43.7
Of which: MDRI account	...	...	-325.5	36.2	36.2	36.2	36.2	36.2
Nonbanking system	107.9	120.0	3.1	33.0	34.2	35.4	36.6	37.9
Treasury correspondent accounts (net)	23.0	41.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	30.2	0.6	5.5	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Resources freed by MDRI debt relief	...	...	73.4	114.7	127.3	141.3	152.0	166.8
IMF	...	...	36.2	36.2	36.2	36.2	36.2	36.2
IDA	...	...	30.6	71.0	83.1	93.3	104.4	117.5
Saving on interest payments	...	...	15.2	32.7	34.0	34.3	34.3	34.2
Saving on amortization	...	...	15.5	38.3	49.1	59.0	70.0	83.3
AfDF	...	...	6.6	7.4	8.1	11.8	11.4	13.1
Saving on interest payments	...	...	2.2	2.2	2.2	2.7	2.5	2.6
Saving on amortization	...	...	4.4	5.2	5.8	9.1	9.0	10.4

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] After MDRI debt relief from 2006 onward.
[2] Includes annexed budgets of quasi public entities (i.e. port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities).
[3] The net cost of structural reforms comprises (a) as receipts, loan recovery by the debt-recovery unit that holds the nonperforming loans of the two (former) public banks (BFV and BTM) after the restructuring of their assets; and (b) as expenditures, those related to civil service reform (i.e., training, bonuses, and wage decompression); the upgrading of pay and equipment in the justice services; privatization (severance pay, administrative costs, transfers to the regional development fund that provides grants and concessional loans for basic social infrastructure purposes or to employees affected by privatization, and indemnification payments to expropriated owners); and to the capital transfers for the asset restructuring at the two insolvent banks (BFV and BTM).
[4] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.
[5] Difference between committed and paid expenditure.

Table 4. Madagascar: Government Financial Operations, 2004-11
(Percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
Total revenue and grants	20.3	16.7	61.2	16.0	16.3	16.8	17.2	17.5
Total revenue	12.0	10.9	11.7	11.9	12.4	12.9	13.4	13.8
Tax revenue	10.9	10.1	11.0	11.5	12.0	12.5	13.0	13.4
Domestic taxes	5.4	5.2	5.4	5.6	5.8	6.0	6.2	6.3
Taxes on foreign trade	5.5	4.9	5.6	5.9	6.2	6.5	6.8	7.0
Nontax revenue	1.2	0.8	0.7	0.4	0.4	0.4	0.4	0.4
Grants	8.2	5.7	49.5	4.2	3.9	3.9	3.8	3.7
Current grants	3.9	1.4	1.5	0.9	0.8	0.8	0.7	0.7
Capital grants	4.3	4.3	48.0	3.3	3.1	3.1	3.1	3.0
Of which: capital transfer, MDRI assistance from IMF via central bank	...	...	3.1	...	...	...	...	...
Of which: MDRI assistance from IDA	...	...	34.7	...	...	...	...	...
Of which: MDRI assistance from AfDF	...	...	6.0	...	...	...	...	...
Total expenditures	25.1	21.2	21.9	21.2	20.9	21.1	21.5	21.8
Current expenditure	12.6	11.0	10.3	10.4	10.7	11.0	11.3	11.6
Noninterest expenditure	8.1	8.3	8.3	8.8	9.3	9.8	10.2	10.6
Personnel	4.9	4.5	5.1	5.3	5.4	5.5	5.6	5.7
Of which: MDRI-financed	...	...	0.0	0.2	0.2	0.2	0.2	0.2
Other noninterest expenditure	3.2	3.0	3.2	3.5	3.9	4.2	4.6	4.9
Of which: MDRI-financed	...	...	0.0	0.2	0.2	0.2	0.2	0.2
Treasury operations [1]	1.6	0.8	0.1	0.1	0.1	0.1	0.1	0.1
Interest obligations	2.9	2.6	2.0	1.6	1.3	1.2	1.1	1.0
Domestic Interest	1.4	1.7	1.6	1.3	1.0	0.8	0.7	0.6
Foreign Interest [2]	1.5	1.0	0.4	0.3	0.4	0.4	0.4	0.4
Capital expenditure	12.5	10.3	11.5	10.7	10.2	10.2	10.2	10.2
Domestically financed expenditure	3.0	3.0	2.6	3.1	3.3	3.4	3.6	3.7
Of which: MDRI financed	...	...	0.6	0.5	0.5	0.5	0.5	0.5
Of which: HIPC financed	0.2	0.4	0.2					
Foreign-financed expenditure	9.5	7.3	8.9	7.6	6.9	6.8	6.7	6.5
Net cost of structural reforms [3]	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Overall balance (commitment basis)								
Excluding grants	-13.1	-10.4	-10.3	-9.3	-8.5	-8.3	-8.1	-8.0
Including grants	-4.9	-4.7	39.2	-5.1	-4.6	-4.4	-4.3	-4.3
Domestic balance [4]	-2.3	-2.2	-0.9	-1.3	-1.2	-1.1	-1.1	-1.1
Domestic balance excluding MDRI financed expenditure	...	...	-0.3	-0.5	-0.4	-0.3	-0.3	-0.3
Float [5]	-0.8	0.4	-0.3	0.0	0.0	0.0	0.0	0.0
Variation of arrears	...	-0.1	-0.2	0.0	0.0	0.0	0.0	0.0
Total overall balance (cash basis, excluding grants)	-13.9	-10.1	-10.8	-9.3	-8.5	-8.3	-8.1	-8.0
Total overall balance (cash basis, including grants)	-5.7	-4.3	38.7	-5.1	-4.6	-4.4	-4.3	-4.3
Total overall balance (cash basis, including grants, excluding MDRI capital transfers)	...	...	-5.1	...	...	...	...	...

continued

Table 4. Madagascar: Government Financial Operations, 2004-11 (concluded)
(Percent of GDP, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
Financing	5.7	4.3	-38.7	5.1	4.6	4.4	4.3	4.3
Foreign (net)	6.4	3.8	-35.7	5.0	4.5	4.4	4.3	4.3
Drawings	7.1	4.5	6.0	5.4	4.8	4.7	4.6	4.5
Budget	1.8	1.6	1.2	1.1	1.0	1.0	1.0	1.0
Projects	5.3	2.9	4.8	4.3	3.8	3.7	3.6	3.5
Amortization [2]	-2.3	-1.8	-41.7	-0.4	-0.3	-0.3	-0.3	-0.1
Of which : MDRI assistance from IDA	...	...	-34.6	...	...	...	...	...
Of which : MDRI assistance from AfDF	...	...	-6.0	...	...	...	...	...
Change in external arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
External debt relief	1.6	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	-1.0	0.5	-3.1	0.1	0.1	0.0	0.0	0.0
Banking sector [6]	-2.6	-1.1	-3.1	-0.2	-0.1	-0.2	-0.2	-0.2
Of which: MDRI Account	...	...	-2.8	0.3	0.3	0.2	0.2	0.2
Nonbanking sector	1.3	1.2	0.0	0.2	0.2	0.2	0.2	0.2
Privatization receipts	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP (in billions of ariary)	8,156	10,095	11,795	13,687	15,495	17,282	19,182	21,297
Resources freed by MDRI debt relief	...	...	0.6	0.8	0.8	0.8	0.8	0.8
IMF	...	...	0.3	0.3	0.2	0.2	0.2	0.2
IDA	...	...	0.3	0.5	0.5	0.5	0.5	0.6
AfDF	...	...	0.1	0.1	0.1	0.1	0.1	0.1

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] Includes annexed budgets of quasi public entities (i.e., port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities).
[2] After MDRI debt relief from 2006 onward.
[3] See Table 3, footnote 3.
[4] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.
[5] Difference between committed and paid expenditure.
[6] Excludes the effect of exchange rate changes on net credit to government in foreign exchange.

Table 5. Madagascar: Quarterly Government Financial Operations, 2006
(Billions of ariary, cumulated since the beginning of the year, unless otherwise indicated)

	March		June	July	Sep.	Dec.
	Target	Est.	Proj.	Prog.	Prog.	Prog.
Total revenue and grants	863.7	733.6	1,340.2	6,293.9	6,621.4	7,214.3
Total revenue	327.1	276.7	631.7	730.4	963.4	1,376.6
Tax revenue	304.0	264.7	599.1	695.1	907.8	1,295.8
Domestic taxes	142.0	128.8	314.8	360.7	461.0	636.2
Taxes on foreign trade	162.0	135.9	284.3	334.4	446.8	659.6
Nontax revenue	23.1	12.1	32.6	35.3	55.6	80.8
Grants	536.6	456.9	708.5	5,563.5	5,658.0	5,837.7
Current grants	28.5	27.4	96.8	106.6	126.1	182.0
Of which: HIPC assistance	24.9	23.9	41.7	46.4	60.4	79.1
Of which: Counterpart funds	3.6	3.5	7.2	8.2	10.7	14.2
Capital grants	508.1	429.5	611.7	5,456.9	5,531.9	5,655.7
Of which: capital transfer, MDRI assistance from IMF via central bank	382.5	361.7	361.7	361.7	361.7	361.7
Of which: MDRI assistance from IDA				4,094.7	4,094.7	4,094.7
Of which: MDRI assistance from AfDF				713.0	713.0	713.0
Total expenditure	734.0	485.2	1,266.5	1,472.4	1,874.8	2,580.5
Current expenditure	322.6	280.5	614.7	720.7	923.5	1,221.3
Budgetary expenditure	312.4	272.2	601.9	707.8	910.2	1,206.9
Personnel	148.8	137.6	297.5	347.2	446.5	599.8
Of which: HIPC-financed	0.0	8.1	17.6	20.5	26.4	35.4
Of which: MDRI-financed	...	0.0	0.0	0.0	0.0	0.0
Other noninterest expenditure	105.3	71.9	163.6	204.6	286.6	371.7
Of which: HIPC-financed	5.6	3.2	10.2	12.5	17.2	22.5
Of which: MDRI-financed	...	0.0	0.0	0.0	0.0	0.0
Interest expenditure	58.3	62.7	140.8	156.0	177.1	235.4
Foreign interest obligations [1]	12.4	13.6	35.5	37.8	40.4	50.6
Domestic interest obligations	46.0	49.1	105.3	118.2	136.7	184.8
Treasury operations (net)	9.7	8.2	11.8	11.8	11.9	12.5
Counterpart funds-financed operations	0.5	0.1	1.0	1.1	1.4	1.9
Capital expenditure	411.4	204.7	651.8	751.6	951.3	1,359.2
Domestically financed	80.9	51.0	136.5	168.6	232.8	304.2
Of which: HIPC-financed	5.2	12.0	21.6	21.6	21.6	21.6
Of which: MDRI-financed	...	0.0	0.0	17.6	52.7	73.4
Foreign financed	330.5	153.7	515.3	583.0	718.5	1,055.0
Net cost of structural reforms [2]	0.2	0.0	-4.0	-4.5	-5.5	-6.2
Overall balance (commitment basis)						
Excluding grants	-406.7	-208.5	-638.8	-746.5	-916.9	-1,210.1
Including grants	129.9	248.4	69.7	4,817.0	4,741.1	4,627.6
Domestic balance (commitment basis) [3]	-58.7	-41.2	-88.0	-125.6	-158.0	-104.5
Domestic balance (excluding MDRI financed spending)	-58.7	-41.2	-88.0	-108.0	-105.4	-31.0
Float [4]	-50.0	-32.3	-40.7	-40.7	-31.5	-40.7
Variation of arrears	0.0	0.0	-10.0	-10.0	-13.3	-20.0
Total overall balance (cash basis, excluding grants)	-456.7	-240.8	-689.5	-787.2	-961.7	-1,270.8
Total overall balance (cash basis, including grants)	80.0	216.1	19.0	4,766.3	4,696.3	4,566.9
Total overall balance (cash basis, including grants, excluding MDRI capital transfers)	-302.5	-145.6	-342.7	-403.1	-473.1	-602.5

continued

Table 5. Madagascar: Quarterly Government Financial Operations, 2006 (concluded)
(Billions of ariary, cumulated since the beginning of the year, unless otherwise indicated)

	March		June	July	Sep.	Dec.
	Target	Est.	Proj.	Prog.	Prog.	Prog.
Financing	-79.9	-216.9	-19.0	-4,766.3	-4,696.3	-4,566.9
Foreign (net)	180.3	62.4	205.7	-4,589.2	-4,441.6	-4,210.3
Drawings	204.8	85.9	265.3	295.5	443.2	710.8
Budget	0.0	0.0	0.0	0.0	87.2	142.1
Projects	204.8	85.9	265.3	295.5	356.0	568.7
Amortization [1]	-24.5	-23.5	-59.6	-4,884.8	-4,884.8	-4,921.0
Of which : MDRI assistance from IDA	...	0.0	0.0	-4,088.5	-4,088.5	-4,079.2
Of which : MDRI assistance from AfDF	...	0.0	0.0	-708.6	-708.6	-708.6
Change in external arrears	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	-260.3	-282.7	-228.6	-180.9	-259.1	-362.1
Banking system	-304.0	-324.7	-339.8	-330.8	-342.5	-365.2
Central bank	-344.2	-379.1	-359.9	-359.9	-362.6	-365.2
Of which: MDRI account	-382.5	-361.7	-343.6	-320.1	-325.5	-325.5
Commercial banks & OPCA	40.2	53.4	20.1	29.1	20.1	0.0
Nonbanking system	43.8	71.0	111.3	149.9	83.4	3.1
Treasury correspondent accounts (net)	0.0	-29.0	0.0	0.0	0.0	0.0
Privatization receipts	0.0	3.4	3.9	3.9	4.3	5.5
Memorandum items:						
Resources freed by MDRI debt relief	0.0	39.2	39.5	29.6	55.7	73.4
IMF	0.0	36.2	36.2	24.1	36.2	36.2
IDA	...	0.0	0.0	4.4	13.2	30.6
Saving on interest payments	...	0.0	0.0	13.2	7.0	15.2
Saving on amortization	...	0.0	0.0	7.0	6.2	15.5
AfDF	...	3.0	3.3	1.1	6.3	6.6
Saving on interest payments	...	0.9	1.1	6.3	2.0	2.2
Saving on amortization	...	2.1	2.2	2.0	4.3	4.4
Net domestic financing [5]	72.2	50.1	86.3	134.0	62.2	-55.6

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] After MDRI debt relief .

[2] See Table 3, footnote 3.

[3] Overall balance, excluding grants, foreign-financed capital expenditures, and foreign interest payments.

[4] Difference between committed and paid expenditure.

[5] Banking system, nonbanking system, Treasury correspondent accounts (net), privatization receipts, float and variation in arrears, excluding capital transfer and MDRI assistance from IMF via central bank.

Table 6. Madagascar: Balance of Payments, 2004-11
(Millions of SDRs)

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
Current account	-273.8	-369.7	-393.5	-436.0	-459.4	-490.8	-518.1	-551.5
Goods and services	-443.0	-479.7	-515.7	-549.1	-575.2	-611.7	-644.4	-682.2
Trade balance	-301.3	-399.4	-394.3	-433.3	-451.3	-476.9	-498.0	-522.6
Exports	673.2	569.9	579.6	622.8	664.0	706.7	752.5	801.9
Imports	-974.5	-969.3	-973.8	-1056.1	-1115.3	-1183.6	-1250.4	-1324.4
Net services	-141.7	-80.2	-121.4	-115.8	-123.9	-134.8	-146.4	-159.7
Services, receipts	287.3	340.7	347.3	368.0	390.4	413.5	437.6	463.1
Services, payments	-429.0	-420.9	-468.7	-483.8	-514.3	-548.3	-584.0	-622.8
Income (net)	-53.5	-53.5	-41.6	-37.8	-40.8	-44.0	-47.5	-51.5
Receipts	10.0	15.5	16.4	17.1	18.1	19.1	20.2	21.4
Payments	-63.5	-69.0	-58.0	-54.9	-58.9	-63.1	-67.7	-72.8
Of which : government interest [1]	-40.6	-32.8	-16.1	-13.5	-15.5	-17.7	-20.0	-22.8
Current transfers	222.7	163.5	163.8	150.9	156.7	165.0	173.8	182.2
Government	112.8	43.5	43.8	24.9	24.4	26.1	27.9	29.1
Budget aid	99.1	53.2	53.5	34.6	34.1	35.8	37.6	38.8
HIPC relief	22.4	20.4	25.2	3.9	3.4	3.3	3.2	2.3
Grants	76.7	32.8	28.3	30.7	30.7	32.5	34.4	36.4
Other (net) [2]	13.7	-9.7	-9.7	-9.7	-9.7	-9.7	-9.7	-9.7
Private	109.9	120.0	120.0	126.0	132.3	138.9	145.9	153.2
Capital and financial account	236.1	326.5	514.8	420.1	441.5	481.6	538.6	580.6
Capital account [3]	1056.0	108.4	1809.2	134.2	136.9	146.4	155.8	165.9
Of which : MDRI grant for debt due after 2006	...	...	1654.1	...	...	...	...	...
Financial account	-774.4	180.3	-1294.4	285.8	304.6	335.2	382.8	414.7
Direct investment	35.7	63.6	60.0	81.1	109.2	129.5	164.9	177.8
Of which : privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	-810.1	116.7	-1354.4	204.7	195.3	205.7	217.9	237.0
Government	-798.3	119.7	-1349.4	204.7	195.3	205.7	217.9	237.0
Drawing	203.9	179.9	226.7	219.8	210.2	221.0	232.3	244.2
Project drawings	153.7	126.0	181.4	174.5	165.0	173.3	181.9	191.0
Budgetary support	50.2	53.9	45.3	45.3	45.2	47.7	50.4	53.2
Nongovernment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization [1, 3]	-1002.2	-60.2	-1576.2	-15.1	-14.9	-15.2	-14.4	-7.3
Of which : IDA and AfdF loans	...	...	-1533.7	...	...	...	...	...
Private sector amortization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Banks, net	-11.8	-3.1	-5.0	0.0	0.0	0.0	0.0	0.0
Other (incl. errors and omissions)	-45.4	37.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-37.7	-43.2	121.3	-15.9	-17.9	-9.2	20.5	29.2

continued

Table 6. Madagascar: Balance of Payments, 2004-11 (concluded)
(Millions of SDRs)

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
Financing	37.7	43.2	-130.6	-33.0	-24.8	-23.2	-33.0	-37.5
Net foreign assets (increase -)	-6.0	9.0	-148.6	-33.1	-24.9	-23.3	-33.1	-37.5
Use of Fund credit (net)	29.5	3.1	-137.2	0.0	0.0	0.0	0.0	2.3
Disbursements	34.9	11.3	0.0	0.0	0.0	0.0	0.0	0.0
Repayments	-5.4	-8.2	-137.2	0.0	0.0	0.0	0.0	2.3
Other assets, net (increase -)	-35.5	5.9	-11.3	-33.1	-24.9	-23.3	-33.1	-39.8
Debt relief and cancellation	43.7	34.2	18.0	0.1	0.1	0.1	0.1	0.0
Of which: MDRI grant for debt due in 2006	...	...	18.0	...	...	...	...	...
Residual financing gap	0.0	0.0	9.2	48.9	42.7	32.4	12.5	8.4
Memorandum items:								
Grants (in percent of GDP)	8.0	4.5	5.3	3.9	3.7	3.7	3.6	3.6
Loans (in percent of GDP)	-27.1	3.5	-35.9	5.0	4.5	4.4	4.3	4.3
Direct investment (percent of GDP)	1.2	1.9	1.6	2.0	2.5	2.8	3.3	3.3
Current account (percent of GDP)								
Excluding net official transfers	-13.1	-12.1	-11.6	-11.4	-11.1	-11.0	-10.8	-10.6
Including net official transfers	-9.3	-10.8	-10.5	-10.7	-10.5	-10.4	-10.2	-10.1
Debt service (percent of exports)	158.3	22.7	17.3	11.2	11.1	11.1	10.9	10.0
Gross official reserves	330.4	337.4	348.7	381.8	406.7	430.1	463.2	503.0
(months of imports of goods and nonfactor services)	2.8	2.9	2.9	3.0	3.0	3.0	3.0	3.1
Exchange rates								
Ariary/SDR (period average)	2,772.1	2,958.8	...	...	...	...	...	...
Ariary/U.S. dollar (period average)	1,871.8	2,005.7	...	...	...	...	...	...

Sources: Central Bank of Madagascar, Ministry of Finance, IMF Finance Dept., and Fund staff estimates and projections.

[1] After MDRI debt relief from 2006 onward.
[2] Other official grants less payments due to scholarships and contributions to international organizations.
[3] Includes impact of HIPC completion point in 2004 and MDRI in 2006.

Table 7. Madagascar: Monetary Survey, 2004-06
(Billions of ariary, unless otherwise specified)

	2004	2005				2006				
		Mar. Act.	Jun. Act.	Sep. Act.	Dec. Act.	Mar. Act.	Jun. Proj.	Jul. Prog.	Sep. Prog.	Dec. Prog.
Net foreign assets	892.9	1,343.5	865.9	975.5	933.4	1,343.5	1,329.9	1,324.7	1,401.1	1,429.6
Net foreign assets (BCM)	520.1	893.7	445.3	610.9	526.5	893.7	899.1	899.1	985.9	1,000.7
Net foreign assets (domestic money banks)	372.8	449.8	420.6	364.5	406.9	449.8	430.8	425.6	415.2	428.9
Net domestic assets	1,218.1	923.3	1,196.9	1,143.6	1,243.6	923.3	971.2	987.4	1,019.7	1,086.7
Domestic credit	1,336.0	1,146.1	1,367.5	1,333.4	1,409.2	1,146.1	1,183.1	1,195.9	1,221.6	1,288.6
Net credit to government (budget)	405.8	-31.6	350.1	266.9	294.1	-31.6	-45.7	-36.7	-48.3	-71.1
Other claims on public sector	95.6	109.0	111.7	112.7	104.7	109.0	104.7	104.7	104.7	104.7
Credit to the economy	834.6	1,068.7	905.8	953.8	1,010.4	1,068.7	1,124.1	1,137.8	1,165.2	1,255.0
Credit to public enterprises	19.9	30.4	15.2	18.4	13.3	30.4	13.3	13.3	13.3	13.3
Credit to private sector	814.7	1,038.2	890.5	935.3	997.1	1,038.2	1,110.8	1,124.5	1,151.9	1,241.7
Other items (net; asset +)	-117.9	-222.8	-170.6	-189.8	-165.6	-222.8	-211.9	-208.5	-201.8	-201.8
M3	2,111.0	2,266.8	2,062.8	2,119.0	2,177.0	2,266.8	2,301.1	2,329.4	2,420.8	2,516.3
Foreign currency deposits	349.3	385.3	365.9	327.7	334.3	385.3	339.5	339.5	339.5	339.5
M2	1,761.7	1,881.5	1,696.9	1,791.3	1,842.7	1,881.5	1,961.6	2,001.2	2,081.3	2,176.9
Currency in circulation	591.4	581.5	560.2	568.1	599.1	581.5	624.9	632.6	649.0	692.5
Deposits in local currency	1,142.0	1,270.3	1,107.4	1,195.1	1,214.5	1,270.3	1,307.6	1,339.5	1,403.3	1,455.3
Short-term obligations of commercial banks	28.4	29.6	29.3	28.1	29.1	29.6	29.1	29.1	29.1	29.1
	(12-month percentage change unless otherwise indicated)									
Memorandum items:										
M3	23.8	6.1	7.5	7.5	3.1	6.1	11.6	12.9	14.2	15.6
M2	18.5	8.3	7.9	11.0	4.6	8.3	15.6	17.3	16.2	18.1
Domestic credit	2.6	-13.7	-0.1	6.5	5.5	-13.7	-13.5	-13.0	-8.4	-8.6
Credit to the private sector	36.9	23.5	27.1	26.0	22.4	23.5	24.7	26.4	23.2	24.5
Net credit to government (NCG)	-34.1	-108.8	-38.4	-34.3	-27.5	-108.8	-113.1	-110.2	-118.1	-124.2
Nominal change in NCG since beginning of year	-209.9	-45.3	-55.7	-138.9	-111.6	-325.7	-339.8	-330.8	-342.5	-365.2
Reserve money	19.1	6.3	20.2	24.4	11.6	6.3	12.7	9.0	11.0	12.2
Currency/M3 (percent)	28.0	25.7	27.2	26.8	27.5	25.7	27.2	27.2	26.8	27.5
Reserve money multiplier (M3/reserves)	2.51	2.59	2.53	2.44	2.32	2.59	2.51	2.50	2.51	2.39
Velocity of money (GDP/end-of-period M3)	3.86	...	...	...	4.64	...	...	...	...	4.69
Exchange rate (ariary per SDR; end of period) [1]	2,895.7	3,171.2	2,946.6	3,022.4	3,086.6	3,171.2	3,134.7	3,134.7	3,134.7	3,134.7

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

[1] Future exchange rate for monetary programming purposes.

