July 2003
IMF Country Report No. 03/203

Madagascar: Third Review Under the Poverty Reduction and Growth Facility—Staff Report; Staff Statement; and Press Release on the Executive Board Discussion

In the context of the Third Review Under the Poverty Reduction and Growth Facility, the following documents have been released and are included in this package:

- the staff report for the third review under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on **March 26, 2003,** with the officials of Madagascar on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 11, 2003**. 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 **June 30, 2003** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its June 30, 2003 discussion** of the staff report that completed the review.

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Madagascar*
Memorandum of Economic and Financial Policies by the authorities of Madagascar*
Technical Memorandum of Understanding*

*May also be 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

MADAGASCAR

Third Review Under the Poverty Reduction and Growth Facility

Prepared by African Department

(In consultation with the Finance, Fiscal Affairs, Legal, Monetary and Financial Systems, Policy Development and Review, and Statistics Departments)

Approved by A. Basu and Martin J. Fetherston

June 11, 2003

Legislative elections were held on December 15, 2002, resulting in a landslide victory for the parties supporting President Ravalomanana. The elections were described as free and fair by international observers. Political and social stability has been broadly established throughout the country.

The second review under the Poverty Reduction and Growth Facility (PRGF) arrangement was concluded on December 23, 2002 (IMF Country Report No. 03/6, 1/9/03). The Board also extended the PRGF arrangement, which was originally scheduled to expire at end-February 2004, to end-November 2004 in order to accommodate a new test date in place of that missed in 2002 because of the political crisis in the first half of the year.

Discussions on the third review under the PRGF arrangement were held during March 10-26, 2003 in Antananarivo. The principal Malagasy representatives included Mr. Benjamin Radavidson, the Minister of Economy, Finance, and Budget, and Mr. Gaston Ravelojaona, Governor of the Central Bank of Madagascar. The mission was received by the President, Mr. Ravalomanana. The mission also met with representatives of the trade unions, and the business and donor communities.

The staff team comprised Messrs. Vaez-Zadeh (head), Cady, and Nassar (all AFR), Mr. Jones (PDR), Mr. Dahl (Senior Resident Representative), and Ms. Haddi-Burleson (Assistant-AFR). Ms. Andriamihaja (Economist, Resident Representative Office) provided valuable assistance to the mission. Mr. Ondo Mañe, Executive Director for Madagascar, participated in some of the mission's meetings, including one with President Ravalomanana. The mission worked closely with the World Bank staff based in Madagascar and with the overlapping Country Financial Accountability Analysis and Assessment and Action Plan missions led by the World Bank.

In the attached letter of intent and memorandum on economic and financial policies (MEFP) dated June 10, 2003 (Appendix III), the Minister of Economy, Finance, and Budget and the Governor of the Central Bank of Madagascar (BCM) review progress under the 2002 program, and outline the government's economic recovery program and the policies for the remainder of 2003. The schedule of future disbursements and program reviews is presented in Table 1.

Contents

Figures

Appendixes

EXECUTIVE SUMMARY

- In the aftermath of the political crisis in the first half of the year, macroeconomic performance in 2002 was weaker than expected at the time of the second review of the program in October 2002. The program's growth, inflation, and balance of payments objectives were not met. However, all quantitative performance criteria for end-December 2002 were respected.

- The authorities have a number of challenges in the period ahead, including reestablishing confidence in the economy and encouraging investment, the resumption of growth and recovery of the export sector, rehabilitating the public enterprise sector, improving access to credit by the private sector, combating fraud and inefficiency at the customs and tax departments, improving budgetary procedures and treasury management, and streamlining administrative procedures to ensure faster project implementation. The program for 2003 is designed to begin addressing these challenges.

- The revised macroeconomic framework for 2003 seeks to achieve a real GDP growth of 6 percent and contain the annual consumer price inflation rate at 7 percent (end-of-year basis). The overall fiscal deficit will be contained at 7.6 percent of GDP (on a commitment basis, excluding grants). All domestic arrears will be cleared and steps taken to prevent their accumulation in the future. The external current account deficit (excluding official transfers) is projected to widen by 1.2 percentage points to 7.3 percent of GDP, with larger inflows of foreign assistance.