Table 8. Madagascar: Balance Sheet of the Central Bank (BCM), 2004-06
(Billions of ariary)

	2004	2005				2006				
		Mar. Act.	Jun. Act.	Sep. Act.	Dec. Act.	Mar. Act.	Jun. Proj.	Jul. Prog.	Sep. Prog.	Dec. Prog.
Net foreign assets	520.1	498.1	445.3	610.9	526.5	893.7	899.1	899.1	985.9	1,000.7
Of which : Outstanding repurchase operations (IMF) [1]	388.2	417.9	416.5	419.0	429.0	36.0	35.6	35.6	35.6	35.6
Net domestic assets	319.6	325.7	369.2	258.1	411.0	-18.4	19.2	31.1	-21.3	51.3
Overall credit to government (net)	264.8	258.5	309.6	255.9	325.3	-53.8	-36.6	-53.5	-87.2	-14.6
Liquidity operations (+ =mop up)	0.0	0.0	0.0	0.0	0.0	0.0	-2.0	6.6	-49.9	25.3
Credit to government (net)	264.8	258.5	309.6	255.9	325.3	-53.8	-34.7	-34.7	-37.3	-39.9
Of which : IMF MDRI debt relief	0.0	0.0	0.0	0.0	0.0	-361.7	-343.6	-343.6	-334.6	-365.2
Claims on public enterprises	3.9	4.0	4.3	4.5	4.5	4.4	4.5	4.5	4.5	4.5
Credit to banks	-7.7	2.0	1.6	-55.4	1.1	-9.1	1.1	1.1	1.1	1.1
Other items (net; asset +)	58.6	61.1	53.6	53.2	80.2	40.1	50.3	53.7	60.4	60.4
Of which : valuation account (losses -)	-82.9	-92.7	-34.6	-52.5	4.7	4.7	14.9	14.9	14.9	14.9
Reserve money	839.7	823.7	814.5	869.0	937.5	875.3	918.3	930.2	964.6	1,051.9
Currency outside banks	591.4	554.4	560.2	568.1	599.1	581.5	624.9	632.6	649.0	692.5
Bank reserves	248.4	269.3	254.3	301.0	338.4	293.8	293.3	297.6	315.6	359.4
Currency in banks	40.2	38.1	39.7	38.0	40.2	39.4	46.3	45.8	44.7	44.7
Deposits	208.2	231.2	214.6	263.0	298.2	254.4	247.0	251.8	270.9	314.7
Cumulative annual flow										
Net foreign assets	235.3	-22.0	-74.8	90.9	6.4	367.2	372.6	372.6	459.4	474.2
Net domestic assets	-100.5	6.0	49.6	-61.5	91.4	-429.4	-391.8	-379.9	-432.3	-359.7
Credit to government (net)	-74.7	-6.3	44.8	-8.9	60.5	-379.1	-359.9	-359.9	-362.6	-365.2
Reserve money	134.8	-16.0	-25.2	29.3	97.8	-62.2	-19.2	-7.3	27.1	114.4

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

[1] Excludes any new IMF purchases.

Table 9. Madagascar: Consolidated Balance Sheet of Commercial Banks, 2004-06
(Billions of ariary)

	2004	2005				2006				
		Mar. Act.	Jun. Act.	Sep. Act.	Dec. Act.	Mar. Prelim.	Jun. Prog.	Jul. Prog.	Sep. Prog.	Dec. Prog.
Net foreign assets	372.8	462.6	420.6	364.5	406.9	449.8	430.8	425.6	415.2	428.9
Net domestic assets	1,146.8	1,119.8	1,082.0	1,186.4	1,170.9	1,235.5	1,245.3	1,282.4	1,356.7	1,394.9
Bank reserves	248.4	269.3	254.3	301.0	338.4	293.8	293.3	297.6	315.6	359.4
Liabilities to BCM	7.7	-2.0	-1.6	55.4	-1.1	9.1	-1.1	-1.1	-1.1	-1.1
Credit to government (net)	141.0	102.0	40.5	11.0	-31.1	22.2	-9.1	6.9	38.9	-56.5
Excluding monetary operations	141.0	102.0	40.5	11.0	-31.1	22.2	-11.0	-2.0	-11.0	-31.1
Other claims on public sector	95.6	107.6	111.7	112.7	104.7	109.0	104.7	104.7	104.7	104.7
Claims on public enterprises	16.1	14.5	10.9	14.0	8.8	26.0	8.8	8.8	8.8	8.8
Credit to private sector	814.7	840.8	890.5	935.3	997.1	1,038.2	1,110.8	1,124.5	1,151.9	1,241.7
Other items (net; assets +)	-176.6	-212.3	-224.2	-243.0	-245.8	-262.9	-262.2	-262.2	-262.2	-262.2
Deposits	1,491.3	1,556.0	1,473.3	1,522.8	1,548.8	1,655.7	1,647.1	1,679.0	1,742.8	1,794.8
Deposits in local currency [1]	1,142.0	1,156.1	1,107.4	1,195.1	1,214.5	1,270.3	1,307.6	1,339.5	1,403.3	1,455.3
Deposits in foreign currency (time deposits)	349.3	399.9	365.9	327.7	334.3	385.3	339.5	339.5	339.5	339.5
(millions of SDRs)	120.6	136.6	124.2	108.4	108.3	121.5	108.3	108.3	108.3	108.3
Short-term bonds (liabilities)	28.4	26.4	29.3	28.1	29.1	29.6	29.1	29.1	29.1	29.1
Cumulative annual flow										
Credit to government (net)	-135.2	-39.0	-100.5	-129.9	-172.1	53.4	20.1	29.1	20.1	0.0

Sources: Central Bank of Madagascar (BCM); and Fund staff estimates and projections.

[1] Includes *Comptes de Cheques Postaux and Caisse d'Epargne de Madagascar* deposit accounts.

Table 10. Madagascar: Sources and Uses of Resources, 2004-11

	2004	2005	2006	2007	2008	2009	2010	2011
		Est.	Prog.	Projections				
	(Percent of GDP)							
Consumption	90.8	91.5	91.9	91.3	90.7	90.3	89.7	89.3
Public	9.8	8.4	8.4	8.8	9.3	9.8	10.2	10.6
Private	81.0	83.1	83.5	82.4	81.3	80.5	79.5	78.7
Investment	24.3	22.5	21.8	22.3	22.5	22.7	23.0	23.2
Domestic investment	24.3	22.5	21.8	22.3	22.5	22.7	23.0	23.2
Government	12.5	10.3	11.5	10.7	10.2	10.2	10.2	10.2
Private	11.8	12.3	10.3	11.5	12.3	12.5	12.7	13.0
Of which: direct foreign investment (flow)	1.2	1.9	1.6	2.0	2.5	2.8	3.3	3.3
Changes in stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Resource gap	-15.1	-14.1	-13.7	-13.5	-13.2	-13.0	-12.7	-12.5
Exports of goods and nonfactor services	32.6	26.7	24.6	24.4	24.1	23.8	23.5	23.1
Of which: exports of goods	22.9	16.7	15.4	15.3	15.2	15.0	14.8	14.7
Imports of goods and nonfactor services	47.7	40.7	38.3	38.0	37.3	36.8	36.2	35.6
Of which: imports of goods	33.1	28.4	25.9	26.0	25.5	25.1	24.6	24.2
Gross domestic savings	9.2	8.5	8.1	8.7	9.3	9.7	10.3	10.7
Government	2.3	2.5	3.3	3.1	3.0	3.1	3.2	3.2
Nongovernment	7.0	6.0	4.9	5.7	6.3	6.6	7.1	7.5
Current account								
Excluding grants	-13.1	-12.1	-11.6	-11.4	-11.1	-11.0	-10.8	-10.6
Including grants	-9.3	-10.8	-10.5	-10.7	-10.5	-10.4	-10.2	-10.1
Gross national savings	15.0	11.7	11.4	11.5	12.0	12.3	12.7	13.1

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

Table 11: Madagascar: Millennium Development Goals

	1995	2001	2002	2004	2015 Target
Goal 1. Eradicate extreme poverty and hunger					
1. Population below US$ 1 a day (percent)	...	49.1	...	...	
2. Poverty gap ratio at US$ 1 a day (percent)	...	18.3	...	...	
3. Share of income or consumption held by poorest 20 percent (percent)	...	5.0	...	...	
4. Prevalence of child malnutrition (percent of children under 5)	34.1	...	33.1	42.0	20.5
5. Population below minimum level of dietary energy consumption (percent)	40.0	36.0	...	...	17.5
Goal 2. Achieve universal primary education					
6. Net primary enrollment ratio (percent of relevant age group)	60.6	66.0	67.0	89.0	
7. Percentage of cohort reaching grade 5	39.7	33.6	...	57.0	
8. Youth literacy rate (percent age 15-24)	...	...	...	70.0	
Goal 3. Promote gender equality and empower women					
9. Ratio of girls to boys in primary and secondary education (percent)	99.2	...	...	...	100.0
10. Ratio of young literate females to males (percent ages 15-24)	88.8	92.1	92.5	94.0	
11. Share of women employed in the nonagricultural sector (percent)	...	...	...	...	
12. Proportion of seats held by women in the national parliament (percent)	4.0	8.0	8.0	4.0	
Goal 4. Reduce child mortality					
13. Under-five mortality rate (per 1,000)	156.0	139.0	135.0	123.0	54.0
14. Infant mortality rate (per 1,000 live births)	95.0	86.0	84.0	76.0	
15. Immunization against measles (percent of children 12-23 months)	55.0	...	...	59.0	
Goal 5. Improve maternal health					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	580.0	550.0	...	...	127.0
17. Proportion of births attended by skilled health personnel	47.3	46.2	...	51.0	
Goal 6. Combat HIV/AIDS, malaria and other diseases					
19. Contraceptive prevalence rate (percent of women ages 15-49)	19.4	...	16.9	27.0	
20. Number of children orphaned by HIV/AIDS	...	18,000	...	30,000	
21. Prevalence of death associated with malaria	...	...	...	...	
22. Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...	
23. Incidence of tuberculosis (per 100,000 people)	...	254.5	...	218.0	
24. Tuberculosis cases detected under DOTS (percent)	51.0	70.0	70.0	74.0	
Goal 7. Ensure environmental sustainability					
25. Forest area (percent of total land area)	...	20.2	...	22.0	
26. Nationally protected areas (percent of total land area)	1.9	1.9	2.1	4.3	
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...	
28. CO2 emissions (metric tons per capita)	0.1	0.1	...	...	
29. Proportion of population using solid fuels					
30. Access to improved water source (percent of population)	...	47.0	...	45.0	72.0
31. Access to improved sanitation (percent of population)	...	42.0	...	...	
32. Access to secure tenure (percent of population)	...	...	...	...	
Goal 8. Develop a Global Partnership for Development [1]					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	
Female	...	...	...	...	
Male	...	...	...	...	
46. Proportion of population access with access to affordable essential drugs	...	...	...	...	
47. Fixed line and mobile telephones (per 1,000 people)	3.0	12.0	13.0	19.5	
48. Personal computers (per 1,000 people)	1.5	2.6	4.4	5.0	

Sources: World Bank; and Fund staff estimates.

[1] Indicators 33-44 are excluded because they can not be measured on a country-specific basis. These are related to official development assistance, market access, and the HIPC initiative.

Table 12. Madagascar : BOP Impact of the Expiry of the ATC and AGOA
(Millions of SDRs)

	2004	2005	2006	2007	2008
			Projections		
A Counterfactural projection assuming no ATC termination and AGOA is extended [1]					
Total affected current account entries					
Exports	673.2	569.9	625.8	674.3	718.9
(percent change)	...	-15.3	9.8	7.8	6.6
of which : Textiles & Clothing	228.9	250.2	281.2	312.7	338.0
(percent change)	...	9.3	12.4	11.2	8.1
Imports	-974.5	-969.3	-1001.3	-1084.5	-1145.7
(percent change)	20.0	-0.5	3.3	8.3	5.6
of which : Textiles & Clothing	-170.5	-175.1	-182.8	-203.2	-219.7
(percent change)	...	2.7	4.4	11.2	8.1
Services (net)	-185.0	-80.2	-125.3	-119.3	-127.7
Overall balance	-37.7	-43.2	136.2	3.6	2.9
NIR accumulation (- increase)	-6.1	9.0	-148.6	-35.6	-31.1
Financing gap	0.0	0.0	-5.6	31.8	28.0
B Projections assuming policy adjustment [2]					
Total affected current account entries					
Exports	673.2	569.9	579.6	622.8	664.0
(percent change)	...	-15.3	1.7	7.5	6.6
of which : Textiles & Clothing	228.9	250.2	240.8	243.2	254.3
(percent change)	...	9.3	-3.7	1.0	4.5
Imports	-974.5	-969.3	-973.8	-1056.1	-1115.3
(percent change)	20.0	-0.5	0.5	8.4	5.6
of which : Textiles & Clothing	-170.5	-175.1	-168.6	-158.1	-165.3
(percent change)	...	2.7	-3.7	-6.2	4.5
Services (net)	-185.0	-80.2	-121.4	-115.8	-123.9
Overall balance	-37.7	-43.2	121.3	-15.9	-17.9
NIR accumulation (- increase)	-6.1	9.0	-148.6	-33.1	-24.9
Financing gap	0.0	0.0	9.2	48.9	42.7
Impact of the expiry of the ATC and AGOA after policy adjustment (A less B)					
Total affected current account entries					
Exports	0.0	0.0	46.2	51.5	54.9
(percent change)	...	0.0	8.1	0.3	0.0
of which : Textiles & Clothing	0.0	0.0	40.4	69.5	83.8
(percent change)	...	0.0	16.2	10.2	3.6
Imports	0.0	0.0	-27.5	-28.5	-30.3
(percent change)	0.0	0.0	2.8	-0.1	0.0
of which : Textiles & Clothing	0.0	0.0	-14.2	-45.1	-54.5
(percent change)	...	0.0	8.1	17.4	3.6
Services (net)	0.0	0.0	-3.9	-3.5	-3.8
Overall balance	0.0	0.0	14.8	19.6	20.8
NIR accumulation (- increase)	0.0	0.0	0.0	-2.5	-6.2
Financing gap	0.0	0.0	-14.8	-17.1	-14.6

Source: Staff estimates.

[1] In the counterfactual scenario, export volumes of clothing and textiles are assumed to grow at an average of 8 percent annually; a rate representative of the period when AGOA was introduced.

[2] Under the baseline scenario the volume of textiles and clothing decline 5 percent in 2006, are flat in 2007 and recover marginally in 2008.

Table 13. Madagascar: Long-Term Economic and Financial Indicators, 2003-15

	2003-05 Avg.	2006-10 Avg.	2011-15 Avg.	2006-15 Avg.
	(Percent unless otherwise specified)			
High Case				
Real GDP growth	6.6	6.6	8.6	7.6
Contribution of capital	2.8	4.2	5.9	5.0
Contribution of labor	1.5	1.5	1.3	1.4
Contribution of TFP	2.3	0.9	1.4	1.1
GDP deflator	11.8	8.3	5.1	6.7
Real GDP per capita, cumulative growth	3.6	20.5	18.2	61.0
Poverty ratio (percent of population) [1]	57.6	52.1	29.1	44.7
Investment (share of GDP)	21.6	24.1	31.6	27.9
o/w: Government	10.2	11.9	12.6	12.3
Budget: overall balance (cash basis, incl. grar	-4.9	2.4	-6.2	-1.9
Current account balance (including grants)	-8.4	-11.2	-12.1	-11.6
Foreign inflows [2]	11.0	12.0	12.5	12.2
External public debt	77.6	30.9	36.9	33.9
Base Case				
Real GDP growth	6.6	5.4	5.7	5.6
Contribution of capital	2.8	3.7	3.7	3.7
Contribution of labor	1.5	1.4	1.3	1.4
Contribution of TFP	2.3	0.4	0.7	0.6
GDP deflator	11.8	7.9	5.1	6.5
Real GDP per capita, cumulative growth	3.6	14.1	9.5	33.3
Poverty ratio (percent of population) [1]	57.6	53.3	41.8	49.4
Investment (share of GDP)	21.6	22.5	23.6	23.0
o/w: Government	10.2	10.6	10.2	10.4
Budget: overall balance (cash basis, incl. grar	-4.9	4.1	-4.2	-0.1
Current account balance (including grants)	-8.4	-10.5	-9.1	-9.8
Foreign inflows [2]	11.0	11.4	10.0	10.7
External public debt	77.6	30.9	38.7	34.8

Source: Staff projections.

[1] Percentage of population in extreme poverty; 2011-2015 column shows 2015 level.

[2] External grants and loans and foreign direct investment.

APPENDIX I—ATTACHMENT I
MADAGASCAR: LETTER OF INTENT

July 6, 2006

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

Dear Mr. de Rato:

1. The government of Madagascar has been committed to a program of economic reform aimed at restoring fiscal discipline and financial stability. Madagascar reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in October 2004 and satisfactorily completed its last three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in March 2005. In January 2006, Madagascar received debt relief from the IMF under the Multilateral Debt Relief Initiative (MDRI). Madagascar has also received considerable technical assistance from the IMF which we value greatly and have incorporated into our medium-term economic program.

2. Despite improved economic growth in recent years, the country remains poor, highly vulnerable to weather, price, and trade-related shocks, and is plagued with an extremely low tax revenue to GDP ratio. Given these challenges, the government is committed to raising economic growth and meeting the Millennium Development Goals. In this regard, the government is requesting a new three-year PRGF arrangement in an amount equivalent to SDR 54.99 million (45 percent of quota), to support its economic program for 2006-08.

3. Following a series of discussions in Antananarivo and Washington between the government and Fund staff, most recently in May 2006, understandings were reached on fiscal revenue and expenditure targets that could form the basis for a Fund-supported economic program for 2006. The government has presented its economic strategy in a Memorandum of Economic and Financial Policies (MEFP), and committed itself to a set of prior actions and structural and quantitative performance criteria for 2006 (attached). We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but the government stands ready to take any further measures that may become appropriate for this purpose. Madagascar will consult with the Fund on the adoption of such measures in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policy on such consultation.

4. Finally, the government is developing policies to mitigate the anticipated adverse impact of the termination of the WTO's Agreement on Textiles and Clothing (ATC) and the scheduled expiration of certain provisions of the American Growth and Opportunities Act (AGOA) III in 2007. In view of the possible effect on Madagascar of these changes, we hereby request activation of the Fund's Trade Integration Mechanism (TIM). Should the impact of the end of these agreements be greater than currently anticipated before policy adjustment, we would request an augmentation of the PRGF arrangement by up to 10 percent of quota, or SDR 12.2 million, under the TIM's deviation feature.

5. Reflecting the urgency in bringing the government's request for a three-year PRGF-supported program for consideration by the IMF Executive Board, the first review is expected to be conducted by end-November 2006 and the second review by end-April 2007, and will be based, respectively, on the end-July and end-December 2006 performance criteria as well as on the continuous PCs and the relevant structural conditions.

Sincerely yours,

/s/

Benjamin Radavidson
Minister of Economy, Finance and Budget
Antananarivo, Madagascar

/s/

Gaston Ravelojaona
Governor
Central Bank of Madagascar
Antananarivo, Madagascar

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

APPENDIX I—ATTACHMENT II
MADAGASCAR: MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2006–08

I. INTRODUCTION

1. Madagascar is doing its utmost to achieve the Millennium Development Goals aimed at reducing poverty by half by 2015. The policy strategy adopted for this purpose is set out in the Poverty Reduction Strategy Paper (PRSP), which was updated in June 2005. Since the programming period for implementation of the PRSP will come to an end on December 31, 2006, the Malagasy government is currently formulating a development policy to take over from the PRSP. This policy, known as the Madagascar Action Plan or MAP, is a five-year plan spanning the period 2007 to 2011. The MAP builds on the achievements of the PRSP and takes account of domestic and international developments in order to make a qualitative leap in development and achieve the objectives of both the MDGs and the long-term vision described in "*Madagascar Naturellement.*"

2. The updated PRSP confirms the country's medium-term desire for strong and stable economic growth, founded on three pillars; (i) good governance; (ii) growth benefiting the entire population; and (iii) and better public services, especially in the education and health sectors. Economic policy to promote economic growth calls for a boost in aggregate supply and greater private and public sector investment, particularly in infrastructure. Thus, in an extension of the value chain, the subsistence economy is expected to evolve toward the market economy, the rural economy will expand into industry, and external openness will be reinforced by export growth.

3. Last year witnessed an inflationary upsurge which was brought under control in early March. The Malagasy economy was thus able to maintain the stability it had acquired in the second half of 2004 in respect of the exchange rate and inflation. However, government finance performed below expectation as a result of a 12 percent shortfall in tax revenues. This decline in earnings resulted in the imposition of two expenditure caps, which were only partially enforced, however, because of administrative weaknesses, with the result that the expenditure and domestic balance[1] targets were exceeded by around 1 percent of GDP. Real GDP growth for 2005 reached 4.6 percent and inflation declined to 11.4 percent by the end of the year**.** The financial problems facing the national water and electricity company (JIRAMA) resulted in power outages which disrupted economic activity and increased the cost of doing business. The current account deficit (including grants) widened to 10.8 percent of GDP owing to the increase in world oil prices and a drop in exports following the termination of the Agreement on Textiles and Clothing and the collapse of vanilla prices

[1] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.

4. In the first quarter of 2006, there appeared to be some slowing in the economy, partly coming from further increases in world oil prices and lower-than-expected rainfall impacting on hydroelectric and agricultural production. Consequently, the government was forced to borrow on the domestic financial markets, which pushed interest rates on treasury bills upward by about 3 percentage points over the quarter. The central bank maintained a restrictive monetary policy during the quarter and inflation—10 percent at end-March year-on-year—edged slightly lower than at end-2005.

5. The country's macroeconomic performance is supported by various measures reflecting its determination to forge ahead. Over the last few years, fiscal management reforms have been the most outstanding, in particular on the revenue front, as shown by the following reforms. In the customs sphere, the rates of import duties and taxes have been restructured and simplified, customs clearance has been streamlined, and the ASYCUDA++ software has been installed in the Toamasina customs offices. The rates of domestic taxes and levies have been lowered, and the tax base expanded by making inspection and oversight more effective. The SYGTAS program has been installed at the Large Enterprise Tax Office (DFGE). Efforts have also been made to achieve greater transparency and sound management of public expenditure. A new program budget system was introduced and laws governing government finance were approved in 2004 and implemented from 2005 onward, including: the organic law on the Budget Laws, the new Public Procurement Code and their respective implementing regulations, and the reorganization of the Council on Budgetary and Financial Discipline. Nevertheless, the difficulties experienced in 2005, both in terms of tax collection and expenditure control, point to the persistence of numerous underlying problems, which the government is committed to resolving in close association with development partners.

6. A new Foreign Exchange Code was drafted to resolve discrepancies among the existing laws and to gather the laws into a single document, to facilitate consultation by administrations and dealers. The main purpose of the revision was to make the Code consistent with the new orientations of the policy of economic openness, in which all current transfers are liberalized. However, capital movements still require prior authorization from the Finance Ministry.

7. Completion point under the enhanced HIPC Initiative was reached in October 2004. Further, Madagascar has qualified for additional debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006, leading to the cancellation of a significant amount of its external debt by its international partners. The total amount of debt relief provided by the IMF, the International Development Association (IDA), and the African Development Fund (AfDF) under the MDRI amounts to MGA 5,237 billion (US$ 2,402 million, 44 percent of GDP, with the ratio of the net present value of debt to GDP declining from about 36 percent in 2005 to about 15 percent. The IMF debt relief, which became effective on January 6, 2006, amounts to US$ 197 million. IDA debt relief, which will become effective in July 2006, amounts to US$1,878 million. And the African Development Fund (AfDF) debt relief, which became effective on April 19, 2006, amounts to US$327 million. Together, the MDRI relief

will free about MGA 73 billion (US$ 36 million, 0.6 percent of GDP) for additional priority spending in 2006, and about double that amount on average each year over the next twenty years.

8. As the government remains convinced of the need to lay a sound foundation for sustainable and lasting growth in the medium term, it is seeking a new Poverty Reduction and Growth Facility (PRGF) arrangement to support implementation of the economic and financial policies contained in this memorandum. In parallel with this request, the government is requesting the activation of the IMF's Trade Integration Mechanism (TIM) in case the effect of the elimination of textiles quotas and the termination of the Africa Growth and Opportunity Act (AGOA) turn out to be greater than anticipated in this program. In this regard we plan to monitor the impact closely to assess whether a request for an augmentation of access under the deviation feature of the TIM would be warranted. This augmentation will be based on a comparison of TIM's baseline projection as defined by the current program projections for 2007 to 2008, with the actual outcomes.

II. Medium-term economic policy framework (2006–08)

9. In order to achieve the Millennium Development Goals to which Madagascar is committed, in particular halving the number of people living in extreme poverty by 2015, the government intends to implement economic policies in the medium term to promote strong and stable growth, fueled by a high level of investment.

10. In accordance with the guidelines adopted in the updated PRSP and the MAP, the strategies to be pursued will be based on: (i) the development of key sectors such as export-oriented manufacturing, mining, tourism, and particularly agriculture, where there will be special emphasis on improving infrastructure and restoring agricultural productivity. Support for this has already been obtained from financial partners, through projects and programs such as the Millennium Challenge Account (MCA) and the Integrated Growth Pole (PIC); (ii) implementation of a package providing incentives and security for private local and foreign investment (FDI); and (iii) development of human capital by improving the population’s access to health, education, water, and sanitation services.

11. The government has established the following macroeconomic goals for the next three years: (i) achieve an average real GDP growth rate of about 5 ½ percent during 2006-2008; (ii) reduce consumer price inflation to 6 percent; (iii) increase the tax burden from 10.1 percent of GDP in 2005 to about 12 percent in 2008; (iv) improve the management and effectiveness of public expenditure; (v) reduce the domestic budget deficit and hold it at about 1 percent of GDP; (vi) maintain the sustainability of both domestic and external debt; (vii) stabilize the current account deficit around 10.5 percent of GDP; and (viii) maintain the level of gross foreign assets held by the central bank to the equivalent of at least three months of imports of goods and nonfactor services.

12. During the period 2006-2008 real GDP growth will essentially be fueled by a high and sustained level of investment (averaging 22.2 percent of GDP), with an initial strong

increase of government investment in 2006, particularly externally-funded investment projects, followed by a rise in private sector investment. The strongest growth is expected to come from the secondary and tertiary sectors, owing to the effects of increased investment activity. The reduction of inflation to 6 percent during the period will be achieved through prudent fiscal and monetary policies and expanded domestic production. This will lead to an increase the population's purchasing power and progress in the poverty reduction process.

13. To attain the macroeconomic goals described above, the government has defined an appropriate set of measures and is implementing the corresponding reform programs (Annex). These measures and reforms include those that underpin strong economic growth sustained by high levels of public and private investment. Against this backdrop, the government is determined to implement suitable macroeconomic and structural policies, with the following objectives: (i) ensure macroeconomic stability; (ii) reduce the country's vulnerability to shocks; and (iii) sustain high levels of growth. To achieve these objectives, the government intends to: (i) maintain political stability; (ii) establish a favorable legal and regulatory framework creating a more attractive and secure climate for investors; (iii) establish the rule of law, guaranteeing respect for property rights; protection of property; individuals and production activities and continuation of the fight against corruption; (iv) strengthen civil service reform to guarantee high-quality public administration and transparent governance; (v) streamline administrative procedures and improve the clarity and predictability of government actions; (vi) persevere with the policy of external openness; (vii) facilitate access to basic infrastructures that act as vectors of development (roads, transport, communications, energy, etc.); and (viii) adjust energy prices continuously in line with oil prices so as to mitigate the impact on the external accounts.

14. Fiscal consolidation will continue over the medium-term. Accordingly, the authorities will redouble efforts to bring the budget into line with the priorities defined in the PRSP, and to maintain the dynamism acquired thus far as a result of reforms already undertaken. The resources freed up by the debt relief granted under the MDRI will be allocated to priority expenditure in line with the PRSP and the MAP. On the revenue side, the key measures will aim to: (i) provide better tax service to economic agents and easier access to related services, in the hope that better understood taxation would be more readily accepted; (ii) set up a comprehensive national record of the entire taxpaying population to ensure better monitoring of taxpayers; (iii) increase the level of nontax receipts (mining and/or fishing royalties, and the agriculture sector particularly). On the public expenditure side, steps will be taken to: (iv) consolidate the link between fiscal policy and poverty reduction; (v) improve budget formulation, execution and monitoring; and (vi) strengthen oversight bodies. Lastly, an effort will be made to improve domestic and external debt management.

15. During 2006-2008, the central bank will continue to implement monetary policy aimed at controlling inflation in a flexible exchange rate environment. The central bank will only intervene in the foreign exchange market to avoid excessive exchange rate volatility. The bank will reinforce its operational framework in line with recent Fund recommendations in the framework of technical assistance. The government will make consistent efforts to

gradually reduce borrowing from the central bank to below 10 percent of total revenues by 2008. In addition, efforts to develop the country's financial sector and strengthen its stability, thus better mobilizing savings and channeling them into productive investments, will be continued. Particular attention will also be paid to reducing the cost of doing business, monitoring the soundness of the banking sector and developing microfinance institutions.

16. To reduce the current account deficit, the government will take steps to apply the following measures: (i) increase the supply of exportable goods and services by improving the economic environment needed to make exports more competitive and by diversifying the goods and services to be exported; and (ii) further streamline the tariff structure over the medium term. The government will step up efforts to attract foreign direct investment.

17. In addition, in order to keep external debt at a sustainable level, the government will give priority to seeking external funding in the form of grants and will not contract any additional external debt except on concessional terms as stipulated in the technical memorandum of understanding (TMU) (Appendix I, Attachment III, para. 3). The government will also keep the more expensive domestic debt at a low level , as well as identify and control contingent liabilities.

18. Apart from the consolidation of actions taken in the field of investment, the government is convinced of the overarching role of education in development and poverty reduction, and has therefore decided to implement the education-for-all policy. Education policy has an important role to play in strengthening Madagascar's competitiveness and making it possible to form a skilled labor force. Efforts to improve infrastructures will be continued (particularly school building and refurbishment), along with the promotion of informal education in order to optimize human capital. As with education, improvements in the health sector are also essential in the fight against poverty. Measures to promote mother and child health, combat malnutrition and disease, and improve healthcare infrastructures will be maintained over the next three years.

19. Implementing this program will help attenuate vulnerability to the main risks facing the Malagasy economy, namely further deterioration in the terms of trade and cyclones. Continuous adjustment of energy prices to keep pace with oil prices will soften the impact on the external accounts. Implementation of a flexible exchange rate policy will make it easier for the exposed sector to adjust to the change in relative prices. A resolute policy of external openness of the Malagasy economy will serve to consolidate and diversify the economic fabric. And further fiscal consolidation and control will facilitate the build up of financial reserves, identification of nonpriority expenditure and securing of development partner confidence needed to fund expenditure in the wake of a natural disaster.

III. PROGRAM FOR 2006

20. In keeping with the medium-term policy framework, the main macroeconomic goals for 2006 are as follows: (i) keep the real GDP growth rate at about 4.7 percent; (ii) reduce

average inflation to 11.2 percent; (iii) increase the tax burden to 11 percent of GDP, compared to 10.1 percent in 2005; (iv) hold the domestic budget deficit to no more than 0.9 percent of GDP; (v) restrict the external current account deficit to 10.5 percent; and (vi) keep the gross foreign assets of the central bank to at least 2.9 months of imports of goods and nonfactor services. To achieve these objectives, the government intends to implement the fiscal, monetary, trade policy, institutional, public enterprise policy and social policy measures described below. The government has set up a follow-up committee to monitor implementation of these measures. The follow-up committee comprises representatives of the Presidency the Prime Minister's Office, the Ministry of Economy, Finance and Budget, the Ministry of Industry, Commerce and Private Sector Development and the Central Bank. The Committee will facilitate information flow and coordinate the activities of the institutions concerned.

A. Fiscal Policy and Reforms

Fiscal policy

21. In 2006, tax revenue is now expected to reach a level of MGA 1,295.8 billion, representing a tax burden of 11 percent of GDP. Given this level of tax revenue and the expected grants and loans under concessional terms, total public expenditure is expected to rise to MGA 2,580.5 billion (21.9 percent of GDP) in 2006. Operating expenses, excluding interest and wages, and payroll costs are set to reach MGA 371.7 billion (3.2 percent of GDP), and MGA 599.8 billion (5.1 percent o GDP) respectively. Public investments will rise to MGA 1,359.2 billion (11.5 percent of GDP). Consequently, the overall deficit (on a cash basis, excluding capital transfers under the MDRI) will stand at MGA 602.5 billion (5.1 percent of GDP).

22. To reach this objective, the government will introduce a supplementary budget to parliament which will reduce current expenditure, excluding interest and payroll costs, and domestically financed capital expenditure by a total amount of about MGA 127 billion[2] (1.1 percent of GDP) compared to the to level approved in the 2006 budget. Cuts in an amount of MGA 200 billion (1.7 percent of GDP) are necessary to offset tax revenue shortfalls of MGA 45.6 billion (0.3 percent of GDP) compared to the 2006 budget, reductions in budgetary support provided by development partners in an amount of MGA 80.6 billion (0.7 percent of GDP), and inadequately budgeted items in the 2006 budget in an amount of MGA 60.5 billion (0.5 percent of GDP), as well as to eliminate excessive spending in an amount of MGA 13.3 billion (0.1 percent of GDP). But the MDRI relief will free about MGA 73.4 billion (0.6 percent of GDP), which will be allocated to poverty reducing spending in the supplementary budget, and limit the size of the reduction in

[2] Under the assumption of African Development Bank budget support of SDR 17.5 million in 2006, and subject to an adjuster for any change in budget support compared to the program scenario, as described in the TMU (Appendix I, Attachment III, paras. 25-27).

expenditure to MGA 127 billion. The government will cut non-priority spending more than priority spending (i.e. education, health, justice, agriculture, environment protection and infrastructure).

23. In the near term, the government regards the key target of fiscal policy to be net domestic financing (NDF)[3] of the budget, which will be limited to a reduction of MGA 55.6 billion (0.5 percent of GDP) in 2006. This will serve to maintain domestic debt sustainability. Should domestic revenue for this year not be in line with forecasts, any under/over performance in revenues (not offset by increased foreign inflows) will be compensated by an adjustment in domestically financed expenditures in order to meet the net domestic financing target. Any surplus revenues will be used to increase the allocations to priority ministries using the procedure of advances by decree. In the case of a revenue shortfall, the following contingency spending reduction will be implemented: expenditure will be reduced by adjusting mainly the commitments for non-priority spending established in the circular from the Ministry of the Economy, Finance and Budget.

Tax administration

24. Given the structural and organizational difficulties encountered in collecting tax revenues, both in 2006 and in previous years, the government is determined to implement the priority measures described in the annexed document (Annex).

25. With regard to customs, and thanks to the implementation of the Administration's new strategy prepared in 2005, the government is carrying out a program of priority reforms to improve the functioning of the administration and boost revenues, based on the following:

- No granting of ad hoc tax and/or tariff exemptions outside those specified in the Customs Code, international treaties and conventions.

- No granting of exemptions from the requirement to present a post-customs inspection report (RIE) for the import and clearance of goods, nor on the use of SGS valuation of goods.

- Strengthening of the unit responsible for coordinating, monitoring, and evaluating customs actions with a view to piloting measures for implementation of the new strategy and taking steps to improve the collection of customs revenues.

- Improvement of the quality of customs services introduced in Toamasina in 2005, by extending installation of the ASYCUDA++ system to the five largest customs bureaus (including Antananarivo, Majunga, Antsiranana and

[3] As defined in the TMU (Appendix I, Attachment III, para. 10).

Tuléar), as well as developing and implementing a service standard in customs offices using this software. These measures should make it possible not only to strengthen the operational effectiveness of the services but also to step up the fight against fraud.

- Strengthening of monitoring and oversight by using modern control tools during the customs clearance process in collaboration with the SGS (scanner and Profiler, Valuenet and Resus software at Toamasina and Ivato).

- Improvement of the communications network among all stakeholders involved in customs clearance (customs, port, shipping companies, freight forwarders, banks, etc.), through use of the TRADENET system, in order to minimize the risk of using false customs documents and facilitate more effective merchandise targeting even before the vessels in question have arrived.

- Tightening of eligibility conditions for economic regimes (temporary admission, customs warehouse, transit, etc.).

- Improving integration of customs manifests in the ASYCUDA++ information system using the converter.

- Stepping up of ex post controls by creating mobile surveillance units in the six provinces.

- Strict application of the requirement to pay customs duties either by guaranteed bills or by bank transfer, to make customs receipts more secure.

- Simplification of the tariff structure for imports by reducing the number of rate categories to three and eliminating excise duties on all products except tobacco, alcohol, petroleum and mining products and cosmetics.

26. With respect to domestic taxation, the government is continuing its program of modernizing management tools and reorganizing structures, simplifying, and pursuing a more coherent tax system, with a view to significantly increasing the level of tax revenues. To this end, steps will be taken to (i) review all existing tax and tariff exemptions and waivers, with a view to eliminating them where necessary; (ii) review provisions of the 2007 Budget Law that allow the Ministry of Finance to negotiate preferential tax treatment with potential investors on an ad hoc basis; and (iii) simplify the number of goods subject to indirect taxes and rationalize their rates.

27. Collection of VAT has been severely undermined by: (i) the accumulation of arrears of VAT payments by the government on externally funded capital expenditure (currently estimated at MGA 9.8 billion, or 0.1 percent of GDP in 2005); (ii) the accumulation of arrears on VAT refunds to free zone enterprises and exporters (MGA 10.8 billion or

0.1 percent of GDP at end-2005); and (iii) the build up of outstanding VAT credits (MGA 45.2 billion, or 0.4 percent of GDP at December 31, 2005). With a view to bringing the proceeds and management of VAT under control once and for all, the government undertakes to: (i) conduct an audit of the government's VAT arrears on capital expenditure by end-September 2006; (ii) reimburse VAT owed to exporters and export processing enterprises for business conducted in 2006 within 60 days starting April 1, 2006; and (iii) conduct a verification of at least 80 percent of outstanding VAT credits at end-June 2006 before end-December 2006. With a view to reducing the build up of VAT arrears, the government will include additional credits amounting to MGA 36 billion in the 2006 Supplementary Budget Law, which will be submitted to Parliament in July, and will ensure that all ministries receive sufficient credits to pay VAT on externally-funded capital expenditures included in the 2007 Budget Law.

28. The actions to be taken to enhance tax system effectiveness with a view to attaining the government's domestic tax revenue target require the mobilization of efforts and resources to give priority to the management of taxpayers with high fiscal potential. To achieve this, the Tax Office (DGI) intends to: (i) strengthen the tax administration management of medium-sized taxpayers (annual turnover of between MGA 0.5 and 2 billion), while continuing to improve management of taxation of large enterprises (turnover of over MGA 2 billion); (ii) develop and implement a selective audit program covering all categories of taxpayers (with priority given to large and medium-sized enterprises) and combine different audit methods ; and (iii) establish monthly activity and performance indicators for all revenue collection services, including the DFGE (Large Enterprise Tax Office) and the regional services. In addition, DGI will implement the following activities: (i) exchange of information and, over time, placement of data held by customs, the Treasury, and the tax administration on a network to optimize the use of such data for tax control purposes; (ii) continuation of tax audits underway in the tourism, construction, and transport sectors; and (iii) expansion of the tax base to encompass the informal sector, supported by systematic taxation made possible by computerized cross checks.

29. As was done for custom duties, the government intends to develop a clear strategy and implement priority reforms to improve the collection of domestic taxes. Building on the IMF Fiscal Affairs Department 2003 and 2006 technical assistance recommendations, the government will develop a priority action plan by end-December 2006.

Public financial management

30. On the public expenditure side, the authorities will implement the priority public financial management (PFM) action plans designed in cooperation with development partners aimed at improving the management and effectiveness of public expenditure, and strengthening control over budget execution and cash management.

31. The objective of the new budget framework is to consolidate integration of the PRSP priorities (specifically the government's programs in the context of poverty reduction) in the budget law preparation process as from 2007 by using a functional and sub-functional

classification regarding poverty reduction, preparing a correspondence table between the MAP and the functional classification of the budget with technical assistance, continuing to eliminate redundancies and establishing fewer but better-defined, measurable indicators, which will facilitate strict management and improved monitoring of budget execution. Simplification of the budget classification by retaining only three programming levels (mission, program, and objective) is also essential and will be rolled over in the 2007 Budget Law, which will be submitted to Parliament in October 2006.

32. For the 2007 budget law, the budget preparation process will be consolidated and the quality of program budgets improved. Budgetary forecasting will be based on more realistic assumptions on both the revenue and expenditure sides, and the budget preparation process started with the establishment of initial guidelines followed by notification of ministries of the preparation of the medium-term expenditure framework (MTEF). The areas covered by the financial data that accompany the draft budget laws will be broadened, and data on payroll expenses will be remodeled. Departments with budget responsibilities will undergo structural reorganization to give them the expertise needed to aid government decision-making and monitor public investments more effectively. Guidelines for improving the MTEF of the various ministries and institutions have also been discussed.

33. In terms of expenditure management, the government will strive to achieve a significant improvement in budget execution and to that end will implement a series of measures that should make it possible to remedy deficiencies in controlling commitments. These measures include: (i) issuance of instructions by Ministry of Finance to the other ministries to submit monthly plans for expenditure commitments in accordance with the quarterly budget appropriations; these monthly plans will serve as tools for monitoring compliance with expenditure ceilings as part of overall control of committed expenditure (Financial Control); (ii) issuance in September 2006 of monthly commitment ceilings for the last quarter of 2006 by the Ministry of Finance to all ministries on the basis of the latest cash flow plan prepared by the Treasury; (iii) an external analytical and organizational audit of Financial Control with a view to taking concrete steps to improve monitoring of commitments before year-end; (iv) reform of the expenditure chain by disseminating the voucher classification, installing information systems software, thereby making it easier to monitor the rate of rejection by Financial Control and the Treasury, and studying the merits of merging the functions of the secondary payment authorizing officer (*ordonnateur secondaire*) and the activities manager (*gestionnaire d'activités*); (v) improvement of government cash management by strengthening the unit responsible for cash flow forecasting and the coordination of liquidity management, training staff of the principal treasuries in the use of the cash management guide, development of a mechanism to improve data centralization through the internet for principal treasuries that do not have the fiscal management system (SIGFP), regular reconciliation of the government's bank accounts and accounts held by the Treasury; (vi) production of four-month budget execution reports by all line ministries, based on an economic classification, in the four weeks following the end of the reference period; and (vii) monitoring of MDRI-financed expenditure. This should result in more effective monitoring of budget execution both in the sectoral ministries and in the

MEFB. With regard to the computerization of fiscal management, the SIGFP development process will begin with the preparation of a blueprint and proceed towards exhaustive coverage of all government expenditure.

34. Reform strategies will also be implemented to strengthen the monitoring and oversight of budget execution, based essentially on the following: (i) management oversight to compensate for difficulties beyond the scope of internal control; (ii) less ex ante control, and, as a corollary, more ex post and on-site controls, to more effectively verify certification of the service provided and foster a culture of performance and effectiveness; (iii) implementation of the action plan contained in the recommendations of the Financial Control audit to be conducted by an independent firm; (iv) enforcement of sanctions against persons responsible for serious irregularities; (v) extension of the scope of oversight activities; (vi) strengthening of external controls and implementation of recommendations made by oversight and inspection bodies; and (vii) timely production of final accounts (budget review laws, end-year treasury accounts) in keeping with the scheduled timeframes (Annex). The capacities (human, material, and training) of oversight bodies such as the Treasury control and internal audit units will be strengthened, and their field of intervention expanded to cover other government areas (account officers of government administrative agencies, diplomatic posts, territorial governments, etc.). Steps will be taken to become involved in implementation of the SIGFP, in order to oversee developments in the computerized fiscal management system and incorporate alert indicators and accounts analysis tools.

35. Audit and budget control functions will also be strengthened by actuating the Inspectorate General of Finance (IGF), appointing its members, and making the necessary resources available. A draft manual of internal control procedures will be prepared, as well as a clarification of its field of competence compared to that of the Inspectorate General of State (IGE) and its positioning relative to the issues involved in decentralization and external financing.

36. In terms of the external oversight exercised by Parliament, the Audit Office, the Financial Tribunals, and the Budgetary and Financial Discipline Council (CDBF), the following measures will be taken: (i) training for members of parliament in fiscal management; (ii) systematic inclusion in the Audit Office annual work plan of thematic studies analyzing the work of payment authorizing officers; and (iii) establishment of financial tribunals in the provinces as well as the CDBF, in order to apply financial sanctions, as promptly as possible, for fiscal mismanagement.

37. The government is currently working to activate the new public procurement system through: (i) establishment of a new legal and institutional framework, by preparing and approving implementing regulations for the new Public Procurement Code; (ii) establishment of the Public Procurement Regulatory Authority; and (iii) strengthening of the capacities of participants in the public procurement system (PRMP, UGPM, secondary payment authorizing officers), with special emphasis on capacity building in the priority ministries.

38. The government undertakes to use the lessons of the current public expenditure analysis with the World Bank to improve the preparation, implementation and monitoring of public investments.

B. Monetary and Financial Policy

39. The central bank monetary program for 2006 will focus on attaining the targets for inflation and level of foreign reserves, and allowing for an adequate expansion of credit to the economy sufficient to achieve the GDP growth target while meeting the financing requirements of the government. To attain the target for inflation, the BCM is currently using indirect monetary policy instruments such as the bank rate, the reserve requirement, and money market liquidity injection and mop up operations. The bank is also improving the operational framework of liquidity forecasting and management, as well as strengthening coordination with the Treasury. BCM will give priority to achieving the foreign reserves target in the second half of the year as the government will benefit from multilateral debt relief under the MDRI and plans to only intervene in the foreign exchange market to smooth exchange rate volatility.

40. The monetary authorities intend to strengthen the effectiveness of the monetary policy instruments available to them, by: (i) fine tuning indirect monetary policy instruments; (ii) improving the operational framework of liquidity forecasting and management, as well as strengthening coordination with the Treasury; and (iii) putting in place the mechanisms necessary to facilitate transactions on the domestic money market. The key measures that have already been taken or are currently under study are as follows: (i) expansion of access to Treasury bill auctions, by lowering the minimum denomination from MGA 40 million to MGA 20 million and extending auctions to other large towns; (ii) broadening of the range of monetary instruments by gradually converting securitized public debt held by the central bank into negotiable securities; to that end, a bill modifying certain provisions of the Central Bank Charter will be submitted to Parliament by year-end; (iii) better coordination of work with the Treasury, in order to forecast and manage liquidity more effectively; (iv) establishment of mechanisms to cover counterparty risks on the interbank money market, with technical assistance from the IMF; and (v) reduction of the time required for the settlement of interbank transactions at the BCM, the diagnostic study for which will be financed by the Millennium Challenge Account (MCA). BCM will work with the Treasury to issue public debt securities at market rates with longer maturity dates than Treasury bills.

41. The government is taking steps to strengthen the financial viability of the Central Bank through a recapitalization of the BCM to provide it with the resources it needs to manage money market liquidity effectively. A recapitalization plan will be included in the 2007 Budget Law to be submitted to Parliament in October 2006. Additionally, the Governor of the Central Bank approved a time-bound action plan for strengthening the central bank's control, accounting, reporting and auditing systems, in line with the main recommendations of the March 2006 Safeguards Assessment. The BCM will strengthen the internal audit department and verify coherence with the data on net domestic and external

assets provided to the IMF to monitor the program. The government commits to limit transactions between the government and the central bank to only those permitted by the Central Bank Act. The annual report by the external auditor will include a separate report on transactions between the central bank and the government and their compliance with the Central Bank Charter.

42. The development of the country's financial infrastructure is a priority, in order to reduce the financial cost of loans to the private sector and to expand the capacity for financing the government through the private sector. To help mobilize domestic saving while ensuing the soundness of the financial system, the authorities have adopted a microfinance law and strengthened staffing at the General Secretariat of the Banking and Financial Supervision Commission (CSBF). New measures to be implemented shortly include: (i) strengthening the training capacity of the CSBF General Secretariat and increasing equipment availability; and (ii) defining a legal and regulatory framework conducive to the development of microfinance institutions. Additionally, the following measures will also be programmed: (i) reform of the regulatory framework with the support of the FSAP mission, to enhance competition in the banking sector; (ii) building judiciary capacity in the area of commercial law; (iii) facilitating the development of micro credit institutions through the training of heads of micro credit institutions with assistance from the World Bank and the MCA, the promotion of new agricultural financing instruments, and by extending the services of the risk-rating agency; (iv) establishment of a legal and regulatory framework to create a capital market; and (v) promotion of access to bank loans by modernizing the property registration system to facilitate the use of land as collateral. The authorities also recognize the importance of expanding private sector financing of the government, and will look at the potential for realignment of taxes on interest income and Treasury bill returns, to encourage saving.

43. The interbank foreign exchange market (MID) has worked well in allowing the foreign exchange rate to fluctuate and respond to market conditions, additional actions are, however, needed to improve its efficiency. To this end, the BCM will (i) ensure that it implements its operational framework more rigorously; (ii) recommend that all bids and offers are brought to market; and (iii) ensure the publication on a real time basis of more data on the volume and price of transactions.

C. External Relations and Regional Integration

44. The current account deficit (including grants) should start to trend downward in 2006 (narrowing from 10.8 percent of GDP in 2005 to 10.5 percent in 2006). This will mainly result from a slackening of imports, which should make itself felt from 2006 onward, supported by a robust export performance, with the situation starting to show improvement thanks to the implementation of various measures such as: (i) creation of a favorable environment for lowering production costs and developing the productive sectors, partly thanks to improved regulatory policies, the growth and diversification of financing instruments, and the strengthening of economic and social infrastructures; and

(ii) diversification of the goods and services export basket as a result of efforts to expand both traditional and nontraditional exports, as well as expansion into new export products (essential oils, mining products, etc.). Efforts to attract foreign capital flows, particularly private flows, will also be continued, in order to make up for shortfalls in official capital transfers or other external funding.

45. Efforts to increase external openness will also be continued, particularly through regional integration processes and the implementation of an effective trade policy. Madagascar's recent admission to the Southern African Development Community (SADC) sends a strong signal to investors seeking new market opportunities, especially since member countries are relying on the country to act as the region's "bread basket." Although further streamlining of the tariff structure is envisaged in the medium term, more immediately the government intends to eliminate duties on certain imported goods (dairy products, wheat, and sugar), and other persistent distortions that could be acting as hidden taxes. In June 2006, the government will launch a study on the tariff rate required to offset the impact of implementation of a single tariff of which the findings will be published by latest June 2007.

46. Policies on external debt management for 2006 will mainly aim to maintain a sustainable level of debt. To achieve this, all new external debt will be contracted at concessional rates. With a view to improving public debt management, the following actions are proposed: (i) implementation of the SYGADE software, which will replace the previous program, thereby making it possible to update the debt file in real time; (ii) staff training in the use of this software; and (iii) establishment of a link between the central bank and the Treasury.

47. In order to achieve the development goals set out in the PRSP, the World Bank, France, the European Union, and the African Development Bank have decided to increase the budgetary support they provide to Madagascar, through a new partnership framework. The aim here is to strengthen cooperation between the government and its partners, in order to make more efficient use of foreign budgetary assistance through: (i) harmonization of partners' processes and procedures; (ii) consolidation of the dialogue between the government and its partners; (iii) greater predictability of flows of budgetary assistance from partners (in terms of scheduling and amount); (iv) closer alignment between budgetary support programs and national processes; and (v) coordinated support for capacity building. A joint performance monitoring framework based on predetermined criteria has been defined, along with a review process to keep it up to date.

D. Institutional Reforms

48. In 2006, institutional and structural reforms will also be implemented to support economic policy measures. They will target the following areas: the fight against corruption; respect for democracy; establishment of the rule of law; and bringing government closer to the citizenry through civil service reform, decentralization and deconcentration.

49. In the fight against corruption, where the superior integrity council (CSI) and BIANCO are already active, steps taken in the first year of this work will be intensified in 2006, through the following actions: (i) a public opinion survey to asses the impact of activities undertaken in the first year of BIANCO operations; (ii) establishment of an anticorruption unit in each ministry as well as the effective application of enforcement measures; and (iii) focusing of research in 2006-2007 on the key economic sectors, including energy, mining, environment, and rural development. The anticorruption strategy will also be brought up to date and the legal framework strengthened.