- The central bank's claims on the government will be converted to marketable government securities and banks' excess liquidity mopped up. The Property Act will be amended to remove the main structural impediments to bank lending and microfinance institutions encouraged. The banks are currently well capitalized, but some are facing rising nonperforming loans and falling profits. Banking supervision will be strengthened to respond to these concerns and detect and prevent bank fragility.

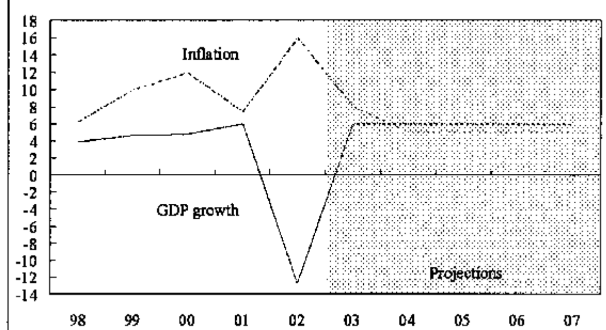
- To make the exchange rate fully market determined, a continuous interbank foreign exchange market will be established by year's end. Foreign exchange regulations will also be revised to facilitate the operations of this market.

- The final PRSP is expected to be presented shortly to the IMF and World Bank. The authorities hope to reach the completion point under the enhanced HIPC Initiative in 2004.

I. Recent Economic Developments and Performance Under the 2002 Program

1. **The political crisis of 2002 caused a major reversal of the promising economic trends of the previous five years and deepened poverty.** Most of the program's objectives were not met: real GDP declined by 12.7 percent (Figure 1 and Table 2), or over 15 percent in real per capita terms, as industrial production, especially in the export processing zone (EPZ), and tourism activity came to a virtual halt during the first half of the year, the marketing of agricultural products was hampered, and transport and utility companies were beset by serious financial difficulties. Reflecting these developments, the United Nations Development Program (UNDP) estimates that the incidence of poverty grew from 69 percent in 2001 to 75 percent in 2002. Moreover, poverty is likely to be further accentuated by the serious drought conditions that continue to prevail in the southern parts of the country, and the cyclone that hit the country in May 2003.

Figure 1. Real GDP Growth and Inflation, 1998-2007[1]
(In percent, unless otherwise indicated)

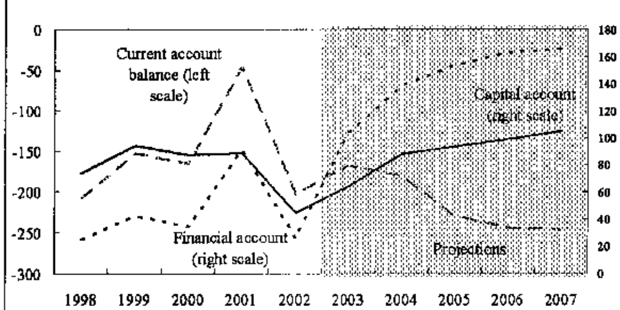


[1] Percentage change in consumer prices based on traditional price index (yearly average).

2. **Inflation accelerated in 2002, mainly owing to supply disruptions caused by the political crisis**. The year-on-year CPI inflation rate at end-December reached 13.5 percent, compared with 4.8 percent in 2001 (Figure 1 and Table 2). Reflecting the trend in inflation, the real effective exchange rate appreciated by about 5.2 percent in 2002 (end-of-year basis), despite a 10 percent depreciation in the nominal effective exchange rate. The foreign exchange market was closed for eight months due to the crisis. On its reopening in October, the exchange rate vis-à-vis euro depreciated by about 8 percent but remained relatively stable thereafter.