50. In the justice sector, the aim is to convince the public in general, and local and foreign investors in particular, of the judiciary's effectiveness and impartiality. Measures to be taken in this regard will consist of: (i) strengthening the anticorruption mechanism within the judiciary; (ii) ongoing implementation of the judicial units provided for in the Constitution; (iii) continued strengthening of existing units; (iv) streamlining of procedures related to the adoption of laws and the handling of cases; and (v) establishment of a plan of action for closely monitoring the effective application of laws and regulations.

51. To guarantee security, additional law enforcement officers (police, gendarmes) will be deployed in both urban and rural areas, particularly in high risk ("red") zones, where the number of security operations will be increased. The authorities will also take steps to improve collaboration between the police and the judiciary on this issue.

52. With regard to the civil service reform, the "Voy Rindra" operation, which the authorities are currently implementing, should result in a new classification of civil service jobs and positions. The resulting database will be used as a basis to rationalize the civil service wage scale, introduce merit-based pay increases, identify capacity building needs, and ensure transparency in recruitment, while remaining within the limits of the total wage bill allocation specified in the program.

53. At the local level, the chief aim of decentralization/deconcentration is to facilitate the production of high-quality local services by including communes and regions in the development process. Actions in 2006 could be aimed towards: (i) consolidation of knowledge acquired by local authorities (mayors, municipal councilors, etc.) regarding measures to boost local government resources; (ii) strengthening of synergy between the various regional structures (regions, communes); and (iii) an increase in the number of district administrative representatives to ensure government presence throughout the national territory. For this purpose, the intervention and advisory support capacities of the decentralized services will be reinforced. In addition, the regions will be better integrated into regional dialogue structures to enable them to participate fully in the coordination, planning, monitoring, and evaluation of programs and projects relevant to their constituency. The same applies to the laws and regulations governing decentralized bodies, through the correction of inconsistencies.

E. Reform of Public Enterprises

54. The government has launched an ambitious plan to restore the profitability of the state electricity and water company JIRAMA. In April 2005 it transferred management of the company to a private company under a two-year management contract, and over the course of 2005 year implemented two tariff increases raising electricity prices by 76 percent. It also contracted with financial experts to review JIRAMA's financial situation and prepare a financial restructuring plan for the utility, which resulted in a conference of development partners held in Paris from January 10-12, 2006 at which the plan was presented to the donor community. The government has increased water and electricity prices by a further 20 and 15 percent, respectively, in 2006, and will contribute MGA 50 billion to capital increases of the company in 2006. The government will include an appropriation of MGA 7 billion in the 2007 Budget Law with a view to repaying the loan contracted by the Treasury with the National Social Security Fund (CNAPS) to fund a transfer to JIRAMA in 2005. In September 2007, the government will grant a concession to a private party regarding the management and operation of JIRAMA when the current private management contract expires. On the basis of these commitments, donors have committed to provide financial support for JIRAMA's restructuring.

55. Reforms aimed at reducing government involvement and liquidating public enterprises will be continued. The schedule for 2006–07 envisages, with the financial support of development partners, liquidation through the divestiture of assets of 22 public enterprises, including principally: ROSO (distribution), FIMA (transport), SIB (wood), COROI (distribution), RNCFM SUD (transport) and Port de Manakara (transport). A timetable and estimates of net proceeds from the sales will be drawn up before October 2006.

F. Social Policies and Poverty Reduction

56. Within the framework of improving the welfare of the population and reducing poverty, specific measures will be continued and strengthened in the fields of education, health, access to drinking water, and sanitation. Educational actions will target the following: (i) improvement of access to education by building new classrooms in rural areas, particularly for primary schools; (ii) more precise identification of intervention sites by improving the distribution of schools; (iii) recruitment, training, and rational distribution of new teachers, including at the primary school level; and (iv) procurement of basic teaching materials and essential equipment. To ensure a significant reduction in the repetition rate, more multigrade classes are needed in rural areas, especially in isolated localities, as well as more full-cycle schools.

57. Actions in the health sector will focus on: (i) improvement of public access to quality services by building and refurbishing basic health centers (CSBs), and raising the technical level of reference hospitals through the rehabilitation and provision of technical equipment and materials; (ii) development of human resources by recruiting medical and paramedical staff, along with support personnel and specialists; (iii) budgetary prioritization for new

structures and remote areas; and (iv) studying of a system of incentives for doctors in remote areas.

IV. Program Performance Criteria and Monitoring

58. The program supported by the IMF under the PRGF will be monitored through semiannual reviews and through quantitative and structural performance criteria and benchmarks, and indicative targets (Tables 1 and 2).

59. The Government of Madagascar will also observe the standard performance criteria against imposing or intensifying exchange restrictions, introducing or modifying multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, and imposing or intensifying import restrictions for balance of payments reasons.

Table 1. Madagascar: Quantitative Performance Criteria for the 2006 PRGF Arrangement [1]
(Billions of Ariary, cumulative from 1st January, 2006, unless otherwise indicated)

	July 31 Performance Criteria	September 30 Benchmark	December 31 Performance Criteria
	Proposed Program	Proposed Program	Proposed Program
I. Quantitative performance criteria			
External			
(a) Ceiling on accumulation of new external arrears (in millions of SDRs) [2]	0.0	0.0	0.0
(b) Ceiling on contracting or guaranteeing of new external debt on nonconcessional terms [2]	0.0	0.0	0.0
Central Bank			
(c) Floor on net foreign assets (NFA) of the BCM	-24.1	62.7	77.5
(d) Ceiling on net domestic assets (NDA) of the BCM	16.8	-35.6	36.9
Fiscal			
(e) Ceiling on domestic financing of the central government	133.9	62.1	-55.7
(f) Floor on tax revenue	695.1	907.8	1,295.8
(g) Ceiling on accumulation of new domestic arrears [2]	0.0	0.0	0.0
II. Memorandum items:			
(h) Budget support grants and loans (in millions of SDRs)	16.6	48.6	73.6
(i) External cash debt service (in millions of SDRs)	17.7	18.2	27.1
(j) Program exchange rate (MGA/US dollar)	3,134.7	3,134.7	3,134.7

Sources: Malagasy authorities; and Fund staff estimates and projections.

[1] See Technical Memorandum of Understanding (TMU) for full description of variables and adjustments.

[2] To be observed on a continuous basis.

Table 2. Prior Actions, Structural Performance Criteria and Benchmarks

	Timing
Prior Actions for Board Consideration of a New-PRGF Supported Program	
• Verification of expenditure and tax revenue performance during the first quarter of 2006 in line with the target discussed with staff.	Implemented
• Publication, in the press and on the government website and via posters in customs offices and tax centers, of the elimination of: (i) ad hoc tax and/or tariff exemptions except in cases provided in the Customs Code, international treaties or conventions and in exceptional cases decided by the Council of Government (natural disaster, public interest, reasons of State); (ii) waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (*Rapport d'inspection recevabilit*é RIR and *Rapport d'inspection enlèvemen*t RIE), or on the use of the pre-/post inspection company SGS valuation of goods.	Implemented
• Adoption of a medium-term PFM action plan that will address deficiencies in the control of the budget commitment and monitoring process.	Implemented
• Finalization of a satisfactory action plan for JIRAMA.	Implemented
• Approval by the central bank Governor of an action plan for implementing the main recommendations of the March 2006 Safeguards Assessment.	Implemented
• Submission to Parliament of a supplementary budget which increases the share of PRSP priority spending in total domestically financed spending compared to the 2006 budget, and is in line with the 2006 fiscal program.	
• Issuance of instructions by Ministry of Finance to all ministries to submit monthly plans for expenditure commitments in accordance with the quarterly budget appropriations.	
Performance Criteria	
• No waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (*Rapport d'inspection recevabilit*é (RIR) and *Rapport d'inspection enlèvemen*t (RIE), or on the use of the pre and post inspection company SGS valuation of goods.	Continuous
• No granting of ad hoc tax and/or tariff exemptions outside those specified in the Customs Code, international treaties or conventions.	Continuous
• Finalization of an audit of the VAT arrears owed by the government on capital expenditure.	September 30, 2006
• No Transactions shall be carried out between the government and the central bank that are contrary to the provisions of the Central Bank Charter.	Continuous
• Issuance of monthly commitment ceilings for the last quarter of 2006 by the Ministry of Finance to all ministries on the basis of the latest cash flow plan prepared by the Treasury.	September 30, 2006
Benchmarks	
• Extension of the new ASYCUDA++ software to the five largest customs bureaus.	September 30, 2006
• Inclusion of a recapitalization plan for the BCM in the 2007 Budget Law.	October 31, 2006
• Development of a comprehensive time bound action plan translating the 2003 and 2006 IMF FAD tax administration recommendations in operational terms.	December 31, 2006
• Install the expenditure tracking information system SIGFP in 13 ministries	December 31, 2006
• Completion of the verification of at least 80 percent of outstanding VAT credits at end-June 2006.	December 31, 2006

APPENDIX I—ANNEX: MADAGASCAR: ECONOMIC AND FINANCIAL POLICY MEASURES FOR 2006–08

Area	Measures	Timing
Tax Policy	**Objective: Generate sufficient internal resources to achieve the MDGs and improve the business climate by:** ➢ **Streamlining the taxation system, and** ➢ **Strengthening its implementation.**	
	• No ad hoc tax or tariff exemptions outside those specified in the Customs Code, international treaties or conventions.	Continuous
	• Disseminate notice of exceptional exemptions decided by the Council of Government (natural disasters, public good, reasons of State) in the press, on the government website and via posters in customs offices and tax centers.	Continuous
	• Report to Fund staff any decision on exemptions made by the Council of Government as quickly as possible.	Continuous
	• Restrict the status of export processing zones to existing sectors.	Continuous
	• Restrict excise duties to alcohol, cigarettes, petroleum products, mining products, and cosmetics.	January 2006
	• Simplify evaluation modalities of excise duties on beverages, alcohol and cigarettes.	January 2006
	• Increase excise duties on gasoline by 66 percent and on diesel by 178 percent.	January 2006
	• Maintain the single VAT rate (non-zero) for both local and imported goods.	January 2006
	• Reduce the number of goods subjected to excise duties and fees.	January 2006
	• Through internal memoranda of the Minister of Economy, Finance, and Budget instruct all officials to apply only those exemptions provided in the Customs Code, international treaties or conventions and those decided by the Council of Government in exceptional cases (natural disasters, public good, reasons of State).	May 2006
	• Transmit to the IMF the audit report on import fees and rice distribution justifying a rebate on customs duties in 2005.	May 2006
	• Publish, in the press and on the government website and via posters in customs offices and tax centers, the elimination of: (i) ad hoc tax and tariff exemptions except in cases provided in the Customs Code, international treaties or conventions and in exceptional cases decided by the Council of Government (natural disaster, public good, reasons of State); (ii) waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (RIR and RIE), or on the use of SGS valuation of goods.	June 2006
	• Complete a study of possible restrictions to the scope of excise duties.	December 2006
	• Reduce the length of the holiday period (currently 5-7 years depending on the sectors) for corporate income tax for new export processing zone (EPZ)	2007 Budget

Area	Measures	Timing
	enterprises, while maintaining the privileges of existing EPZ enterprises.	
	• Eliminate exemptions on corporate income tax, including for export processing zone enterprises, while maintaining the privileges of existing enterprises.	2008 Budget
	• Generalize VAT repayment on petroleum products to all sectors subject to VAT.	January 2007
	• Eliminate excise duties and fees on sugar and flour.	January 2008
	• Reduce the number of rates of excise duties and fees.	2008
Customs Administration	**Objective: improve customs duties collection and streamline procedures.**	
	• No waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (RIR and RIE), or on the use of SGS valuation of goods.	Continuous
	• Tighten eligibility for economic regimes (temporary admission, customs warehouse, transit, etc.).	January 2006
	• Verify post-customs inspection reports (RIE) not returned to SGS to determine whether duties and taxes were actually paid.	May 2006
	• Update exemption arrangements in the ASYCUDA system.	May 2006
	• Implement the CIVIO system by SGS to verify the value of used vehicles.	July 2006
	• Publish monthly table in the press and on the government website presenting all duty and tax exemptions (name of beneficiary, nature of goods, reason for exemption, amount of forgone revenues) prepared using the ASYCUDA computer system.	June 2006 onward
	• Issue a monthly table of goods not inspected by the PSI company (SGS).	June 2006 onward
	• Deploy the new ASYCUDA++ software in the next five largest customs bureaus.	September 2006
	• Use a "watermark" securing system to minimize risks of counterfeit customs documents (Council of Government decisions granting duty-free treatment, inspection reports, etc.).	September 2006
	• Establish of the TRADENET electronic information platform at Tamatave Port.	December 2006
	• Implement strictly the requirement on bank transfers for duty and tax payment.	January 2007
Tax Administration	**Objective: Broaden tax base.**	
	• Strengthen coverage of, and compliance with tax obligations by, medium-sized taxpayers (annual turnover of between 0.5 and two billion Ariary), while continuing to improve the tax management of large enterprises (turnover above two billion Ariary).	2006
	• Design and implement a selective audit program covering all categories of	2006

Area	Measures	Timing
	taxpayers (giving priority to large and medium-sized enterprises) and combine different audit methods.	
	• Provide for 36 billion additional credits in budget for paying counterpart funds (VAT, RPI).	2006 Supplementary Budget Law
	• Reduce to two months the time limit required for VAT refunds.	March 2006 onward
	• Establish monthly activity and performance *indicators* for all tax collection entities, including the DFGE (large taxpayer directorate) and the regional services.	May 2006
	• Establish monthly activity and performance reports for all tax collection entities, including the DFGE (large taxpayer directorate) and the regional services.	2006
	• Publish a monthly table in the press and on the government website presenting all tax and duty exemptions (name of beneficiary, nature of goods, reason for exemption, amount of forgone revenues) prepared using the SYGTAS and SURF computer systems.	As of June 2006
	• Establish an action plan for better taxation on mining and tourism sectors.	June 2006
	• Start implementing these action plans in line with the timetable approved.	September 2006
	• Rotate tax inspectors in the DFGE (large taxpayer directorate).	December 2006
	• Audit the management of the various DFGE units.	December 2006
	• Draw up a comprehensive time bound action plan translating the 2003 and 2006 IMF FAD tax administration recommendations in operational terms.	December 2006
	• Implement that action plan.	2007-08
	• Establish a computerized communication network between the Tax Directorate, Customs, and Treasury to enable rigorous checks on tax revenues.	January 2007
	• Establish payment of taxes and duties through commercial banks.	January 2007
Public Finance Management	**Objective: Improve contribution of public expenditures to growth and poverty reduction by strengthening budget preparation and execution and the control of budget execution.**	
	• Improve the ratings of at least 5 out of the 28 criteria between 2006 and 2008 for performance of public finance management under the PEFA program. Madagascar is associated with the donor community under the joint annual ratings for performance of public finance management under PEFA program. The first PEFA exercise (May 2006) will make it possible to build a medium term action program (3 years) for improving PFM.	2006-08
	• Start implementing 2006 priority action plan of public finance management, including namely:	March 2006
	➢ adoption and implementation, for the 2007 budget, of a new schedule for budget preparation that starts in June.	June 2006

Area	Measures	Timing
	➢ action plan that will address deficiencies in the control of budget commitment.	May 2006
	➢ transmission of 2004 -management accounts (June 2006) and 2005-(December 2006) to the Auditor General (Cour des comptes) and.	Before end 2006
	➢ transmission of 2002 and 2003 draft reports on budget execution (Lois de Règlement) (June 2006) and 2004-(December 2006) to Parliament.	June 2006 December 2006
	➢ setting up the new legal public procurement framework (enforcement texts and standard documents).	By Jan 1st 2007
	➢ enforcing new legal public procurement framework.	2007-08
	• Send to IMF the audit report prepared by IGE on exceptional expenditures in 2003-04.	February 2006
	• Adopt a medium-term PFM action plan that will address deficiencies in the monitoring and control of budget commitments.	May 2006
	• Issue instructions (Ministry of Finance to spending ministries to submit monthly plans for expenditure commitments in accordance with the quarterly budget appropriations.	June 2006
	• The Ministry of Finance issues monthly commitment ceilings for the last quarter of 2006 to all ministries on the basis of the latest cash flow plan prepared by the Treasury. • Limit commitments to the monthly expenditure ceilings specified in the ministries' monthly commitment plans.	September 2006 onward
	• Present expenditures according to a three-level classification (mission, program, objectives) in the 2007 Budget Law submitted to Parliament.	October 2006
	• Create a Budget Directorate integrating recurrent and capital expenditures so as to strengthen consistency in the preparation and execution of both types of expenditures.	December 2006
	• Complete verification of at least 80 percent of VAT credits outstanding as of June 30, 2006.	December 2006
	• Identify, audit, and settle all VAT payment arrears owed on externally-funded capital expenditure:	December 2006
	➢ Establish the modalities.	March 2006
	➢ Make a public appeal to identify arrears.	April 2006
	➢ Complete the audit of the government's VAT arrears on capital expenditure.	July 2006
	➢ Check the arrears.	September 2006
	➢ Implement the modalities of a multi-year plan for settlement of arrears in the 2007 Budget Law.	October 2006
	• Establish the modalities for settlement of other government arrears.	January 2007
Monetary Policy	**Objectives: (i) Improve effectiveness of monetary policy; (ii) reduce financial intermediation costs; and (iii) broaden the range of monetary policy instruments, including use of indirect instruments for managing liquidity.**	
	• Introduce a bill modifying the provisions of the Central Bank Charter governing the securitization of government debt held by the Central Bank in negotiable securities.	December 2006

Area	Measures	Timing
	• Use open market operations as the primary means of managing money market liquidity and avoiding overly frequent changes in the required reserve ratio.	Continuous from January 2007 onward
	• Define the mechanism for implementing the conversion of State securitized debt held by BCM in exchangeable securities.	June 2006
	• Limit transactions between the government and the central bank to only those permitted by the Central Bank Act, as certified by the external auditor in its report on the annual audit of the central bank accounts.	July 2006
	• Reduce gradually the monetary financing of Treasury (« statutory advances ») to below 10 percent of the previous year's revenues.	2008
	• Improve liquidity management and coordination between the Central Bank and the Treasury regarding Treasury bill issuance.	Continuous
Exchange Rate Policy	**Objective: Make the exchange market more efficient.**	
	• Implement the operational guide for BCM interventions on the interbank foreign exchange market (MID).	Continuous
	• Make sure that MID screens are updated on a regular basis.	Continuous
	• Make sure that all sale and purchase orders go through MID.	Continuous
	• Publish every day in the official media and newspapers and on BCM website, for the attention of the wider public, the quantity transacted, weighted average, and minimum and maximum rates by currency for currencies exchanged on the MID.	Continuous
	• Remind banks to observe the MID market rules (Convention de Place du MID).	Continuous
	• Submit a bill to Parliament proposing a new foreign exchange code.	October 2006
Financial Sector Reforms	**Objective: Increase the size and effectiveness of financial markets and reduce transaction costs.**	
	• Draw up a priority action timeline to strengthen the financial system following the Financial System Assessment Program (FSAP).	September 2006
	• Complete actuarial surveys in the two public pension funds and make any required parameter changes.	June 2007
	• Implement priority action timeline to strengthen the financial system.	2006-08
	• Extend access to public auctions of treasury bills to other major cities.	2006
	• Reduce minimum denomination of treasury bills to below MGA 20 million	2007
	• Define a schedule for resolving the problems of the distressed insurance company.	October 2006
Payment System Reforms	**Objective: Reduce transaction fees with MCA assistance.**	

Area	Measures	Timing
	• Launch an exhaustive reform program for payment systems.	2006-08
	• Reduce to maximum 5-10 days the time limit for cashing off site checks, the diagnostic survey for which will be financed by MCA.	2006-08
	• Computerize the keyboarding of checks and the calculation of trade-off balances.	2006-08
	• Amend the law to enable electronic means of payment.	2006-08
	• Set up a steering committee to implement reform of payment systems.	2006-08
Strengthening the Financial System Supervision	**Objective: Strengthen the financial system.**	
	• Strengthen supervision of the banking system by increasing the Banking and Financial Supervision Commission's (CSBF) resources.	June 2006
	• Include a recapitalization plan for the central bank in the 2007 Budget Law.	October 2006
	• Strengthen the supervisory agency for insurance companies (training, staff and additional financial resources).	June 2007
	• Issue implementing decrees for the Law on Microfinance.	December 2006
	• Define prudential and management standards for the Law on Microfinance	December 2006
	• Define a plan to remedy current weaknesses in supervision of nonbank financial institutions and insurance companies (e.g. , private pension funds, post office saving banks, financial services by post).	December 2007
	• Strengthen training of central bank staff who specialize in supervising microfinance institutions.	December 2007
	• In the new Banking Law, make CSBF responsible for authorizing and controlling foreign exchange bureaus.	December 2007
Statistics	**Objective: Improve information supporting economic policy.**	
	• Produce revised national accounts based on the new estimates for 2001 compiled with IMF technical assistance.	2007
	• Increase the number of skilled staff in INSTAT and enhance their training.	2006-08
	• Adopt a law for the compilation and distribution of statistics required for establishing national accounts.	2006-07
Improving the Financial System Environment	**Objective: Improve financial system contribution to financing the development of the economy.**	
Legal and Judiciary Framework	• Set up a regular schedule of meetings between the Minister of Justice and financial sector professionals to raise awareness of problems and push reforms of the financial sector.	

Area	Measures	Timing
	• Ensure the independence of the "Conseil Supérieur de la Magistrature" and transparency in appointments, promotion and sanctions of judges.	
	• Launch medium- and long-term plans to reform the judiciary based on existing diagnoses and provide sufficient funding.	
	• Improve theoretical and practical training (particularly by increasing the resources provided to ENMG--the Institute for Magistrates and Clerks of Court).	
	• Make legal information more accessible: through the official gazette, then CD ROMs, and finally through the Internet).	
	• Build capacity for drafting texts and the strengthening of the independence and capacity of the Business Law Reform Committee (Commission de réforme du droit des affaires).	
	• Reform land legislation to ease land titling and mortgaging.	
	• Streamline the law governing the use of securities as collateral for credit.	
Improving Financial Information Quality	• Set up a data base on enterprises balance sheets.	
	• Launch an incentive and assistance program to foster the use of reliable accounting documents by enterprises so as to broaden the pool of bankable enterprises.	
Financial Taxation	• Revise the taxation of financial products to eliminate distortions.	January 2006
	• Implement the reform.	January 2007
Assessing BCM safeguard procedures	**Objective: Ensure the financial transparency of the central bank by adopting fiduciary procedures that observe best international practices.**	
	• Analyze the source of central bank losses, and set up a program to enhance its financial independence.	August 2006
	• Publish the 2005 BCM audited accounts.	August 2006
	• Have the central bank governor approve a satisfactory time-bound action plan for implementing the main recommendations of the March 2006 IMF Safeguards Assessment, including an assignment of responsibilities.	June 2006
	• Include a recapitalization plan for the central bank in the 2007 Budget Law.	October 2006
	• Recapitalize the central bank.	2007
	• Secure executive board approval of an action plan for total adoption of IFRS standards, starting with the 2007 financial statements.	June 2006
	• Correct the presentation of balances relative to Madagascar's status as an IMF member, as well as to its obligations: (i) report the SDR 11.3 million disbursement in the PRGF as part of obligations to the IMF; (ii) report the	June 2006 December 2006

Area	Measures	Timing
	quota subscription in the Securities Account in the balance sheet.	
	• Conduct quarterly reviews of data relative to net foreign assets and to net domestic assets and communicate the results to the IMF to ensure that they are consistent with the technical memorandum of understanding (for the PRGF modality envisaged), as well as accounting data and financial statements.	Ongoing during program
	• Appoint an international auditor working according to international audit standards (ISA) and having IFRS expertise in the bidding process for the 2006 external audit. • So as to facilitate transition to IFRS standards, make sure the external auditor selected is associated with a professional audit firm from an international financial center that will countersign the audit opinion report.	June 2006
	• Adjust the book entry transfers from the special exchange account that offset central bank cumulated losses and increased non-distributed revenues.	August 2006
	• The BCM sets up, in its accounting system, a system which identifies realized and unrealized foreign exchanges gains or losses.	June 2006
	• Have the internal audit department (IAD) acquire a database in which it can list and monitor implementation of the recommendations of the audit.	December 2006
Foreign Trade Policy	**Objective: Strengthen growth potential by increasing its integration into the world economy.**	
	• Reduce the number of tariffs on foreign trade (non-zero tariff band) from four to three, with the ultimate goal of a single, non-zero tariff.	January 2006
	• Announce and start a study on the tariff level required to neutralize the tax impact of the uniform tariff.	June2006
	• Publish the results of the study.	June 2007
	• Reduce clearance time at the main port to two days for an importer presenting the required documents.	
Foreign Indebtedness	• **Objective: Maintain a sustainable level of foreign indebtedness.**	
	• Do not accumulate foreign arrears.	Continuous
	• Do not contract or guarantee foreign debt on nonconcessional conditions.	Continuous
JIRAMA	**Objective: Strengthen the growth potential of the economy by ensuring a continuous and competitive energy supply.**	
	• Finalize a satisfactory action plan for JIRAMA.	May 2006
Civil service Reforms	**Objective: Strengthen potential for growth and poverty reduction by ensuring an economical supply of first quality public services.**	
	• Adopt (Council of Ministers) measures for reforming the civil service, including a new classification of assignments and positions, decompression of the salary	2007-08

Area	Measures	Timing
	gap among civil servants, and introduction of merit-based salary increases.	
	• Computerize the civil servant database to better match individual qualifications with job requirements.	2007-08

APPENDIX I—ATTACHMENT III
MADAGASCAR: TECHNICAL MEMORANDUM ON MONITORING THE 2006 PROGRAM SUPPORTED BY THE ARRANGEMENT UNDER THE POVERTY REDUCTION AND GROWTH FACILITY (PRGF)

1. This technical memorandum defines the variables used to establish the quantitative performance criteria and indicative targets for the program, how they are calculated, and any adjustments deemed necessary. It also explains the monitoring of contingent variables upon which adjustments may be made, for example, the actual exchange rate or balance of payments assistance received. Unless otherwise indicated, all variables are measured as the cumulative change from their January 1, 2006 level. The objectives for end-September are indicative targets; those for end-July and end-December are performance criteria. **Program and benchmark targets must be adjusted (as explained below) for comparison to actual outturns.**

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Ceiling on Accumulation of New External Payments Arrears

2. These arrears will consist of overdue debt-service obligations (i.e., payments of principal and interest) in respect of loans contracted or guaranteed by the government or the Central Bank of Madagascar (BCM). Debt service obligations (including unpaid penalties and interest charges) are overdue if they have not been paid within the contractual due date or within a grace period agreed with, or unilaterally granted by, each creditor prior to the contractual due date. They will exclude arrears resulting from nonpayment of debt service for which rescheduling negotiations are under way or that are in dispute. This performance criterion should be observed on a continuous basis.

B. Ceiling on the Contracting or Guaranteeing of Nonconcessional External Debt

Definition

3. Nonconcessional external debt is defined as having a grant element of less than 35 percent. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (IMF Executive Board Decision No. 12274-00/85, August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Under the program, nonconcessional debt includes financial leasing and any other instrument giving rights to a current financial liability, under a contractual arrangement by the central government (CG) of Madagascar (defined in paragraph 9) or guarantee by the CG, but it excludes debt contracted under rescheduling agreements and normal import-related credits of less than one year. If the CG has a special need for external nonconcessional financing, the staff should be informed in advance to consider including the request in the program. This performance criterion should be observed on a continuous basis.

Calculation/Adjustment method

4. Calculation of the degree of concessionality of new external debt is based on the ten-year average of the OECD's commercial interest reference rate (CIRR) for loans or leases with maturities greater than 15 years and the six-month average CIRR for loans or leases maturing in less than 15 years.

C. Floor for Net Foreign Assets (NFA) of the Central Bank of Madagascar

Definition

5. NFA are defined as the "Net Foreign Position" of the BCM, which is the difference between gross foreign assets and total foreign liabilities of the BCM, including debt to the IMF.

Calculation/Adjustment method

6. The program target of NFA must be adjusted in Ariary (MGA) for the difference between the actual and program exchange rate, for comparison with the actual outturn. The target is also subject to adjustment for the shortfall/excess in net external balance of payments assistance as described below.

D. Ceiling on Net Domestic Assets (NDA) of the Central Bank of Madagascar

Definition

7. The NDA of the BCM is the difference between reserve money and the NFA of the BCM. It includes: net credit to the government, credit to enterprises and individuals, claims on banks, liabilities to banks (including the proceeds of central bank deposit auctions—*appels d'offres négatifs*), and other items net.

Calculation/Adjustment method

8. The target for NDA will be adjusted for the variation of the actual versus the program exchange rate, applied to the level of foreign exchange deposits held by the government. The target is adjusted for the excess/shortfall in the net external balance of payments support as explained below. Finally, the target NDA will be adjusted for changes in the reserve requirement in an amount equal to the percentage point change in the reserve requirement ratio times the amount of deposits held by the public with the commercial banks.

E. Ceiling on the Net Domestic Financing Requirements of the Central Government

Definition

9. The central government (CG) corresponds to the scope of operations of the treasury shown in the o*pérations globales du Trésor* (or OGT).

10. The net domestic financing of the CG is the sum of:

a. the variation in the stock of net bank claims on the CG, plus
b. the change in CG's debt to the nonbank system (domestic and non-resident), plus
c. the variation in net debt to treasury correspondents (*correspondants du Trésor)*, plus
d. domestic or foreign receipts from privatization operations, plus
e. the level of central government domestic payments float (*paiements en instance*), plus
f. the payment of outstanding arrears.

11. The amount of central government domestic payments float is the difference between committed and paid expenditure.

12. The payment of outstanding arrears refers to the MGA 20 billion of unpaid bills (prior to 2006) to JIRAMA and TELMA.

13. Net bank claims on the government are measured by the change in net credit to government in the monetary survey; and consist of BCM and commercial bank claims on the CG, including auctioned treasury bills (BTAs) and other securities and liabilities, net of CG deposits with the BCM and commercial banks, including foreign currency deposits.

14. Nonbank claims consist of BTAs and other treasury bills (BTs) and bonds placed with nonbank institutions (domestic and non-resident) and the public.

Calculation/Adjustment method

15. The amount for net bank claims on the CG should be adjusted for foreign exchange deposits of the government valued at the actual exchange rate. The government should inform Fund staff of any substantive changes in CG accounts with the banking system, which may affect the calculation of bank claims.

16. For nonbank borrowing, BTAs and other government securities should be recorded at their net value at time of initial issue—not at their redemption value.

17. Net domestic financing is subject to adjustment for excess/shortfall in balance of payments assistance less cash debt service, as described in section III, and for exchange rate variation from the program rate.

F. Floor on Tax Revenue

Definition

18. Tax revenue includes all revenues received by the treasury, including suspense items and those related to the public investment program.

G. Ceiling on Accumulation of New Domestic Payments Arrears

Definition

19. Payments arrears consist of all Treasury expenditures for which payment orders have been issued but have not been paid by the Treasury within three months (*dépenses ordonnancées mais non-payées*). This performance criterion should be observed on a continuous basis.

II. Monitoring Variables and Memorandum Items

H. Balance of Payments Assistance

Definition

20. External balance of payments assistance is defined as cash nonproject loans and grants provided as financing and resulting in funds available to the treasury (budget support). It does not include the stock of International Development Association (IDA) and African Development Fund (AfDF) debt cancellation under MDRI. It excludes any disbursement of loans by the IMF and assistance that gives rise to counterpart funds for the treasury with a delay of longer than one year. (See TMU Table 1, attached, for specification of flows.)

Calculation method

21. Programmed amounts of financial assistance are recorded in foreign exchange and converted into MGA at the program exchange rate. Programmed amounts will be adjusted for comparison to actual outturn as described below. Counterpart funds to assistance in kind should be posted when deposited with the treasury.

I. Cash Debt Service

22. Amount of external debt service expected to be paid in cash by the central government, net of HIPC and MDRI debt relief. (See TMU Table 1, attached, for specification of flows).

J. Program Exchange Rate

Definition

23. For program purposes, all foreign exchange stocks and flows that affect performance criteria have been converted to Ariary at the program exchange rate of 1 SDR = MGA 3,134.7. (Amounts denominated in U.S. dollars and in euros are converted to SDRs by applying the program rates of US$1.44=SDR 1, and €1.20=SDR 1).

III. Exchange Rate and Net Balance of Payments Assistance Adjusters

A. Differences Between Program and Actual Exchange Rate

24. To compare program targets to actual outturns, those foreign exchange stocks and flows that affect program targets will be adjusted for the difference between the actual and programmed SDR exchange rate.

B. Excess/Shortfall in Balance of Payments Assistance less Cash Debt Service

25. **Net external balance of payments assistance is defined** as external budget support for grants and loans (paragraph 20 above) less external cash debt service (paragraph 22).

26. **In the event of a shortfall** in net external balance of payments assistance at end-July 2006, end-September 2006, or end-December 2006 versus the programmed amount for the corresponding period, the floors and ceilings will be adjusted by the amount of the shortfall up to a cumulative maximum of SDR 15 million, on an as needed basis and according to the following method:

a. the floor on the BCM's NFA target will be adjusted downward by an equal amount up to a cumulative maximum of SDR 15 million (the adjustment will be converted at the actual exchange rate);

b. the ceiling on the BCM's NDA target will be adjusted upward by an equal amount up to a cumulative maximum of SDR 15 million (the adjustment will be converted into MGA at the actual exchange rate); and

c. the ceiling on the central government's net domestic financing target will be adjusted upward by an equal amount up to a cumulative maximum of SDR 15 million (the adjustment will be converted into Ariary at the actual exchange rate).

27. **In the event of a cumulative excess** in net external balance of payments assistance of more than SDR 17.5 million, the following adjustments will be made: [1]

a. the floor on the BCM's NFA target will be adjusted upward by the excess (the adjustment will be converted into Ariary at the actual exchange rate);

b. the ceiling on the BCM's NDA target will be adjusted downward by the excess (the adjustment will be converted into Ariary at the actual exchange rate); and

c. the ceiling on net domestic financing target of the central government will be adjusted downward for the excess (the adjustment will be converted into Ariary at the actual exchange rate).

IV. Consultations with Fund Staff on the Performance Criterion

28. In the event that a major shift in monetary policy or exchange rate policy is required, or if monetary outturns exhibit substantial variation from their targets, the authorities will consult Fund staff on measures to be taken in the context of exchange and monetary policy management.

29. In the event of substantial unexpected fiscal expenditures, for example, concerning JIRAMA or privatizations, the authorities will inform Fund staff to discuss corrective actions.

V. Information and Data to be Supplied to Fund Staff

30. The Malagasy authorities will provide Fund staff with information and data by email or facsimile according to the schedule provided; the Fund's resident mission will be copied on all such exchange of information.

The Central Bank of Madagascar will report the following statistics:

Monthly

- market results of treasury bill auctions, including the bid level, the bids accepted or rejected, and the level of interest rates;
- data on the secondary market for treasury bills and other government securities;

[1] The amount of SDR 17.5 million was used because it is equal to the second tranche from the ADB, which is not programmed to be disbursed in 2006 but could be disbursed. In the event of disbursement, this adjuster would allow the authorities to spend this tranche according to the contingent expenditure plan that has been identified.

- information on monetary developments, as required by the Statistics Department of the International Monetary Fund (STA);
- monthly balance sheets of the BCM and deposit money banks;
- bank lending by economic sector and by term;
- the banking risk situation;
- money market operations and rates;
- changes in bank liquidity;
- the monthly foreign exchange cash flow table, including foreign debt operations;
- the table of interbank foreign exchange operations on the MID, including the amount of non-satisfied bids for sales and purchases;
- banking sector prudential ratios; and
- data on foreign trade (exports and imports).

Quarterly

- updated balance of payments reconciled with monetary and fiscal information.

The Ministry of Economy, Finance, and Budget will report the following information:

Monthly

- OGT data on cash and commitment basis and the related tables;
- comprehensive cash plan based on monthly cash inflow and outflow projections;
- monthly commitment ceilings to spending ministries on the basis of the cash plan;
- expenditure on structural reform;
- central government revenue and expenditure (current and capital), including short-term treasury on-lending;
- treasury liabilities (including statutory advances and operations on the treasury bill market showing holding by banks and nonbanks);
- external public debt operations (debt contracted and publicly guaranteed, settlement of arrears, and operations of public enterprises) and debt service paid;
- any other contingent liabilities;
- consumer price indices; and
- indicators of sectoral economic activity.

Quarterly

- Consolidated Treasury accounts (balance consolidée des comptes du Trésor)

Every four months

- Reports on budget execution by ministry (*rapports quadrimestriels sur l'exécution du budget par ministère*).

31. Moreover, information on important measures adopted by the government in the economic and social areas that would have an impact on program development, changes in legislation, including laws passed by the National Assembly and new rules established by the Banking Supervision Commission (CSBF), and any other pertinent legislation should be reported to Fund staff on a timely basis for consultation or information, as appropriate.

Table 1. Madagascar: Net Balance of Payments Assistance
(Millions of SDRs, cumulative from 1st January, 2006)

	July 31	September 30	December 31
Budget support	16.6	48.6	73.6
Grants	16.6	20.8	28.3
European Union	16.6	20.8	28.3
Loans	0.0	27.8	45.3
World Bank	0.0	27.8	27.8
African Development Bank	0.0	0.0	17.5
External debt service (cash basis) [1]	17.7	18.2	27.1
Interest	12.1	12.3	16.1
Amortization	5.6	5.9	11.0
Net balance of payment assistance	-1.1	30.4	46.5

Source: Malagasy authorities; and Fund staff estimates and projections.

[1] Net of HIPC and MDRI debt relief.

APPENDIX II—MADAGASCAR: RELATIONS WITH THE FUND
(As of April 30, 2006)

I. Membership Status: Joined 9/25/63; Article VIII

II. General Resources Account:

	SDR Million	% Quota
Quota	122.20	100.00
Fund holdings of currency	122.17	99.98
Reserve position in Fund	0.03	0.02

III. SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	19.27	100.00
Holdings	0.24	1.22

IV. Outstanding Purchases and Loans:

	SDR Million	% Quota
PRGF Arrangements	11.35	9.29

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	03/01/01	03/01/05	91.65	91.65
ESAF/PRGF	11/27/96	11/30/00	81.36	78.68
ESAF	05/15/89	05/14/92	76.90	51.27

VI. Projected Payments to Fund (after HIPC and MDRI assistance)
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					1.13
Charge/interest	0.56	0.73	0.73	0.73	0.72
Total	0.56	0.73	0.73	0.73	1.86

VII. Implementation of HIPC Initiative:

Commitment of HIPC Initiative assistance	Enhanced Framework
Decision point date	12/21/2000
Assistance committed (NPV terms)	

Total assistance (US$ Million)[1]	835.75
Of which: Fund assistance (US$ million)	19.17
(SDR equivalent in millions)	14.73
Completion point date	October 2004

Disbursement of IMF assistance (SDR million)

Assistance disbursed to the member	14.73
Interim assistance	5.62
Completion point balance	9.11
Additional disbursement of interest income[2]	1.69
Total disbursements	16.42

VIII. Implementation of MDRI Assistance:

Total Debt Relief (SDR million)[3]	137.29
Of Which: MDRI	128.50
HIPC	8.79

Debt Relief by Facility (SDR million)

	Eligible Debt		
Delivery Date	**GRA**	**PRGF**	**Total**
January 2006	N/A	137.29	137.29

---

[1] Assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point. Hence these two amounts can not be added.

[2] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest income earned on the amount committed at the decision point but not disbursed during the interim period.

[3] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries that are qualified for the assistance. The debt relief covers the full stock of debt owed to the Fund as of end-2004 which remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions and the Fund's own resources, as well as the resources already disbursed to the member under the HIPC Initiative (see Section VII above).

IX. Safeguards Assessments:

A safeguards assessment of the Central Bank of Madagascar (BCM) was completed on March 17, 2006; a previous assessment was completed in November 2001. The 2006 assessment identified continued weaknesses in the BCM's system of internal controls, financial reporting, and legal framework, and made recommendations to address the observed vulnerabilities. The recommendations included: (i) an annual external audit report on the BCM's transactions with the government and their compliance with the central bank law; (ii) quarterly reviews by the BCM's internal audit function of monetary program data reported to the Fund; (iii) adoption of International Financial Reporting Standards (IFRS) as the BCM's accounting framework; and (iv) measures to strengthen the quality of the BCM's external audit, i.e., appointment of an international audit firm with experience in IFRS and international auditing standards.

X. Exchange System and Exchange Rate Arrangements:

After April 1982, when the peg to the French franc was discontinued, the exchange rate was managed with reference to a basket of ten currencies. However, by end-1991, the authorities ceased the practice of adjusting the exchange rate to offset inflation differentials with key trading partners. The exchange rate regime is classified as a managed float with no predetermined path. Since July, 2004, the Malagasy franc has been determined through a continuous interbank foreign exchange market system and on January 1, 2005, the Ariary (AR) replaced the Malagasy franc as the country's official unit of account, at the rate of AR 1=FMG 5. The exchange rate in terms of the SDR at end-March 2006 was AR 3,171.2 = SDR 1.

Madagascar accepted the obligations under Article VIII, Sections 2(*a*), 3, and 4 on September 18, 1996 and maintains no restrictions on the making of payments and transfers for current international transactions.

XI. Last Article IV Consultation:

The 2005 Article IV consultation staff report was discussed by the Executive Board on June 1, 2005 (Country Report No. 05/350, September 27, 2005).

II. Technical Assistance:

Department	Dates	Purposes	Results of Missions
FAD	July-August 1994	Assess the decline in the country's tax effort and recommend measures to mobilize additional revenue.	Elimination of all ad hoc tax exemptions, beginning with the 1995 budget, recommended.
FAD	September 1995	Assess the need for reforming the value-added tax (VAT) and develop a strategy to improve tax and customs administration.	Broadening of the VAT base and the creation of a special office for the monitoring of transactions in the free export zone recommended.
FAD	September 1996	FAD advisor to assist the authorities in implementing the recommendations of FAD September 1995 mission. Assignment extended to March 1998.	The large-taxpayer unit established. Implementation of VAT reform continued.
FAD	December 1997	Review existing tax incentives and prepare action plan to improve the performance of the tax and customs departments.	Program proposed to curtail exemptions and implement an exemption-monitoring scheme.
FAD	February 1998	Hold follow-up discussion on tax and tax administration reform program.	Schedule for the preparation and implementation of key measures established.
FAD	March 1998	Examine and assess budgetary expenditures, control, and management.	Comprehensive report prepared for the reform of budget planning, execution procedures, and control systems.
FAD	April 1998	Review important issues to be addressed in the area of customs administration.	Agenda for follow-up mission identified (July 1998).
FAD	June 1998	Conduct follow-up visit on expenditure control.	Action plan, based on the report of the FAD mission of March 1998, established.

Department	Dates	Purposes	Results of Missions
FAD	May, September, and December 1998 and April, May, and June 1999	Hold follow-up discussions on tax and tax administration reform.	Assistance for the revision of the VAT law provided, and a VAT reimbursement system introduced for free export zone producers.
FAD	July 1998	Identify measures to strengthen customs administration.	Report prepared on duty assessment and collection procedures, the coordination between the pre-shipment inspection company and the customs department, the computerization strategy, and organizational issues.
FAD	January 1999	Help implement earlier FAD recommendations on improving public expenditure management.	Aide-mémoire prepared on progress in harmonization of budget and treasury classifications, computerization of treasury offices, implementation of a cash management and financial plan, and implementation of a budget and accounting classification for the decentralized budget.
FAD	June 1999	Strengthen tax audit system of large-taxpayer unit.	Action program developed and agreed with the authorities.
FAD	February-March 2001	Examine and assess budgetary control and management.	Comprehensive report prepared for the reform of budget planning, execution procedures, and control systems.
FAD	January-February 2003	Examine and assess tax and customs administration.	Comprehensive action plan and report on establishment of an oversight committee prepared.
FAD	July-August 2003	Examine and assess tax policy and assist in tax policy design.	Comprehensive action plan and report on next steps prepared.

Department	Dates	Purposes	Results of Missions
FAD	May-June 2004	HIPC Assessment and Action Plan (AAP).	Comprehensive action plan established.
FAD	July 2005	Examine and assess the status of recent reforms in PEM.	Short and medium term strategy for continuation of reforms established.
FAD	March 2006	Examine and assess tax and customs administration.	Comprehensive recommendations proposed.
LEG	July 2005	Diagnostics for the drafting of a new foreign exchange code.	Factual aspects of the current FX regime were clarified and a number of issues identified, which must be resolved. Discussions are ongoing.
MFD	August 1993–99	Assign a bank supervision advisor and assist in the adoption of an interbank foreign exchange market.	Supervisory agency strengthened.
MFD	April-May 1994	Review the modalities for liberalizing the exchange regime and accompanying monetary and credit measures.	Interbank exchange market adopted in May 1994. Central bank base rate and reserve requirements increased.
MFD	May 1995	Review interbank foreign exchange market, develop indirect instruments of monetary management, and reduce banks' excess reserves.	Recommendations adopted during the second half of 1995.
MFD	October-November 1998	Assess the operation of the foreign exchange and treasury bill markets; introduce the euro quotation currency.	Recommendations for treasury bill market adopted in November 1998.
MFD	December 1998	Prepare the change to the euro as pivot currency.	Euro introduced as scheduled.

Department	Dates	Purposes	Results of Missions
MFD	May-June 1999	Prepare for introduction of continuous-quotation foreign exchange market, including procedures manual and market rules.	To be implemented by end-2003.
MFD	October-November 1999	Assess exchange regulations and compliance with the Basel Core Principles for effective banking supervision.	Recommendations on banking regulation implemented in 2004.
MFD	November-December 2002	Assess progress in the implementation of the Core Principles for effective banking supervision; and examine the early warning system for detecting bank failures.	Recommendations being implemented.
MFD	November 2002	Take an inventory of micro-finance institutions and define a strategy for their supervision.	Recommendations being implemented.
MFD	November 2002	Assess management of foreign reserves and propose concrete steps for its improvement.	Recommendations being implemented.
MFD	March 2003	Review central bank internal audit functions.	Recommendations being implemented.
MFD	March 2003	Review microfinance regulation.	Recommendations being implemented.
MFD	June 2003	Review currency reform.	Recommendations being implemented.
MFD	September 2004	Review operations of the newly installed interbank foreign exchange market.	Recommendations being implemented.
MFD	November-December 2004	Strengthening of banking supervision.	Recommendations being implemented.

Department	Dates	Purposes	Results of Missions
MFD	February-March 2005	Review monetary and exchange operations, bank liquidity management, and banking supervision.	Recommendations being implemented.
MFD	April-May and July 2005	Financial sector assessment program (FSAP) mission.	The report has been circulated to the board.
MFD	September-October 2005	Strengthening the financial supervision of the central bank.	Recommendations have been made to strengthen financial supervision.
MFD	October 2005	FSAP follow-up.	Recommendations being implemented.
MFD	November 2005	Assist the central bank in improving foreign reserve management.	Recommendations have been made to improve foreign reserve management.
MFD	February-April 2006	Assist the central bank in further strengthening its foreign exchange, monetary, and banking supervision areas.	Recommendations have been made to strengthen foreign exchange, monetary, and banking supervision.
STA	October 1995	Review money and banking statistics.	Recommendations for data improvements adopted.
STA	June 2001	Review balance of payments compilation system.	Recommendations for improvements accepted and being adopted.
STA	July-August 2001	Review money and banking statistics.	Recommendations for data improvements accepted and being adopted.
STA	February 2004	Multisector statistics mission.	Recommendations for data improvements accepted.
STA	February 2006	Improve national account statistics.	Reviewed estimation of national income accounts and provided technical guidance to move base year to 2005.

XIII. Resident Representative:

Madagascar has had a Fund Resident Representative since September 1989. Mr. Pierre van den Boogaerde took up the post in February 2006.

.

APPENDIX III—MADAGASCAR: RELATIONS WITH THE WORLD BANK

(As of June 2006)

Partnership in Madagascar's Development Strategy

1. **The Government has been implementing its poverty reduction strategy (PRSP) since 2003.** The Annual PRSP Progress Reports have assessed that implementation has been satisfactory, despite the difficult macroeconomic environment and external shocks. The 2005 Annual PRSP Progress Report is currently under review by the staffs of the IMF and the World Bank and the JSAN is being prepared. The Bank's Country Assistance Strategy (CAS) for Madagascar was finalized in October 2003 and outlines the Bank's program of support for the FY04-06 period. The main objective of the FY04-06 CAS was to support the implementation of the PRSP's three key priorities (i) improving governance; (ii) promoting broad-based growth; and (iii) providing human security.

2. **In November 2004, the Government articulated a vision up to 2015 called *Madagascar Naturellement*.** While recognizing the enormous potential of Madagascar, it states that Madagascar will be a newly industrialized country with maximized competitiveness by 2020. The core of growth will be derived from the country's unique natural resources and from the transformation of its natural products. The vision aims to develop a diversified and rich natural resource base (agriculture, livestock, fisheries, and mining) that will contribute to the creation of products with high value added such as essential oils, agri-business, pharmaceuticals, and mining products. A broader impact of growth and a progressive redistribution of its benefits will help reduce poverty substantially. The key priorities identified include the reinforcement of the effectiveness of Government, good governance, infrastructure, education for all, rural development and environment, drinking water for all, health and AIDS prevention, private sector development, and tourism.

3. **The Government is currently preparing the follow-up strategy to the PRSP—the Madagascar Action Plan (MAP)**—which is the Government's new vision that sets out a "roadmap" for development. The purpose of the MAP is to produce a quantum leap in the development process by having a five year plan that will mobilize the Malagasy people and the country's international partners to ignite rapid growth, thus leading to the reduction of poverty. Its goal is also to ensure that the country develops in response to the challenges of globalization and in accordance with the national vision "Madagascar Naturellement".

4. **The MAP's goals are ambitious targets that the Government is committed to achieving over the coming five years.** It is recognized that these targets are challenging but, at the same time, it is expected that results will be delivered through the mobilization of the full array of the available resources (human, technical and financial), combined with strong leadership, hard work, creativity and excellent coordination. The MAP outlines eight specific areas of focus; (i) good governance; (ii) educational transformation; (iii) health and family planning; (iv) infrastructure; (v) rural development; (vi) the economy and the private sector;

(vii) environment; and (viii) national solidarity. There are quantifiable goals set out for each of these areas of focus to be achieved by 2012; these goals will be further refined, costed and clearly linked to the MDGs during the course of 2006.

5. **The MAP is a direct follow-on from the PRSP and covers the five year period 2007-2011.** The Government believes that it has effectively implemented the initial PRSP and intends now for the MAP to supersede the PRSP as the country's main development strategy. The MAP will be finalized in October 2006 and presented to Parliament together with the 2007 budget.

6. **A summary of IMF-World Bank collaboration in Madagascar is provided in Table 1.** The IMF leads in supporting Madagascar's medium-term program for maintaining macroeconomic stability. Madagascar completed its PRGF program with the IMF in March 2005, and concluded its Article IV consultations in May 2005. It is currently discussing a new program with the IMF. The World Bank leads the policy dialogue in structural and institutional reforms aimed at: (i) strengthening governance in the public sector; (ii) accelerating pro-poor economic growth and supporting foreign investment and private sector development; and (iii) ensuring human development and security, such as in health, education, nutrition and social protection.