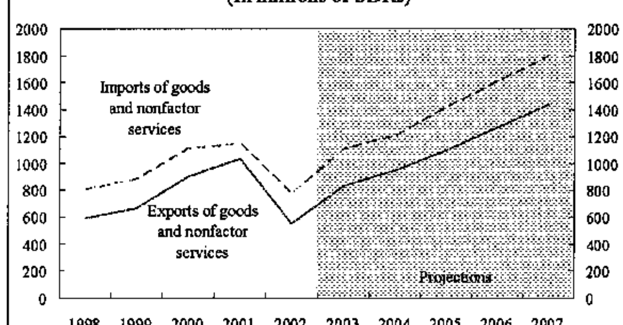
3. **The balance of payments deteriorated** sharply **in 2002 owing to the disruption of economic activity** (Figures 2 and 3). Exports and imports declined substantially. Foreign

Figure 2. External Balances, 1998-2007
(In millions of SDRs)



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

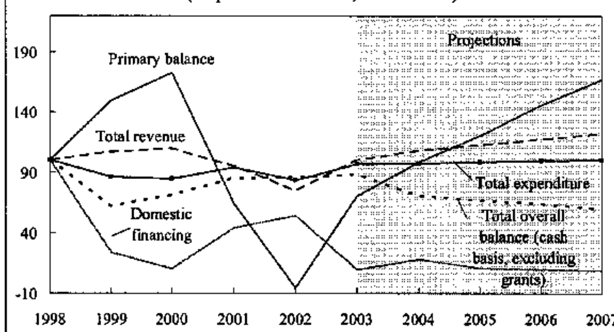
Figure 3. Trends in Exports and Imports, 1998-2007
(In millions of SDRs)



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

direct investment (FDI) inflows declined, and donor assistance was lower than expected, reflecting administrative delays and a slower rate of government spending. Gross international reserves declined by SDR 51 million to SDR 267 million, amounting to about 4.1 months of 2002 imports, compared with the 4.9 months expected under the program.

Figure 4. Fiscal Sector, 1998-2007
(In percent of GDP; 1998=100)

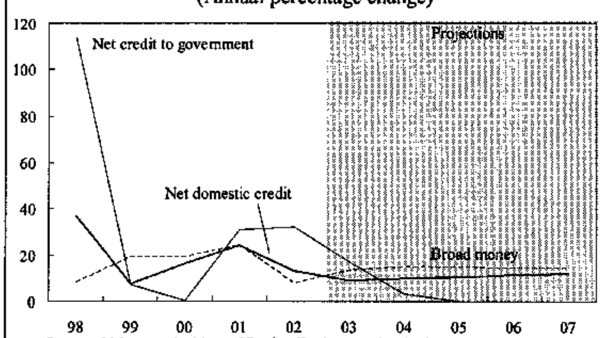


Sources: Malagasy authorities; and Fund staff estimates and projections.

4. **Performance on the fiscal front weakened in 2002 (Figure 4).** As a result of the general strikes and declining economic activity in that year, tax revenue fell to 7.7 percent of GDP, from 9.7 percent in the previous year (Tables 3, 4, and 5). The decline in revenues, compounded by a shortfall in external budgetary assistance of about 1 percent of GDP (SDR 45 million), resulted in an unavoidable but disruptive reduction in government expenditure (particularly capital outlays) of almost 2 percent of GDP compared with 2001, further accentuating the economic downturn. The overall deficit, on a commitment basis, excluding grants, was contained at 7.7 percent of GDP, compared with 8.2 percent in 2001, but the primary balance became negative for the first time since 1996. While substantially weaker than 2001, fiscal performance deteriorated only modestly relative to the program as revenues were higher, and current expenditure lower, than expected. Excluding grants, the deficit on a cash basis exceeded the program target as the net repayment of arrears was more than programmed, amounting to FMG 212 billion (0.7 percent of GDP). With external assistance and privatization receipts lower than programmed, bank financing of the budget rose sharply to 2.4 percent of GDP, exceeding the program by 0.3 percent of GDP.

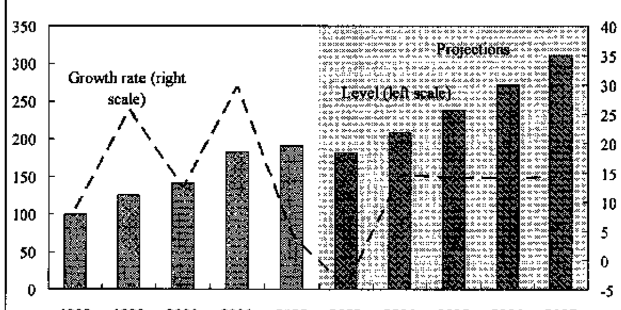
5. **Fueled by the credit needs of the government, broad money (M3, including deposits in foreign exchange), base money, and domestic credit grew substantially faster in 2002 than the nominal GDP, although more slowly than envisaged under the program (Figures 5 and 6, and Tables 2, 6, and 7).** The monetary developments reflected an