Bank group strategy and lending operations

7. **As noted above, the World Bank's FY04-06 Country Assistance Strategy (CAS) for Madagascar was fully aligned to the Government's program**. For the first year of the CAS (FY04) the Bank approved new projects in transport, environment and governance. The CAS proposed a gradual transition from investment to programmatic lending with annual Poverty Reduction Credits (PRSC) starting in FY05. The first Poverty Reduction Support Credit (PRSC) addressing governance, education and nutrition was approved in July 2004. A second PRSC was approved in July 2005 and a third is under preparation and is expected to be presented to the Board in July 2006. Investment projects have also been approved for the Integrated Growth Poles Project addressing infrastructure and private sector development, a repeater project for HIV/AIDS and a health supplemental credit. An Energy Sector Project and a Supplemental Credit to the Community Development Project (FID) will be presented to Board in July 2006, at the same times as the PRSC 3. A watershed management project is also under preparation for presentation to the Board in September 2006.

8. **The Bank is in the process of preparing its new Country Assistance Strategy for FY07-11** which will be fully aligned with the MAP and will provide support to MAP implementation in selected areas where the Bank can most effectively have an impact, bring value-added and maximize its comparative advantages vis-à-vis other development partners. As of June 2006, the Bank's current portfolio consists of 14 IDA projects and one GEF project with total commitments of US$906 million. Of that, a total of US$463 million remains undisbursed.

IMF-World Bank Collaboration in Specific Areas

Areas where the Bank takes the lead

9. Areas in which the World Bank takes the lead are related to specific sector advice in the areas in which the Bank has active lending operations (especially in the social sectors, infrastructure, agriculture and environment) as well as through a number of analytical studies. Together with the Government and other donors, the Bank is also involved in supporting aid coordination which has included mobilizing donor support for implementing the Government's PRSP and for the Education for All initiative.

Areas in which the IMF takes the lead

10. Areas where the Fund takes the lead role relate to policy advice and reforms with respect to (i) overall macroeconomic policies and targets; (ii) tax policy and administration; (iii) budgetary accounting; (iv) treasury procedures; (v) public sector wage policy; and (vi) monetary management and exchange rate policy. The Bank team actively participates in discussions between the Fund and the government in all these areas, however, especially with respect to the setting of overall macroeconomic targets as well as tax policy.

Areas of joint responsibility

11. IMF and World Bank staff maintain a close working relationship, especially with respect to (i) monitoring the Poverty Reduction Strategy Paper; (ii) analyses and reforms in public financial management; (iii) other governance reforms, including customs; and (iv) financial sector assessment. Joint policy advice between the Bank and the Fund is given on budgetary procedures, including expenditure execution, and the functioning of internal and external budget control institutions. Table 1 includes a short description of each of the areas and specific support from the two institutions with respect to policy advice.

TABLE 1: BANK/FUND COLLABORATION

Area	**Description**	**Specialized Advice/ Reforms Supported by Fund**	**Specialized Advice/ Reforms Supported by Bank**
Support to PRS and accompanying JSANs	Together with multi- and bilateral donors, Bank/Fund provided continuous technical assistance toward completion of full PRSP in 2003 and are providing support to the MAP.	Macroeconomic framework: growth, revenue, expenditure, trade projections.	Poverty analysis; rural poverty study; education and health sector work.
HIPC completion point reforms	Regular joint Bank/Fund supervision missions; joint preparation of HIPC 'Tracking Poverty-Related Spending' assessment and action plan.	Reforms linked to budgetary accounting and controls.	Reforms in education, health, rural transport sector.
Public financial management	Joint Bank/Fund missions analyzing fiscal management.	Tax analysis and reform, strengthening control organs; expenditure management.	Budget formulation, expenditure monitoring and analysis, especially in sectors important for poverty reduction; procurement, strengthening internal and external controls.
Other governance reforms	New Government has embarked on large governance reform agenda; Bank/Fund staff work closely with UNDP/EU/AfDB staffs on assisting development of implementation plans.	Customs	Anti-corruption agenda, decentralization, judicial sector reform and support to customs action plan.

APPENDIX IV—MADAGASCAR: JOINT BANK-FUND DEBT SUSTAINABILITY ANALYSIS

Madagascar's risk of debt distress is moderate, albeit in the low range of the moderate category. Madagascar's external debt burden indicators under the baseline scenario remain below the relevant policy-dependent indicative thresholds. The stress tests, however, reveal that external debt sustainability is sensitive to export shocks. The inclusion in the analysis of the small domestic debt does not change the assessment of country's risk of debt distress.

A. Introduction

1. **This debt sustainability analysis (DSA) has been prepared jointly by IMF and World Bank staff.** It is based on the framework for low-income countries approved by the respective Executive Boards. The framework takes into account indicative thresholds for debt burden indicators determined by the quality of the country's policies and institutions.[1] It comprises of a baseline scenario (which assumes, among others, implementation of the Multilateral Debt Relief Initiative –MDRI– by the African Development Fund (ADF), IDA and the Fund) and a set of alternative scenarios.

B. Recent Developments and Current Debt Situation

2. **Madagascar reached its completion point under the Enhanced HIPC Initiative in October 2004.** The resulting debt relief, including additional bilateral debt relief from most Paris Club creditors, reduced the end-2003 NPV of debt-to-exports ratio to an estimated 137 percent.[2, 3] At that time, the ratio was projected to increase to 154 percent in 2004 and decline thereafter.

---

[1] According to the World Bank Country and Policy Institutional Assessment (CPIA) Index, Madagascar is rated as a medium performer. The indicative thresholds applicable for that category of countries are: (i) 150 percent for NPV of debt-to-exports ratio, (ii) 40 percent for the NPV of debt-to-GDP ratio, (iii) 250 percent for the NPV of debt to fiscal revenues ratio, (iv) 20 percent for the debt service to exports ratio and (v) 30 percent for the debt service to revenue ratio.

[2] Total debt relief to Madagascar under the Initiative amounts to US$836 million in NPV terms. To date, Madagascar has secured about 90 percent of that amount through agreements reached with all multilateral and Paris-Club creditors, as well as some non-Paris Club creditors.

[3] Most Paris Club creditors have written-off their outstanding claims after full delivery of HIPC debt relief, reducing claims on Madgascar by further US$466 million in NPV terms.

3. **At end-2005, Madagascar's external public debt (including arrears) amounted to US$3.5 billion in nominal terms.** [4] The decline from the end-2003 level (US$4.8 billion) was due to debt write-offs granted by most Paris Club creditors, and has consequently been accompanied by a drastic change in the creditor composition. As of end-2005, bilateral and commercial creditors represented only 23 percent of total outstanding obligations (with Paris Club creditors accounting for less than 5 percent), compared to about 46 percent by end-2003. The bilateral Paris Club debt that remains is mainly to Russia. Conversely, the share of multilateral creditors has increased to more than 75 percent at end-2005 from 54 percent at end-2003.[5]

Madagascar : External Debt Outstanding 2005

Creditor	Amounts (millions of $US)	In percent of GDP
Total external debt	3,510.3	69.7
Bilateral Creditors	784.4	15.6
Paris Club	163.4	3.2
Other countries	620.9	12.3
Private creditors	18.1	0.4
Multilateral	2707.8	53.8

Source: Madagascar authorities and Fund Staff estimates

4. **Full delivery of debt relief under MDRI will significantly reduce Madagascar's external debt.** IMF's debt relief under the MDRI became effective in January 2006 and amounts to US$197 million.[6] MDRI debt relief from IDA is expected to be implemented starting in July 2006 through the 100 percent reduction of the debt outstanding and disbursed

[4] As of end-2005, Madagascar has estimated US$405 million in arrears towards non-Paris Club and private creditors that are not delivering HIPC debt relief (Algeria, Libya and Iraq are the largest). Madagascar continues to make efforts to contact these creditors, regularize the payments and obtain full debt relief under the HIPC Initiative.

[5] The change in creditor composition also reflects the fact that multilateral creditors deliver their share of HIPC debt relief primarily trough debt service reductions instead of debt write-offs.

[6] See www.imf.org for details on the implementation of the MDRI by the IMF.

as of end-2003. Total MDRI debt service relief from IDA is estimated at SDR1.2 billion (equivalent to about US$1,878 million).[7] As for the ADF, debt relief under the MDRI will be delivered though a write-off of the outstanding obligations as of end-December 2004, with retroactive application to January-2006. Estimated MDRI debt relief from the ADF amounts to US$327 million. The implementation of MDRI by the IMF, IDA and the ADF is expected to reduce Madagascar's outstanding debt at end-2006 by almost two thirds compared to end-2005.

C. Baseline Medium- and Long-Term Scenario

5. **The baseline scenario is built on a number of key macroeconomic assumptions, the implementation of sound macroeconomic and structural policies and external financing that is through grants and highly concessional loans.** Key macroeconomic assumptions are indicated in Box 1. With respect to external financing, new borrowing is projected to remain largely at highly concessional terms. External assistance as a share of GDP which had climbed very rapidly to close to 14 percent as a share of GDP in 2004 due to large inflows of external aid and borrowing to finance recovery after the 2002 political crisis, will remain relatively high in the short term (close to 8 percent on average of GDP in 2005 and 2006 based on recent information from donors) and gradually decrease to about 6 percent of GDP by the end of the projection period. The borrowing is largely for financing infrastructure projects, improvements in ports and other facilities aimed at lowering costs and enhancing competitiveness, and to help Madagascar attain the Millennium Development Goals (MDGs).

6. **Under the baseline scenario which includes MDRI, Madagascar's external debt indicators remain well below the thresholds throughout the projection period** (Figure 1a and Table 1a)**.** The debt indicators drop sharply (by about 50 percent) in 2006 as result of the MDRI (Table 1a). The NPV of debt to GDP ratio which was at about 36 percent in 2005 (a level already below the threshold for moderate performers) drops to 15 percent in 2006 (Figure 1a and Table 1a); it increases subsequently to peak at 24 percent in 2016 and drops after to about 20 percent in the outer years. The NPV of debt-to-exports and NPV of debt-to-revenue ratios (Table 2a) exhibit a similar profile. The increase in these ratios in the initial years (from the low post MDRI levels) reflects relatively high new borrowing albeit at concessional terms to finance needed investment expenditures. The slow performance of the Export Processing Zones (EPZ) sector due to the textile shock and also the weak performance of agricultural prices for the projection period, limits the increase in the value of exports and the improvements in the debt indicator based on exports. Given the highly

[7] For details on the implementation of the MDRI by IDA, see IDA/SecM2005 and IDA/SecM2006-0131.

concessional nature of the existing debt and new borrowing, the debt service ratios are well below the indicative thresholds throughout the projection period but show a rising trend due to the accumulation of new debt.

7. **Madagascar's total public debt ratios, including domestic debt, also stay well below the external debt sustainability thresholds under the base case scenario** (Figure 2a and Table 2a)**.** The domestic debt is projected to remain under 10 percent of GDP through the projection period, as primary expenditure is assumed to be broadly kept in check with available financing from tax revenue and external assistance, and the fiscal deficit is projected to remain predominantly financed by external assistance on concessional terms.

D. Sensitivity Analysis

External public debt indicators

8. **The sensitivity analysis suggests that the external debt indicators could deteriorate with inappropriate policies, and/or if confronted by adverse shocks.**[8]

- The debt indicators in the **historical scenario** (Scenario A1 in Figure 1A and Table 1b based on the average of the years 1999-2005) follow a lower trajectory than under the base line It should be noted, however, that the years leading up to 2005 include years of political turmoil, large terms of trade shocks, cyclones and natural disasters. Given the above and the limited availability of data, only the last five years have been kept for the purpose of this scenario. During that period, real growth averaged only about 3 percent, imports and the current account deficit were also low a as the EPZ sector (recently put in place) was growing at very high growth rates from a very small base. These factors explain the relatively benign trajectory of the debt indicators under the historic scenario. If the years of the political crisis (decline of 12.7 percent in 2002) and the recovery from this (growth of 9.8% in 2003) are excluded, the average growth is significantly higher at 5 percent, which is much closer to the baseline scenario.

- The **financing scenario** (Scenario A2) reveals that Madagascar's external debt indicators are particularly sensitive to the terms of new borrowing. Under this scenario, the

[8] The stress tests performed under the sensitivity scenario assumed permanent modifications of key baseline assumptions ("alternative scenarios") as well as temporary deviations ("bound tests"). The "alternative scenarios" include a "historical scenario", under which the main variables that determine the debt dynamics are assumed to remain at their historical average, and a "financing scenario" that depicts the impact of lower concessionality in new borrowing. The "bound tests" are designed examine the impact on debt and debt service indicators of shocks, based on the country's historical volatility, to key variables.

NPV of debt to GDP remains below the threshold but peaks at 34 percent in 2016, and remains at about that level through 2026. The NPV of debt to exports ratio, however, does breach the threshold and remains above it, stabilizing at about 155 percent in the outer years i.e. 2025 and 2026. The projected path of these two ratios, together with the continuous rising trend of the debt service ratio, points to the risks to debt sustainability from new borrowing at less favorable terms than assumed in the baseline scenario. [9]

- **The bound tests also reveal some underlying vulnerabilities.** These are underscored under the most extreme stress tests represented by the combined exports and growth shock (Scenario B5) on the NPV of debt-to-GDP ratio, and the exports shock (Scenario B2) on the NPV of debt-to-exports ratio. The NPV of debt-to-GDP increases significantly (to 36 percent) but does not cross the threshold level. On the other hand, the export based indicator--the NPV of debt to exports, crosses the threshold and remains above the threshold throughout the period. The shock to exports is somewhat extreme (the standard deviation is about 35) as it is influenced by the rapid increase in exports in the historical period from textiles exports in the export processing zones, and the large decline in exports that took place during the political crises and the subsequent rapid recovery . The implications for vulnerability are nevertheless to be noted, as it illustrates the impact of shocks to certain export commodities (such as textiles) which have become large as a share of total exports in Madagascar (about 40 percent in 2005), as a result of exogenous factors such as the termination of the ATC and AGOA. The risks stemming from the potential volatility to exports is also demonstrated by the result that the debt indicator based on exports would reach the threshold even if the standard deviation is reduced to a third of that in the above extreme bound test (i.e., to 10 as opposed to 35—Scenario B7 [10]). While declines in textile exports (largely from the export processing zones) could in reality have offsets in terms of imports (which are not captured given the partial nature of the shock), the bound tests point to some real potential risks.

Total public debt indicators

9. **Total public debt indicators are most sensitive to economic growth shocks**. A temporary or permanent deviation from the baseline real GDP growth path would put the total public debt on an unsustainable path, if spending plans were kept unchanged, which is unlikely in view of past experience (Table 2b, Scenarios A3 and B1).

---

[9] This scenario is similar to a sharp decline in grant financing, compared to the baseline, compensated by loans.

[10] This scenario is equivalent to excluding the exceptional crisis years 2002-03 from the historical scenario.

E. Debt Distress Classification and Conclusions

10. **Madagascar's risk of debt distress is moderate, albeit in the low range of that category.** In the baseline scenario Madagascar's debt indicators are below the thresholds. The debt situation, however, appears vulnerable to shocks. The export based indicator reaches the threshold if borrowing is undertaken at non-concessional terms. Debt sustainability also appears vulnerable if large export shocks materialize, which is a risk in the medium term given the expected termination of AGOA.

11. **In conclusion, the debt situation seems under control but is not exempt of risks.** In that regard, there is a need not only for implementing the policies underpinning the baseline scenario, but also for careful monitoring of borrowing policies and export performance. The latter is critical given the concentration of exports in textiles and clothing and the termination of the ATC and AGOA renders exports highly vulnerable given the concentration of exports in textiles. The baseline projections assume that the current structural weakness in this sector will be offset by export increases and diversification, given a positive response to the large depreciation which has taken place in 2004 and from the policies put in place which would enhance competitiveness. Borrowing at non-concessional terms as well new borrowing beyond the levels assumed under the baseline could also raise Madagascar's risk of debt distress.

Box 1. Baseline Macroeconomic Assumptions

Real GDP growth is projected at a little under 6 percent on average, accelerating from 5.5. percent in the initial years to 6 percent subsequently as the reform measures take hold.

Inflation as measured by the GPD deflator averages about 6 percent, with higher rates 8 percent in the initial years and decelerating to 5 percent subsequently.

Export volumes grow a little under 6 percent on average and support GDP growth, despite a sharp slowdown in the initial years to about 4.5 percent due to a slowdown in textiles exports (impact of the shock related to the termination of the AGOA and ACTA).Subsequently exports accelerate to slightly above 6 percent, supported by exports of commodities related to mining, agro industry products, shrimps, gems and other commodities.

Import volumes average about 6 percent for the period. Imports slow down to under 4 percent in the initial years due to declines in 2005 and 2006 largely in response to the winding of tax related effects which raised the levels of investment related imports to very high levels in earlier years. After this initial slowdown, imports grow at a higher pace than GDP, reflecting disbursements of external support for infrastructure and other projects and the associated high levels of investment activity.

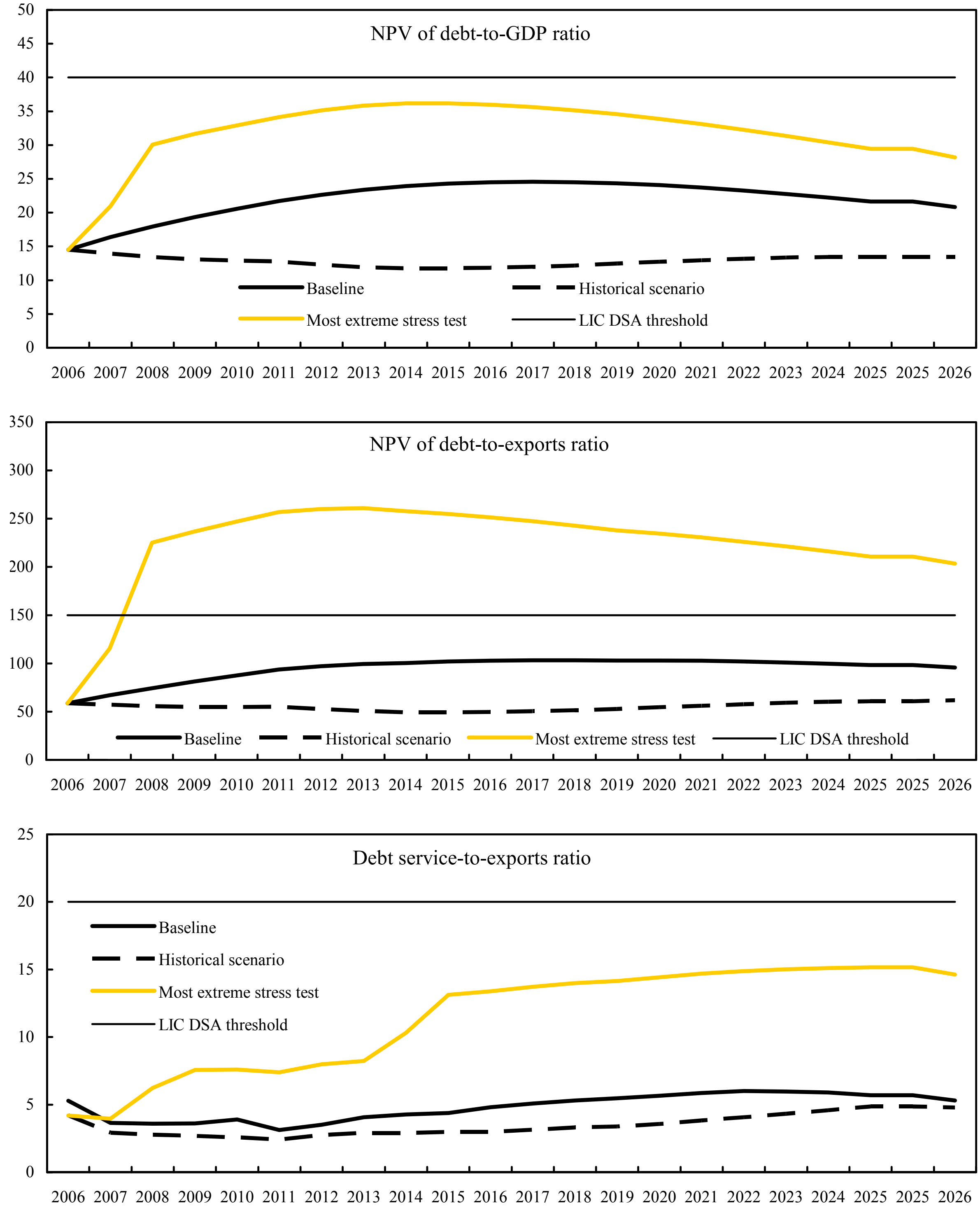
The current account deficit is projected to gradually decline from its high level of over 12 percent in 2005 to about 11 percent by 2011 and further to about 7 percent by the end of the projection period.

Tax revenues are projected to increase from 10.1 percent of GDP in 2005 to about 16.4 percent of GDP in 2026, owing to the termination of ad hoc tax and import duty exemptions and steadfast improvements in tax and custom administration.

N**on-interest expenditures** are broadly kept in check with available financing from tax revenue and external assistance, resulting in a moderate increase of about 1.5 percent of GDP over the projection period.

External assistance progressively unwinds from the exceptionally high level of about 11 percent of GDP reached during the period 2004 to 2006 to about 6 percent of GDP observed during the late 1990s. The share of grants gradually increases from less than half in the initial years to more than half in the later years.

Figure 1a. Madagascar : Indicators of Public and Publicly Guaranteed External Debt
Under Alternative Scenarios, 2006-2026
(In percent)



Source: Staff projections and simulations.

Table 1a. Madagascar: External Debt Sustainability Framework, Baseline Scenario, 2006-2026 [1]
(Percent of GDP, unless otherwise indicated)

	Actual								Historical Average [6]	Standard Deviation [6]	Projections									
	1998	1999	2000	2001	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
External debt (nominal) [1]	**103.7**	**118.4**	**104.1**	**87.5**	**92.7**	**83.2**	**79.9**	**69.7**			**25.6**	**28.8**	**31.1**	**33.2**	**35.0**	**36.8**		**41.1**	**35.5**	
o/w public and publicly guaranteed (PPG)	103.7	118.4	104.1	87.5	92.7	83.2	79.9	69.7			25.6	28.8	31.1	33.2	35.0	36.8		41.1	35.5	
Change in external debt	...	14.7	-14.3	-16.6	5.2	-9.5	-3.3	-10.2			-44.1	3.1	2.3	2.1	1.9	1.8		0.3	-1.2	
Identified net debt-creating flows	...	-0.7	-3.8	-16.8	1.2	-15.4	-6.6	-7.0			1.2	4.1	3.4	3.0	2.2	2.0		0.4	-0.6	
Non-interest current account deficit	**5.2**	**4.2**	**4.3**	**0.4**	**5.0**	**4.2**	**8.1**	**10.0**	**5.2**	**2.9**	**10.0**	**10.2**	**10.0**	**9.9**	**9.7**	**9.5**		**7.4**	**6.2**	7.0
Deficit in balance of goods and services	7.8	8.0	7.3	3.2	6.6	9.0	15.1	14.1			13.7	13.5	13.2	13.0	12.7	12.5		10.0	7.4	
Exports	21.4	24.4	30.7	29.1	16.0	23.1	32.6	26.7			24.6	24.4	24.1	23.8	23.5	23.1		23.8	21.7	
Imports	29.3	32.4	38.0	32.3	22.6	32.1	47.7	40.7			38.3	38.0	37.3	36.8	36.2	35.6		33.8	29.1	
Net current transfers (negative = inflow)	-2.3	-3.5	-3.5	-3.2	-2.2	-5.5	-7.6	-4.8	-4.1	1.8	-4.4	-3.7	-3.6	-3.5	-3.4	-3.3		-2.9	-2.5	-2.8
Other current account flows (negative = net inflow)	-0.3	-0.3	0.5	0.4	0.6	0.7	0.6	0.8			0.7	0.4	0.4	0.4	0.4	0.4		0.4	1.2	
Net FDI (negative = inflow)	**-3.4**	**-6.8**	**-5.1**	**-2.9**	**-4.2**	**-4.9**	**-37.0**	**-7.2**	**-8.9**	**11.4**	**-6.2**	**-5.3**	**-5.6**	**-5.9**	**-6.3**	**-6.3**		**-5.3**	**-5.1**	-5.2
Endogenous debt dynamics [2]	**...**	**1.8**	**-3.1**	**-14.3**	**0.4**	**-14.6**	**22.4**	**-9.9**			**-2.7**	**-0.8**	**-1.0**	**-1.1**	**-1.2**	**-1.3**		**-1.7**	**-1.7**	
Contribution from nominal interest rate	...	1.4	1.3	0.9	1.0	0.8	1.2	0.8			0.4	0.5	0.5	0.5	0.5	0.6		0.6	0.4	
Contribution from real GDP growth	...	-4.9	-5.4	-5.4	11.0	-7.6	-5.5	-3.2			-3.1	-1.3	-1.5	-1.6	-1.7	-1.8		-2.2	-2.0	
Contribution from price and exchange rate changes	...	5.3	1.0	-9.8	-11.6	-7.8	26.6	-7.5			…	…	…	…	…	…		…	…	
Residual (3-4) [3]	**...**	**15.4**	**-10.4**	**0.2**	**4.0**	**5.9**	**3.3**	**-3.2**			**-45.3**	**-1.0**	**-1.1**	**-0.9**	**-0.3**	**-0.2**		**-0.2**	**-0.6**	
o/w exceptional financing	...	-1.5	-2.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
NPV of external debt [4]	...	...	...	...	...	...	...	35.8			14.5	16.4	17.9	19.3	20.6	21.7		24.5	20.8	
In percent of exports	...	...	...	...	...	...	...	134.3			58.8	67.2	74.3	81.3	87.6	93.8		102.9	95.9	
NPV of PPG external debt	**...**	**...**	**...**	**...**	**...**	**...**	**...**	**35.8**			**14.5**	**16.4**	**17.9**	**19.3**	**20.6**	**21.7**		**24.5**	**20.8**	
In percent of exports	...	...	...	...	...	...	...	134.3			58.8	67.1	74.3	81.3	87.6	93.8		102.9	95.8	
Debt service-to-exports ratio (in percent)	23.9	17.3	13.3	8.8	17.5	10.2	107.0	8.4			5.3	3.6	3.6	3.6	3.9	3.1		4.8	5.3	
PPG debt service-to-exports ratio (in percent)	23.9	17.3	13.3	8.8	17.5	10.2	107.0	8.4			5.3	3.6	3.6	3.6	3.9	3.1		4.8	5.3	
Total gross financing need (billions of U.S. dollars)	...	62.8	126.8	2.5	162.1	84.9	260.1	257.5			278.5	339.4	329.5	333.0	313.5	315.5		382.2	583.6	
Non-interest current account deficit that stabilizes debt ratio	...	-10.4	18.6	17.0	-0.2	13.7	11.4	20.2			54.1	7.1	7.7	7.8	7.8	7.7		7.2	7.4	
Key macroeconomic assumptions																				
Real GDP growth (in percent)	3.9	4.7	4.7	6.0	-12.7	9.8	5.3	4.6	3.2	5.9	4.7	5.6	5.6	5.6	5.6	5.6	5.4	5.9	6.0	5.9
GDP deflator in US dollar terms (change in percent)	...	-4.9	-0.8	10.4	15.3	9.2	-24.2	10.4	2.2	13.6	2.6	2.4	2.3	2.2	2.2	2.2	2.3	2.2	3.4	2.3
Effective interest rate (percent) [5]	...	1.3	1.2	1.0	1.1	1.0	1.2	1.2	1.1	0.1	0.6	2.2	2.0	1.9	1.8	1.7	1.7	1.5	1.1	1.4
Growth of exports of G&S (US dollar terms, in percent)	...	13.3	30.6	11.0	-44.6	72.9	12.8	-5.6	12.9	35.5	-0.8	7.1	6.7	6.4	6.4	6.4	5.4	8.1	8.2	7.9
Growth of imports of G&S (US dollar terms, in percent)	...	10.1	22.0	-0.5	-29.6	70.4	18.6	-1.3	12.8	30.6	1.1	7.0	6.1	6.5	6.1	6.3	5.5	7.1	6.0	6.9
Grant element of new public sector borrowing (in percent)				...	...	...	...	...	...	...	43.0	43.0	43.0	43.0	43.0	43.0	43.0	43.0	43.0	43.0
Memorandym item:																				
Nominal GDP (billions of US dollars)	3738.1	3723.1	3867.0	4527.6	4557.1	5463.8	4357.7	5033.1			5409.5	5846.3	6315.4	6816.6	7357.1	7942.5		11727.9	26371.1	

Source: Staff simulations.

[1] Includes public sector external debt.

[2] Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.

[3] Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

[4] Assumes that NPV of private sector debt is equivalent to its face value.

[5] Current-year interest payments devided by previous period debt stock.

[6] Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

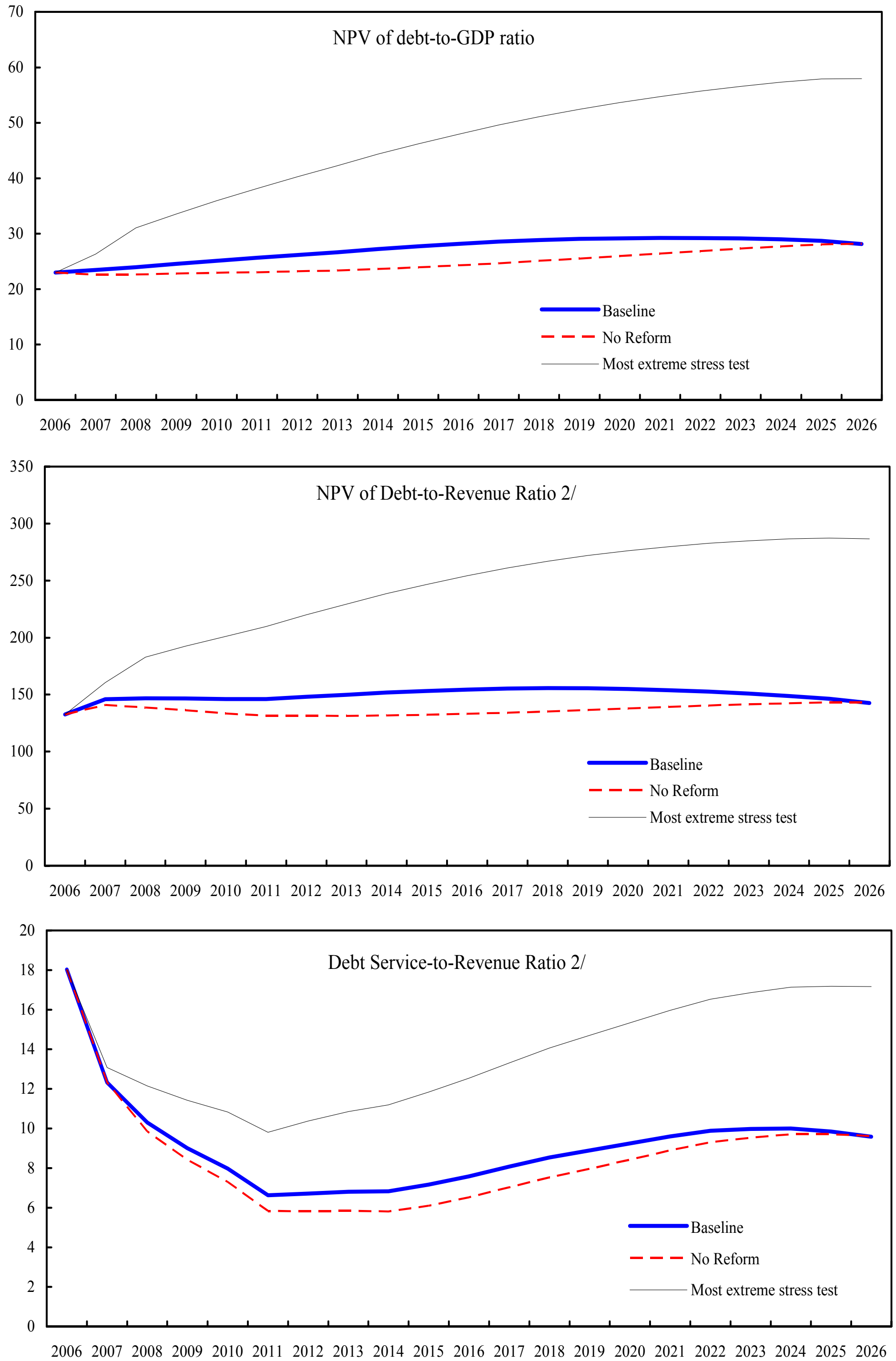
Table 1b. Madagascar: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2006-26
(Percent)

	Projections								
	2006	2007	2008	2009	2010	2011	**2016**	2025	2026
NPV of debt-to-GDP ratio									
Baseline	14	16	18	19	21	22	**24**	22	21
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2007-26 [1]	14	14	13	13	13	13	**12**	13	13
A2. New public sector loans on less favorable terms in 2007-26 [2]	14	18	20	23	25	27	**34**	34	33
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	14	18	21	23	24	26	**29**	25	25
B2. Export value growth at historical average minus one standard deviation in 2007-08 [3]	14	20	28	30	30	31	**31**	24	23
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	14	19	24	26	27	29	**33**	29	28
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 [4]	14	18	22	23	24	25	**27**	23	22
B5. Combination of B1-B4 using one-half standard deviation shocks	14	21	30	32	33	34	**36**	29	28
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 [5]	14	23	25	27	29	31	**35**	31	29
B7. Export value growth at historical average minus one third of standard deviation in 2007-08 [3]	14	20	28	30	30	31	**31**	24	23
NPV of debt-to-exports ratio									
Baseline	59	67	74	81	88	94	**103**	98	96
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2007-26 [1]	59	57	56	55	55	55	**50**	61	62
A2. New public sector loans on less favorable terms in 2007-26 [2]	59	73	85	96	107	118	**142**	156	154
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	59	67	74	81	88	94	**103**	98	96
B2. Export value growth at historical average minus one standard deviation in 2007-08 [3]	59	115	225	237	247	257	**251**	211	204
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	59	67	74	81	88	94	**103**	98	96
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 [4]	59	75	90	97	103	108	**113**	103	100
B5. Combination of B1-B4 using one-half standard deviation shocks	59	85	123	132	139	146	**149**	132	128
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 [5]	59	67	74	81	88	94	**103**	98	96
B7. Export value growth at historical average minus one third of standard deviation in 2007-08 [3]	59	88	132	139	145	151	**147**	124	119
Debt service ratio									
Baseline	5	4	4	4	4	3	**5**	6	5
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2007-26 [1]	4	3	3	3	3	2	**3**	5	5
A2. New public sector loans on less favorable terms in 2007-26 [2]	4	3	3	3	4	4	**6**	10	10
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2007-08	4	3	3	3	3	3	**5**	7	7
B2. Export value growth at historical average minus one standard deviation in 2007-08 [3]	4	4	6	8	8	7	**13**	15	15
B3. US dollar GDP deflator at historical average minus one standard deviation in 2007-08	4	3	3	3	3	3	**5**	7	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2007-08 [4]	4	3	3	3	3	3	**6**	7	7
B5. Combination of B1-B4 using one-half standard deviation shocks	4	3	4	4	4	4	**8**	9	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2007 [5]	4	3	3	3	3	3	**5**	7	7
B7. Export value growth at historical average minus one third of standard deviation in 2007-08 [3]	4	3	4	4	4	4	**8**	9	9
Memorandum item:									
Grant element assumed on residual financing (i.e., financing required above baseline) [6]	41	41	41	41	41	41	**41**	41	41

Source: Staff projections and simulations.

[1] Variables include real GDP growth, growth of GDP deflator (U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
[2] Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
[3] Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
[4] Includes official and private transfers and FDI.
[5] Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
[6] Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 2a.Madagascar: Indicators of Public Debt Under Alternative Scenarios, 2006-2026 1/



Source: Staff projections and simulations.
1/ Most extreme stress test is test that yields highest ratio in 2016.
2/ Revenue including grants.

Table 2a.Madagascar: Public Sector Debt Sustainability Framework, Baseline Scenario, 2003-2026
(Percent of GDP, unless otherwise indicated)

	Actual			Historical Average [5]	Standard Deviation [5]	Estimate	Projections								
	2003	2004	2005			2006	2007	2008	2009	2010	2011	2006-11 Average	2016	2026	2012-26 Average
Public sector debt [1]	99.2	92.3	80.2			34.2	35.8	37.1	38.4	39.6	40.8		44.7	42.8	
o/w foreign-currency denominated	83.2	80.0	69.7			25.6	28.8	31.1	33.2	35.0	36.8		41.1	35.5	
Change in public sector debt	-7.9	-6.8	-12.2			-46.0	1.7	1.3	1.3	1.2	1.2		0.5	-1.0	
Identified debt-creating flows	-18.9	23.4	-4.6			-46.3	1.9	1.6	1.4	1.3	1.2		0.5	-1.0	
Primary deficit	2.0	2.0	2.0	1.6	1.4	2.6	3.5	3.2	3.2	3.2	3.3	3.2	3.1	1.8	2.6
Revenue and grants	15.4	20.3	16.7			17.3	16.0	16.3	16.8	17.2	17.5		18.2	19.7	
of which : grants	5.1	8.2	5.7			5.7	4.2	3.9	3.9	3.8	3.7		3.5	2.9	
Primary (noninterest) expenditure	17.4	22.2	18.7			19.9	19.5	19.5	20.0	20.4	20.8		21.3	21.5	
Automatic debt dynamics	-18.9	23.8	-4.9			-4.3	-1.5	-1.6	-1.7	-1.9	-2.0		-2.5	-2.8	
Contribution from interest rate/growth differential	-9.4	-5.8	-5.0			-4.0	-1.4	-1.5	-1.6	-1.8	-1.3		-1.7	-1.6	
of which : contribution from average real interest rate	0.2	-0.8	-0.9			-0.3	0.4	0.4	0.3	0.2	0.8		0.8	0.9	
of which : contribution from real GDP growth	-9.5	-5.0	-4.1			-3.6	-1.8	-1.9	-2.0	-2.0	-2.1		-2.5	-2.5	
Contribution from real exchange rate depreciation	-9.5	29.6	0.1			-0.4	-0.1	-0.1	-0.1	-0.1	-0.7		...	...	
Other identified debt-creating flows	-2.0	-2.4	-1.7			-44.5	-0.1	-0.1	-0.1	-0.1	0.0		0.0	0.0	
Privatization receipts (negative)	-0.2	-0.4	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	-1.8	-2.0	-1.7			-44.5	-0.1	-0.1	-0.1	-0.1	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	11.0	-30.2	-7.6			0.3	-0.3	-0.2	-0.1	-0.1	-0.1		0.0	0.0	
NPV of public sector debt	...	...	46.2			23.0	23.4	23.9	24.6	25.1	25.6		28.2	28.1	
o/w foreign-currency denominated	...	...	35.8			14.5	16.4	17.9	19.3	20.6	21.7		24.5	20.8	
o/w external	...	...	35.8			14.5	16.4	17.9	19.3	20.6	21.7		24.5	20.8	
NPV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Gross financing need [2]	18.7	20.5	16.4			14.6	12.8	11.1	10.1	9.3	8.6		7.5	10.0	
NPV of public sector debt-to-revenue ratio (in percent) [3]	...	...	277.5			132.6	146.0	146.9	146.7	146.1	146.2		154.4	142.6	
o/w external	...	...	215.0			83.5	102.2	110.0	115.5	119.5	123.8		134.2	105.7	
Debt service-to-revenue ratio (in percent) [3, 4]	26.5	25.9	26.4			18.0	12.3	10.3	9.0	8.0	6.6		7.6	9.6	
Primary deficit that stabilizes the debt-to-GDP ratio	9.8	8.8	14.2			48.6	1.8	1.9	1.9	2.0	2.1		2.6	2.8	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	9.8	5.3	4.6	3.2	5.9	4.7	5.6	5.6	5.6	5.6	5.6	5.4	5.9	6.0	5.9
Average nominal interest rate on forex debt (in percent)	1.1	2.0	1.5	2.0	0.9	0.7	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.1	1.3
Average real interest rate on domestic currency debt (in percent)	7.5	-2.3	-1.4	-0.5	4.7	5.4	6.8	8.0	8.9	9.1	9.2	7.9	8.3	7.5	8.2
Real exchange rate depreciation (in percent, + indicates depreciation)	-11.4	37.6	0.1	4.2	14.8	-0.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	2.8	14.3	18.3	10.8	5.2	11.5	9.9	7.2	5.6	5.1	5.1	7.4	5.1	5.3	5.1
Growth of real primary spending (deflated by GDP deflator, in percent)	41.8	34.7	-12.1	9.2	21.2	11.7	3.5	5.6	7.8	8.1	7.5	7.4	6.5	5.9	6.1
Grant element of new external borrowing (in percent)	0.0	0.0	43.2	4.3	13.7	44.2	44.2	44.2	44.2	44.2	44.2	44.2	44.2	44.2	...

Sources: Malagasy authorities; and Fund staff estimates and projections.

[1] Central government. Gross public debt.

[2] Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

[3] Revenues including grants.

[4] Debt service is defined as the sum of interest and amortization of medium and long-term debt.

[5] Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b.Madagascar: Sensitivity Analysis for Key Indicators of Public Debt 2006-2026

	Projections							
	2006	2007	2008	2009	2010	2011	2016	2026
NPV of Debt-to-GDP Ratio								
Baseline	23	23	24	25	25	26	28	28
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	23	22	22	22	21	21	21	25
A2. Primary balance is unchanged from 2006	23	23	23	23	23	23	24	28
A3. Permanently lower GDP growth [1]	23	24	25	26	28	29	39	64
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	23	26	31	34	36	38	48	58
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	23	23	23	24	25	25	28	28
B3. Combination of B1-B2 using one half standard deviation shocks	23	23	24	24	25	25	26	25
B4. One-time 30 percent real depreciation in 2007	23	29	29	28	28	28	29	28
B5. 10 percent of GDP increase in other debt-creating flows in 2007	23	32	32	32	32	32	33	31
NPV of Debt-to-Revenue Ratio [2]								
Baseline	133	146	147	147	146	146	154	143
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	133	137	132	127	122	118	111	115
A2. Primary balance is unchanged from 2006	133	141	139	136	134	132	133	143
A3. Permanently lower GDP growth 1/	133	148	152	156	160	165	211	310
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	133	161	183	193	201	210	254	287
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	133	143	143	143	143	143	152	142
B3. Combination of B1-B2 using one half standard deviation shocks	133	144	144	142	139	138	140	124
B4. One-time 30 percent real depreciation in 2007	133	181	176	170	164	160	158	144
B5. 10 percent of GDP increase in other debt-creating flows in 2007	133	202	196	190	185	181	178	155
Debt Service-to-Revenue Ratio [2]								
Baseline	18	12	10	9	8	7	8	10
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	18	13	10	8	7	5	5	9
A2. Primary balance is unchanged from 2006	18	12	10	8	7	6	7	10
A3. Permanently lower GDP growth [1]	18	12	11	9	9	7	10	19
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2007-2008	18	13	12	11	11	10	13	17
B2. Primary balance is at historical average minus one standard deviations in 2007-2008	18	12	10	9	8	6	8	10
B3. Combination of B1-B2 using one half standard deviation shocks	18	13	10	9	8	6	7	9
B4. One-time 30 percent real depreciation in 2007	18	13	11	10	9	8	9	11
B5. 10 percent of GDP increase in other debt-creating flows in 2007	18	12	15	12	11	9	8	10

Sources: Country authorities; and Fund staff estimates and projections.

[1] Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).

[2] Revenues are defined inclusive of grants.

APPENDIX V—MADAGASCAR: STATISTICAL ISSUES

1. Serious shortcomings in data provision hamper economic analysis and surveillance. Madagascar's database remains weak, particularly in the areas of real sector, government finances, the balance of payments, and social statistics. The authorities are aware of these deficiencies and are working, with technical assistance from the international community, including the Fund, to strengthen their statistical system. Madagascar is a participant in the General Data Dissemination System (GDDS), and its metadata was posted on the Data Dissemination Bulletin Board (DSBB) on May 20, 2004. However, the metadata need to be reviewed, as they have not been updated since first published. A STA multisector statistics mission took place in February 2004;prior to that, balance of payments and monetary and financial statistics missions visited the country in June and July 2001, respectively.

Real sector

2. Production of a complete set of national accounts (based on benchmark data) is infrequent and depends on irregularly collected source data. The last complete sets of benchmark data refer to 1995 and 1984. For the intervening years, only estimates of GDP at current and constant (1984) prices broadly following the *1968 SNA* methodology have been produced. These estimates are revised frequently and are unreliable, due to gaps in the source data and methodological shortcomings. In particular, the estimates of the agricultural activities are weak because of the unavailability of suitable information about the size and the evolution of this sector. Moreover, service activities are not properly covered and little information is available on the magnitude of the informal sector. The February 2006 STA national accounts mission reviewed progress made by the statistical agency (INSTAT) since the 2002 multisector mission and helped the authorities complete a comprehensive exercise for 2001 GDP. The INSTAT plans to complete the details of the 2001 national accounts exercise for 2001 and use it to accomplish the passage to a new base year–2005.

3. The INSTAT currently produces two industrial production indices, one for the export processing zone (IPI-ZF) and another for enterprises outside the export processing zone (IPI-RC). These two indices have different survey frameworks and base years (2000 for the IPI-ZF and 2001 for IPI-RC). Both indices are quarterly but the release timeliness is irregular, sometimes with a lag of up to one year.

4. A revamped consumer price index (CPI) covering the four principal cities with base year 2000 and expenditure weights based on a 1999 household survey is currently compiled. The CPI is generally reported to Fund staff on a timely basis. The INSTAT plans to update the base year to 2005 and to derive new weights from the 2005 household expenditure survey in the near future. Data on producer prices and nationwide employment are not available. Various considerations underlie ongoing work on revising the wholesale price index (WPI)—the key issue being the relative importance of the commercial activities in the Malagasy

economy. However, the utility of such an indicator is reduced due to the limited coverage of manufacturing products.

Government finance

5. The 2004 multisector mission found that data on central government financial operations are disseminated only annually, and data on public debt are not disseminated. The mission recommended monthly dissemination of data on central government operations, and quarterly dissemination of public debt data, as well as monthly reporting of these data to STA for publication in *IFS*. The mission also found significant gaps in the coverage of government financial statistics (GFS), and recommended that it be broadened to include public agencies that are part of the central government. Finally, the mission made recommendations concerning classification and recording of transactions, as well as the calculation of domestic arrears.

6. The latest data reported to STA and published in the *GFS Yearbook* cover the consolidated central government for 2004. However, the coverage does not include all extra budgetary units within the central government, and many classification problems remain (requiring extensive use of adjustment entries to current expenditure). Moreover, since 1996, detailed breakdowns of data on budgetary and non-budgetary transactions and central government debt have not been provided. Madagascar does not report subannual data for publication in *International Finance Statistics* (*IFS*).

Balance of payments

7. Since 1984, the Central Bank of Madagascar (BCM) has been in charge of compiling and disseminating balance of payments statistics, and in 1997, it implemented the fifth edition of the *Balance of Payments Manual (BPM5)*. However, the current compilation system is flawed in many respects: the external trade data are derived from customs data, which suffer from inadequate coverage and deficient recording procedures. Moreover, significant smuggling activities, particularly related to the mining sector, further reduce the reliability of trade data. Because the customs processing system has experienced numerous technical disruptions since 1998, the trade data have limited serviceability and require many manual corrections. The current implementation of the ASYCUDA (Automated System for Customs Data, Version 2.7) was largely completed by mid-2002, with the system installed in most customs offices. Plans to further upgrade the customs processing system to ASYCUDA throughout the country should be completed by end-2006.

8. The 2004 multisector technical assistance mission reviewed the progress made in the transition to *BPM5* and found that the authorities had implemented direct foreign investment enterprise surveys and are utilizing an upgraded international transactions reporting system (ITRS). The mission noted that the compilation system is still hampered by several recurring

issues: excessive processing lags due to partial automation of customs reports; and inadequate coverage, for example, of transactions for the private sector, NGOs, and foreign embassies. Also, debt relief obtained from multilateral financial institutions remains misclassified as a current transfer rather than as a capital transfer.

9. In addition, the EPZs that process goods and reexport them to a third economy are not properly identified within other business services (merchandising and other trade related services).

10. Although ASYCUDA and port authorities can provide separate data for freight, insurance and other categories, the current 12 percent c.i.f./f.o.b. correction for balance of payments statistics is entirely attributed to freight. Data for the service and income accounts rely excessively on the ITRS reports, with accuracy not routinely assessed against other readily available data sources.

11. As noted by the mission of June 2001 and the February 2004 multisector mission, INSTAT and the BCM continue to adjust customs data using different techniques and publish two distinct series of trade statistics, bringing into question the reliability of Madagascar's balance of payments statistics.

12. The compilation of external debt statistics is generally satisfactory, and the United Nations Conference on Trade and Development (UNCTAD) is installing the latest version of the Debt Management and Financial Analysis System (DMFAS). This system is not yet fully operational; some data entry remains to be completed, and certain DMFAS modules have yet to be installed.

Monetary and financial statistics

13. The 2004 multisector mission assessed the implementation status of the 2001 mission's recommendations and made additional recommendations to improve monetary and financial statistics. It found that several recommendations remain pending, such as: (i) improvement of the staff and computer resources of the unit in charge of compiling monetary statistics; (ii) electronic transmission of monthly call report forms by the commercial banks to the BCM; and (iii) expansion of broad money survey to include the microfinance institutions that issue liabilities meeting the national definition of broad money. Furthermore, the mission recommended improvements to the source data and the compilation of monetary statistics in accordance with the Fund's methodology as described in the *Monetary and Financial Statistics Manual (MFSM)*.

14. Since August 2001, the BCM has reported monetary data to STA by e-mail for publication in *IFS*. After a brief interruption in data reporting in 2002, regular data reporting resumed in July 2002. Data for the monetary authorities and deposit money banks through

May 2005 have been published in the *IFS* and in August 2005 the BCM began reporting monetary data to STA using the new Standardized Report Forms.

Madagascar: Table of Common Indicators Required for Surveillance
As of June 12, 2006

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	5/31/06	5/31/06	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/30/06	5/31/06	M	M	M
Reserve/Base Money	4/30/06	5/31/06	M	M	M
Broad Money	3/31/06	5/31/06	M	M	M
Central Bank Balance Sheet	4/30/06	5/31/06	M	M	M
Consolidated Balance Sheet of the Banking System	4/30/06	5/31/06	M	M	M
Interest Rates[2]	3/31/06	5/31/06	Q and M	Q and M	Q and M
Consumer Price Index	April 2006	5/31/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	3/31/06	5/31/06	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	3/31/06	5/31/06	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec 2005	5/31/06	A	A	A
External Current Account Balance	2005-Q4	3/31/06	Q	Q	Q
Exports and Imports of Goods and Services	2006-Q1	5/31/06	Q	Q	Q
GDP/GNP	2005	3/31/06	A	A	A
Gross External Debt	Dec 2005	3/31/06	A	A	A

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

Statement by the IMF Staff Representative
July 21, 2006

Since the issuance of the staff report, the following information has become available. The thrust of the staff appraisal remains unchanged.