Figure 5. Money and Credit, 1998-2007
(Annual percentage change)



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

Figure 6. Reserve Money, 1998-2007
(December 98=100)

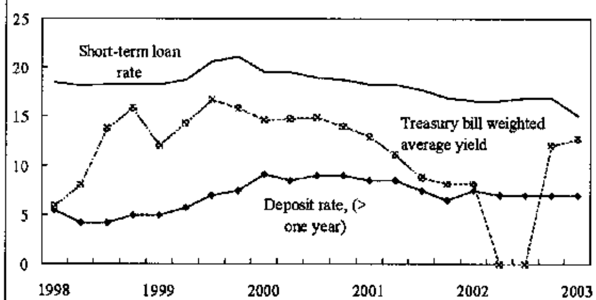


Sources: Malagasy authorities; and Fund staff estimates and projections.

easing of monetary policy in October, when the BCM reduced reserve requirements from 24 percent to 18 percent on demand deposits and from 3 percent to 2 percent on time and savings deposits. The move was essentially intended to provide banks with additional liquidity to purchase government securities.[1]

6. **Interest rates,** though **higher than in December 2001 (Figure 7), were lower than the inflation rate during much of 2002**. The additional borrowing requirement of the government led to an increase in the weighted average auction rate on treasury bills (TBs) from 8 percent at the end of 2001 to 12 percent in December 2002. Limited competition among banks, lack of investment opportunities for banks' excess funds, and a number of structural impediments to lending led to the contradictory developments of large excess reserves and high loan rates, while excess liquidity reduced banks' incentive to attract deposits by raising deposit rates. As a result, the spread between average deposit and loan rates remained wide. Structural impediments to lending include restrictions imposed by banks' head offices on exposure to country risk, the prohibition on land ownership by foreigners, and cumbersome procedures for the seizure of collateral in case of nonpayment.[2]

Figure 7. Interest Rates, 1998-2003[1]
(Quarterly data; in percent)



Source: Malagasy authorities.
[1] The treasury bill auctions were closed during March-September 2002.

7. **Monetary policy was further eased in January 2003, but the BCM later pushed up short term rates through sales of TBs.** To provide banks with additional liquidity and incentive to invest in TBs, the reserve requirement was lowered to 12 percent on demand deposits and to zero percent on both time and savings deposits. The BCM later absorbed part of the excess reserves through the sale of TBs. The resources generated by these sales were used mainly to repay the central bank's statutory advances to the government. Although the BCM reduced its base rate (*taux directeur*) from 9 percent to 7 percent in January 2003, this change had no direct impact on banks' interest rates because banks do not borrow from the central bank. By contrast, given the large volume of shorter-term TBs (up to 12 weeks) sold during the first quarter of 2003, the rates on these instruments continued to rise, while those on the longer-term TBs and bank loans remained relatively stable.

---

[1] The BCM believed that free reserves of banks had fallen below the threshold they considered prudent and that banks were unlikely to purchase treasury bills in the amounts needed for budgetary financing, without a substantial rise in the interest rates, which the authorities did not favor.

[2] Of the existing seven banks, six are foreign owned, and the locally owned bank started operations only in March 2003.

8. **Some progress was achieved with the implementation of structural reforms and strengthening of governance.** Negotiations for the sale of public enterprises continued, and budgetary management, tax administration and treasury accounting reforms were advanced, including those constituting Initiative for Heavily Indebted Poor Countries (HIPC Initiative) completion point conditions (Appendix I). In particular, the budget execution law (*loi de règlement*) for 1999 was submitted to the Accounts Court (Cours des comptes) before end-2002, and the treasury balances for 2002 were being established.