The two outstanding prior actions have been completed. The Ministry of Finance has issued a circular requiring all ministries to submit monthly plans for expenditure commitments in accordance with the quarterly budget appropriations. In addition, the authorities have submitted to parliament a supplementary budget which is in line with the 2006 fiscal program and increases the share of PRSP priority spending in total domestically financed spending compared to the initial 2006 budget. While the latter measure was implemented only on July 20, 2006, this was principally owing to administrative and procedural delays and, as the authorities explained, a technical error in the original submission that was subsequently addressed through the issuance of a correction to the draft supplementary budget. The staff has reviewed the revised supplementary budget and can confirm that it is in line with the understandings previously reached with the authorities.

Inflation in May rose to 12.8 percent (year-on-year), owing mainly to higher food prices and a further increase in petroleum product pump prices. This higher than projected outcome requires that monetary policy remains tight throughout the remainder of 2006 to achieve the program target for year end (11.3 percent).

Fiscal revenue appears to have remained on track to meet the authorities' program target. Based on preliminary information through end-June, both domestic tax revenues and customs receipts exceeded the program target by a small margin.

As envisaged in the staff report, the World Bank cancelled Madagascar's debt to the International Development Association under the Multilateral Debt Relief Initiative effective July 1, 2006. The cancellation amounts to US$ 1,780 million, in addition to US$ 444 million of relief previously granted under the enhanced Heavily Indebted Poor Countries Initiative.

The authorities concurred with the Fund's reclassification of Madagascar's foreign exchange rate regime from "independently floating" to "managed float with no predetermined path." This classification reflects Madagascar's de facto exchange rate policy in which the central bank intervenes in the foreign exchange market to smooth large exchange rate fluctuations and to meet its foreign reserve target.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/163
FOR IMMEDIATE RELEASE
July 24, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$ 80.8 Million PRGF Arrangement for the Republic of Madagascar and Activation of the Trade Integration Mechanism

The Executive Board of the International Monetary Fund (IMF) has approved a three-year, SDR 55.0 million (about US$80.8 million) arrangement under the Poverty Reduction and Growth Facility (PRGF) for the Republic of Madagascar to support the government's economic program for 2006–2008. The first disbursement under the arrangement will amount to SDR 7.9 million (about US$11.5 million).

The Executive Board also noted the authorities' intention to activate the Trade Integration Mechanism (TIM) in light of the possible impact on Madagascar from the end of textile quotas of the Agreement on Textiles and Clothing of the World Trade Organization in 2005 and the implementation of the U.S. African Growth and Opportunities Act (AGOA) in 2007. Should the impact of these measures be greater than anticipated, the TIM's deviation feature would allow an augmentation of the PRGF by up to 10 percent of quota, or SDR 12.2 million (about US$17.9 million).[1]

Following the Executive Board's discussion on July 21, 2006, of Madagascar's IMF-supported economic program, Ms. Anne O. Krueger, First Deputy Managing Director and Acting Chair, said:

"The Malagasy authorities are to be commended for their commitment to reform and for taking strong measures to accelerate the country's economic development. The new three year arrangement under the Poverty Reduction and Growth Facility and the activation of the Trade Integration Mechanism (TIM) will assist them in making progress toward achieving the Millennium Development Goals (MDGs) by supporting sustained private-sector led growth, promoting fiscal consolidation, strengthening the financial sector and reducing the country's vulnerability to exogenous shocks.

[1] The Republic of Madagascar joined the IMF on September 25, 1963. Its quota is SDR 122.2 million (about US$179.4 million), and its outstanding use of IMF resources totals SDR 11.4 (about US$16.7 million).

"Increasing domestic resource mobilization and improving public financial management will be essential for fiscal consolidation. The modernization of tax administration, including elimination of ad hoc custom duty exemptions, will be of paramount importance to minimize revenue leakages. To keep spending in line with projected resource flows and avoid a recurrence of spending overruns, the authorities will carry out an analytical audit of the expenditure commitment process and put in place monthly ministerial expenditure commitment plans.

"The monetary stance will need to remain sufficiently tight throughout the remainder of 2006 to prevent a spillover of energy-related price increases into general inflation. Monetary policy implementation will be strengthened through the development of indirect instruments. Madagascar's exchange rate regime is broadly appropriate, particularly given the economy's vulnerability to exogenous shocks.

"Madagascar's debt situation is sustainable, reflecting debt relief under the Multilateral Debt Relief Initiative. In view of the country's vulnerability to shocks and the financing required in order to make progress towards achieving the MDGs, continued prudent borrowing—in the form of concessional loans, and preferably, grants—will be needed. Progress in export diversification will also be necessary, notably through further trade liberalization. At the same time, the activation of the TIM should enable Madagascar to better weather balance-of-payments shocks that could result from the termination of trade preferences.

"The measures being undertaken to address the financial and structural problems facing the national public utility company are welcome. They should increase the reliability of electricity production, reduce its cost, and thereby improve the business environment. The development of the second generation poverty reduction strategy—the Madagascar Action Plan—will be instrumental in prioritizing key reforms for the period ahead," Ms. Krueger said.

The PRGF is the IMF's concessional facility for low-income countries. It is intended that PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Background

Madagascar is one of the poorest countries in sub-Saharan Africa, ranking 146 out of 177 on the United Nations Human Development Index. Economic development has been hampered by such factors as low domestic savings, poor social and economic infrastructure, uneven application of government regulations, and most recently, power outages owing to a financial crisis at the national public utility company (JIRAMA).

The country has one of the lowest tax revenue-to-GDP ratios in the world (10.1 percent in 2005). This impedes the authorities' ability to finance critical development expenditure and mobilize donor assistance. These problems, combined with persistent weaknesses in PFM, exacerbate an already tenuous fiscal situation.

Madagascar's economy is vulnerable to exogenous shocks**,** such as intermittent cyclones and drought, volatility in key commodity prices (notably for oil and vanilla), the termination of the WTO's Agreement of Textiles and Clothing (ATC) in early 2005, and the expected termination in 2007 of the third party provision under the U.S.'s AGOA.

To address these challenges, the authorities requested a new three-year arrangement under the PRGF to support their economic program for 2006–08. The goals of the program are to sustain economic growth, promote fiscal consolidation, and alleviate poverty, while reducing vulnerability to shocks. Access requested is an amount equivalent to SDR 55.0 million (45 percent of quota), reflecting the strength of the program and the balance of payments need. Seven disbursements would be phased uniformly following Executive Board reviews over the three-year period under the program.

The authorities also requested activation of the TIM to help the country deal with expected shocks in the textile sector such as those from the ATC and AGOA terminations. Should the impact of these shocks during the arrangement be worse than anticipated, the authorities would like to reserve the possibility of augmenting access of up to 10 percent of quota under TIM's deviation feature.

The authorities' response to past Fund policy advice has been mixed. As the 2005 ex-post assessment (EPA) noted, this is principally because there have been persistent weaknesses in public financial management (PFM) and limited institutional capacity. Since 2005, the country has benefited from Fund technical assistance in the areas of revenue administration, PFM, and a Financial Sector Assessment Program (FSAP). In addition, the central bank has benefited from a Safeguards Assessment. The authorities, who intend to seek additional technical assistance, have incorporated the main recommendations in each of these areas into their economic program. Additionally, political stability has been restored, following the 2001 political crisis. Presidential elections are scheduled for December 2006 and parliamentary, regional, and municipal elections for 2007.

Program Summary

For 2006, the authorities have set realistic, though ambitious, macroeconomic objectives. Real GDP is targeted to grow at 4.7 percent, average inflation to hold at 11.2 percent in spite of the recent price shocks, and official reserves to remain at the equivalent to 2.9 months of imports of goods and services. The goal is to promote fiscal consolidation while aligning expenditure with Madagascar's Poverty Reduction Strategy Paper objectives. Despite the shortfalls in revenue and budgetary assistance in the first half of the year, the authorities intend to achieve an overall deficit (on a cash basis, excluding grants) equivalent to 10.8 percent of GDP, consistent with their macroeconomic objectives. To do so, they have had to reduce domestically financed spending across the board by the equivalent of about 1.7 percent of GDP. However, thanks to the resources freed up by the Multilateral Debt Relief Initiative (equivalent to 0.6 percent of GDP), the authorities were able to reduce the planned cuts in priority sector spending (see Press Release No. 05/286 for background on the MDRI). A supplementary budget with these changes was submitted to Parliament in mid July. The overall fiscal deficit will be fully financed by grants and highly concessional loans from development partners. Achieving the program's objectives for 2006 will require a concerted effort on revenue mobilization, PFM, monetary and exchange rate management, and reform of JIRAMA.

Madagascar: Selected Economic and Financial Indicators, 2004-11

	2004	2005 Est.	2006 Prog.	2007 Projections	2008	2009	2010	2011
	(Percent change, unless otherwise indicated)							
National income and prices								
Nominal GDP growth	20.3	23.8	16.8	16.0	13.2	11.5	11.0	11.0
Real GDP growth	5.3	4.6	4.7	5.6	5.6	5.6	5.6	5.6
GDP deflator	14.3	18.3	11.5	9.9	7.2	5.6	5.1	5.1
Consumer price index (period average)	13.9	18.4	11.2	9.6	7.0	5.5	5.0	5.0
Consumer price index (end of period)	27.3	11.4	11.3	8.0	6.0	5.0	5.0	5.0
External sector								
Export, f.o.b	0.1	-15.3	1.7	7.5	6.6	6.4	6.5	6.6
Imports, c.i.f.	20.7	-0.7	0.5	8.4	5.6	6.1	5.6	5.9
Export volume	5.6	13.4	-1.6	4.1	5.2	6.2	6.2	6.5
Import volume	7.4	-11.6	-9.7	6.6	6.6	6.1	6.2	6.3
Terms of trade (deterioration -)	-15.7	-33.5	-7.1	1.5	2.3	0.2	0.8	0.4
Public finance								
Revenue (excluding grants)	40.6	12.3	24.8	18.2	18.0	16.0	15.3	14.3
Total expenditure	54.6	4.9	20.1	11.9	11.8	12.9	13.0	12.6
Current expenditure	33.6	7.7	10.0	16.4	15.8	14.5	14.4	14.3
Investment expenditure and net lending	84.2	2.0	30.9	7.9	7.8	11.3	11.6	10.6
Money and credit [1]								
Broad money	23.8	3.1	15.6	16.0	13.2	11.5	11.3	11.3
Net foreign assets	23.3	1.9	22.8	8.8	5.9	4.7	5.0	5.1
Net domestic assets	0.6	1.2	-7.2	6.6	7.1	6.9	6.4	6.2
Credit to government	-12.3	-5.3	-16.8	-1.0	-0.6	-1.0	-0.8	-1.1
Credit to the private sector [2]	36.9	22.4	24.5	24.3	22.5	19.0	18.5	17.0
Velocity of money (M3; average)	3.9	4.6	4.7	4.7	4.7	4.7	4.7	4.7
TB weighted-average auction rates (in percent; end of period)	17.4	18.6	...	...	...	...	...	...
	(Percent of GDP)							
Public finance								
Total revenue (excluding grants)	12.0	10.9	11.7	11.9	12.4	12.9	13.4	13.8
Of which: tax revenue	10.9	10.1	11.0	11.5	12.0	12.5	13.0	13.4
Total grants	8.2	5.7	49.5	4.2	3.9	3.9	3.8	3.7
Current expenditure	12.6	11.0	10.4	10.4	10.7	11.0	11.3	11.6
Capital expenditure	12.5	10.3	11.5	10.7	10.2	10.2	10.2	10.2
Total expenditure	25.1	21.2	21.9	21.2	20.9	21.1	21.5	21.8
Domestic balance	-2.3	-2.2	-0.9	-1.3	-1.2	-1.1	-1.1	-1.1
Overall balance (cash basis, incl. grants)	-5.7	-4.3	38.7	-5.1	-4.6	-4.4	-4.3	-4.3
Overall balance (cash basis, excl. grants)	-13.9	-10.1	-10.8	-9.3	-8.5	-8.3	-8.1	-8.0
Domestic financing	-1.0	0.5	-3.1	0.1	0.1	0.0	0.0	0.0

continued

Madagascar: Selected Economic and Financial Indicators, 2004-11 (concluded)

	2004	2005 Est.	2006 Prog.	2007 Projections	2008 Projections	2009 Projections	2010 Projections	2011 Projections
	(Percent of GDP, unless otherwise indicated)							
Money and credit								
Broad money (M3)	25.9	21.6	21.3	21.3	21.3	21.3	21.4	21.4
Net foreign assets	10.9	9.2	12.1	12.1	11.8	11.4	11.3	11.1
Net domestic assets	14.9	12.3	9.2	9.2	9.4	9.8	10.0	10.2
Credit to government	5.0	2.9	-0.6	-0.7	-0.7	-0.8	-0.9	-1.0
Credit to the private sector	10.0	9.9	10.5	11.3	12.2	13.0	13.9	14.6
Savings and investment								
Resource gap	-15.1	-14.1	-13.7	-13.5	-13.2	-13.0	-12.7	-12.5
Investment	24.3	22.5	21.8	22.3	22.5	22.7	23.0	23.2
Government	12.5	10.3	11.5	10.7	10.2	10.2	10.2	10.2
Nongovernment	11.8	12.3	10.3	11.5	12.3	12.5	12.7	13.0
Gross domestic savings	9.2	8.5	8.1	8.7	9.3	9.7	10.3	10.7
Gross national savings	15.0	11.7	11.4	11.5	12.0	12.3	12.7	13.1
External sector and public debt								
Export, f.o.b	22.9	16.7	15.4	15.3	15.2	15.0	14.8	14.7
Imports, c.i.f.	39.0	33.4	30.4	30.6	30.0	29.6	29.0	28.5
Current account balance (excluding grants)	-13.1	-12.1	-11.6	-11.4	-11.1	-11.0	-10.8	-10.6
Current account balance (including grants)	-9.3	-10.8	-10.5	-10.7	-10.5	-10.4	-10.2	-10.1
Public debt	92.3	80.2	34.2	35.8	37.1	38.4	39.6	40.8
External	80.0	69.7	25.6	28.8	31.1	33.2	35.0	36.8
Domestic	12.4	10.4	8.5	7.0	6.0	5.2	4.6	3.9
Net present value (NPV) of external debt								
NPV of debt-to-GDP ratio	...	35.8	14.5	16.4	17.9	19.3	20.6	21.7
NPV of debt-to-exports ratio	...	134.3	58.8	67.1	74.3	81.3	87.6	93.8
NPV of debt-to-revenue ratio	...	215.0	83.5	102.2	110.0	115.5	119.5	123.8
	(Units as indicated)							
Gross official reserves (millions of SDRs)	330.4	337.4	348.7	381.8	406.7	430.1	463.2	503.0
Months of imports of goods and nonfactor services	2.8	2.9	2.9	3.0	3.0	3.0	3.0	3.1
Residual Financing Gap (millions SDR)	0.0	0.0	9.2	48.9	42.7	32.4	12.5	8.4
Exchange rate: Ariary per SDR (period average)	2,772.1	2,958.3	...	...	...	...	...	...
Exchange rate: Ariary per U.S. dollar (period average)	1,871.8	2,005.5	...	...	...	...	...	...
GDP per capita (U.S. dollars)	251	282	294	310	326	342	360	379
Nominal GDP (billions of ariary)	8,156	10,095	11,795	13,687	15,495	17,282	19,182	21,297

Sources: Malagasy authorities and IMF staff estimates and projections.
[1] Growth in percent of beginning of period money stock (M3).
[2] Year-on-year growth.

Statement by Damian Ondo Mañe, Executive Director for Republic of Madagascar
July 21, 2006

Introduction

On behalf of my Malagasy authorities, I would like to thank management and staff for their constructive policy dialogue and candid exchanges during the series of discussions held in Antananarivo and Washington, on a new PRGF-supported program. They are also grateful to the Executive Board for its continuous support under previous Fund-supported programs, and for the debt relief provided under the HIPC Initiative and the MDRI. My authorities are of the view that their policy challenges have been well identified in the report, and call on the support of the Executive Board for a new PRGF arrangement that would help them address the difficult challenges ahead.

Madagascar has made satisfactory progress in poverty reduction, in improving macroeconomic performance, and in public expenditure management. These achievements enabled Madagascar to qualify for debt relief under the MDRI, in December 2005. The authorities remain committed to keeping external debt at a sustainable level by giving priority to seeking external financing in the form of grants and nonconcessional borrowing. The substantial resources made available under this initiative –and the HIPC Initiative before–, will help my authorities achieve faster progress towards meeting the MDGs. Efforts to strengthen public expenditure management, including through the adoption of a functional classification of the budget to better track poverty reduction expenditure will give assurances to the donor community that the MDRI resources will be used effectively. Madagascar also became the first country to qualify for U.S. assistance under the Millennium Challenge Corporation last year, based on the soundness of the country's policies and progress in governance.

Maintaining macroeconomic stability and pursuing the necessary adjustments to address the sizable fiscal revenue shortfalls are at the center of my authorities' policy agenda. They have also taken key steps, with the help of development partners, to tackle the structural and financial weaknesses at the public utility company (JIRAMA). The Madagascar Action Plan (MAP) –the authorities' new PRSP–, covering the period 2007/11, will continue to address these issues while fostering stronger and more stable economic growth, founded on good governance, the promotion of pro-poor growth, and better public services, especially in the education and health sectors.

My authorities are of the view that a PRGF-supported program is an appropriate framework to help them achieve the objectives they have set in their MAP, and to promote higher and more sustainable growth levels needed to halve poverty in Madagascar, by 2015. A substantial increase in investment, both private and public, and a scaling up of financial aid in the form of grants and FDI –to avoid unsustainable debt levels in the future–, will be needed to reach the levels of growth necessary to reduce poverty more rapidly. A PRGF-supported program along with further technical assistance from the international community will also help the authorities to raise the tax revenue-to-GDP ratio to more comfortable levels, and thereby increase the financing of crucial development expenditures.

The implementation of the Fund-supported program will also help make the economy more resilient to the main risks that the economy faces, notably a further deterioration of the terms of trade and climatic shocks. Other potential shocks include the elimination of textiles quotas and the termination of the Africa Growth and Opportunity Act (AGOA), for which the authorities are requesting the activation of the Trade Integration Mechanism (TIM), in case the effects of these shocks turn out to be greater than anticipated in the program.

Macroeconomic Performance in 2005/06

In 2005, **real GDP growth** declined slightly to 4.6 percent. Although some sectors, notably agriculture and tourism, performed strongly, other major sectors of the economy were affected by rising oil and electricity prices. However, a substantial decline in food prices led to a fall of the consumer price index from 18.4 percent in 2005 to 14 percent in 2006. The **current account deficit** widened to 10.8 percent of GDP, due to the increase in world oil prices and a slowdown in exports following the termination of the Agreement on Textiles and Clothing along with the collapse of vanilla prices. **Government finance** was below expectations, as a result of a 12 percent shortfall in tax revenues due, in part, to difficulties in VAT collection and higher expenditure.

In the first quarter of 2006, the economy also experienced a slight slowdown, partly due to further increases in world oil prices and lower-than-expected rainfall impacting hydroelectric and agricultural production. Consequently, the government had to borrow on the domestic financial markets, which pushed interest rates higher, on treasury bills. The central bank, however, maintained a restrictive monetary policy stance during the first quarter, and inflation declined slightly compared to end-2005. To enhance the effectiveness of monetary policy, efforts are being made to strengthen coordination with the Treasury on liquidity management. ***In 2006,*** the overall deficit will stand at 5.1 percent of GDP. ***For the remainder of the year,*** the government intends to reach a **real GDP growth** rate of about 4.7 percent, while the average **inflation** should decline to 11.2 percent. The **tax-to-GDP ratio** should increase to 11 percent of GDP, compared to 10.1 percent in 2005. This should hold the **budget deficit** to no more than 0.9 percent of GDP. The **current account deficit** should stand at 10.5 percent with **gross foreign reserves** of the central bank stabilizing at 2.9 months of imports of goods and nonfactor services.

On the fiscal front, the government is committed to addressing the weaknesses in tax collection and expenditure control. In this regard, they will build on the IMF's Fiscal Affairs

Department 2003 and 2006 technical assistance recommendations to improve the collection of domestic taxes with the objective of raising the tax revenue-to-GDP ratio from 10.1 percent in 2005 to 12 percent by 2008. *On the revenue side,* the government will continue to expand the tax base notably by the adoption of the VAT with a single rate for both local and imported goods, while simplifying and pursuing a more coherent tax system. To this end, steps will be taken to review all existing tax and tariff exemptions and exonerations to eliminate them where necessary. In the customs area, the rates of import duties and taxes have been restructured and simplified, and customs clearance has been streamlined. In addition, no more ad hoc tax and/or tariff exemptions will be granted, outside those specified in the Customs Code, international treaties, and conventions. Efforts are also being made to achieve greater transparency and sound *management of public expenditure.* Also, to insure domestic debt sustainability, the government will rein in net domestic financing of the budget, in accordance with the levels agreed upon for the program. In addition, continuous adjustment of energy prices will help alleviate the impact of rising oil prices on the budget.

As regards **monetary and financial policy,** the central bank monetary program for the rest of 2006 will focus on attaining the targets set for inflation, and allowing for an adequate expansion of credit to the economy, sufficient to achieve the GDP growth target. The central bank will also give priority to achieving the projected foreign reserves level of 2.9 months of imports cover, and intends to only intervene in the foreign exchange market to smooth exchange rate volatility.

With regard to the **external sector,** the current account deficit should start to improve in 2006 (narrowing from 10.8 percent of GDP in 2005 to 10.5 percent in 2006). This will mainly result from a slowdown in imports, which should make itself felt from 2006, supported by a robust exports performance, as a result of the recent efforts to diversify exports of goods and services by expanding both traditional and nontraditional exports, as well as diversifying into new exports products (essential oils, mining products).

Efforts to increase **external openness** will also continue, particularly through regional integration and the implementation of an effective trade policy. In this regard, Madagascar’s recent admission to the Southern African Development Community (SADC) is expected to give investors new market opportunities, particularly in agriculture and textile.

Institutional and structural reforms will focus on the fight against corruption, the establishment of the rule of law, and bring government closer to the citizenry through civil service reform, and decentralization. Furthermore, reforms aimed at reducing government involvement and liquidating public enterprises will also continue with the financial support of development partners. Liquidation through the divestiture of assets of 22 public enterprises are scheduled in 2006/07.

The government has launched an ambitious plan to restore the profitability of the state electricity and water company **JIRAMA.** In April 2005, it transferred management of the company to a private enterprise under a two-year management contract. Also in 2005, it implemented two tariff increases, raising electricity prices by 76 percent. It has also contracted with financial experts to review JIRAMA's financial situation and prepare a financial restructuring plan, which was presented at a conference of development partners held in Paris, in January 10-12, 2006. The donor community has committed to provide financial support to JIRAMA's restructuring. The government has increased water and electricity prices by a further 20 and 15 percent, respectively, in 2006, and will increase the capital of the company by the end of the year.

Medium-Term Policy Framework (2006/08)

Over the medium-term, my authorities' objective is to ensure macroeconomic stability while sustaining higher levels of growth and reducing the country's vulnerability to shocks. During the period 2006/08, **real GDP growth,** will be initially driven by a strong increase in spending on social and economic infrastructure which is expected to boost private sector investment in the medium term. The strongest growth is expected to come from the secondary and tertiary sectors, owing to the effects of increased investment activity. The projected reduction of **inflation** to 6 percent during the period will be achieved through prudent **fiscal and monetary policies,** and expanded domestic production.

Furthermore, in accordance with the guidelines adopted in the **updated PRSP** and the **MAP,** the strategy pursued will be based on the development of key sectors such as export-oriented manufacturing, mining, tourism, and particularly agriculture, where there will be special emphasis on improving infrastructure and restoring agricultural productivity. Support for this strategy has already been obtained from financial partners, through projects and programs such as the Millennium Challenge Account (MCA) and the Integrated Growth Pole (PIC).

Fiscal consolidation will also continue over the medium-term. Accordingly, the authorities will redouble efforts to bring the budget in line with the priorities defined in the PRSP. The resources freed up by the debt relief granted under the MDRI will be allocated to priority expenditure in line with the PRSP and the MAP.

During 2006/08, the central bank will continue to implement a **monetary policy** aimed at controlling inflation in a flexible exchange rate environment. The central bank is committed to only intervene in the foreign exchange market to avoid excessive exchange rate volatility. In addition, the Governor of the Central Bank approved a time-bound action plan for strengthening the central bank's control, accounting, reporting, and auditing systems, in line with the main recommendations of the March 2006 Safeguards Assessment. In addition, the authorities are committed to limit transactions between the government and the central bank to only those permitted by the Central Bank Act.

Efforts are also under way to develop the country's **financial sector** and strengthen its stability to better mobilize savings and channel it into productive investments. Particular attention will also be given to reduce the cost of doing business, monitoring the soundness of the banking sector, and developing microfinance institutions.

Conclusion

Despite the macroeconomic and structural progress achieved in recent years, Madagascar remains a poor country and continues to be highly vulnerable to weather and trade-related shocks. Moreover, a very low tax revenue-to-GDP ratio has impeded the government's ability to finance crucial development expenditure. To address the challenges they face, my authorities are determined to pursue the adjustment efforts and promote a more rapid diversification of the economy which they hope will raise growth to higher and more sustainable levels in order to meet the MDGs. Hence, they are requesting the Board's support for a new PRGF arrangement that would help them underpin their economic policies for 2006/08.

In view of the potential adverse effects of the termination of the Agreement on Textiles and Clothing and the scheduled expiration of certain provisions of the American Growth and Opportunities Act, my authorities also call on the Board's support for the activation of the TIM, should the impact of the end of these agreements be greater than currently anticipated.

My authorities greatly value the support they have received from the Fund over the years, under various Fund-supported programs and for the debt relief provided under the HIPC and MDRI initiatives. They are also grateful for the substantial technical assistance they have received. However, to achieve the MDGs, Madagascar will continue to require large amounts of financial resources in support of their reform efforts. Therefore, I call on the international community to scale up its financial and technical assistance to Madagascar.