9. **All quantitative performance criteria for end-December 2002 were met by wide margins** (Appendix III, Attachment I, Table 1). No structural performance criteria or benchmarks were set for end-December 2002. The two policy actions constituting structural benchmarks for end-March 2003 on (i) establishment of an activity plan and organizational chart for the central bank's audit department, and (ii) examination of the accounts of the state oil company (SOLIMA) for 2000 by a general shareholders' meeting, were implemented in early April (Appendix III, Attachment I, Table 2). The structural benchmark (originally established for end-September and end-December 2001) concerning the upgrade of the computerized customs information system to the ASYCUDA ++ version continued to be missed, owing to delays in provision of technical assistance. A United Nations Conference on Trade and Development (UNCTAD) mission is expected to complete the installation in 2003.

II. Policy Discussions

10. The discussions focused on the macroeconomic framework and required policies for 2003, medium-term prospects, and the preparation of the poverty reduction strategy paper (PRSP). The key immediate economic challenges facing the authorities are to achieve a strong recovery in economic growth and exports, a substantial reduction in the inflation rate, and an improvement in both the fiscal and balance of payments positions. The program for 2003 sets out macroeconomic policies and structural reforms in the fiscal, banking, external, and public enterprise sectors to achieve these goals.

A. Ownership, the PRSP, and the Medium-Term Framework

11. **The authorities noted that program ownership was improving owing to several initiatives.** First, the PRSP is being prepared through a consultative process. Following a series of national and regional workshops, the government organized a final national workshop on March 26–27, 2003 to discuss the draft PRSP. Over 500 delegates (representing a broad cross section of interests from different regions of Madagascar), the Fund, the World Bank, and other donors participated in the workshop. Second, a social safety net for those affected by the reform of public enterprises has been instituted, and a number of poverty and

social impact studies are being carried out with the assistance of the World Bank.[3] Third, as envisaged by the program, small borrowers are gaining better access to credit through the microfinance network, arrears to the private sector are being settled, and poverty-reducing social expenditure is growing. Fourth, efforts are under way to improve governance and transparency throughout the government.

12. **The final version of the PRSP is expected to be presented to the Fund and the World Bank shortly.** The document incorporates comments by various stakeholders, presents the medium-term framework, clarifies priorities and their costing, and develops a number of indicators to gauge the progress in implementation, including toward the goal of reducing the incidence of poverty to 65 percent by 2006. The PRSP includes overall medium-term strategic objectives for each ministry, with specific shorter-term objectives spelled out.

13. **The macroeconomic framework and policies for 2003 contained in the PRGF-supported program are fully aligned with those underlying the PRSP, and the medium-term scenario assumed under the PRGF arrangement falls between the high- and low-growth scenarios in the PRSP.** The high-growth scenario envisages an average annual growth rate of 7.5 percent during 2004–06, compared with the 6 percent per year rate assumed under the PRGF-supported program. The difference arises almost entirely from the PRSP's more optimistic assumptions regarding the rise in the private sector savings rate and the absorptive capacity of the economy, allowing a higher level of domestic investment and resulting in a larger budget deficit. The staff believes that, even if the higher savings rate is realized, it is unlikely that the economy could absorb the larger resources in productive investments as rapidly as assumed under the PRSP. The low-growth scenario is based on an average growth rate of 4.5 percent per year and assumes that the rate of project implementation, investment productivity, and the inflow of foreign resources will be the same as the average of the past five years (excluding 2002). In this scenario, economic performance will be the same as in the previous five years. No improvements in economic efficiency and absorptive capacity are assumed. This scenario is, therefore, too pessimistic, given the Malagasy economy's potential and the commitment to achieve the Millennium Development Goals.

14. **The sources of growth and policy priorities in the medium term are similar under the full PRSP and the PRGF-supported programs.** Growth is spurred by robust expansion in the agriculture, construction, manufacturing, mining, and tourism sectors, where potential for substantial investment exists. Both private investment and public investment (mainly infrastructure) are expected to increase relative to GDP by 2006 (Figure 8 and Table 10), assuming FDI and donor assistance grow as expected and the pace of public sector

[3] To limit the adverse impact of the 2002 crisis on the most vulnerable population groups, for a six-month period beginning October 2002, the government eliminated school fees and provided essential care and medications free of charge.

project implementation accelerates. The budgetary framework for the medium term aims at an ambitious but realistic increase in government revenue. However, while the PRGF-supported program allows for only a modest recourse to domestic bank financing, the authorities' medium-term scenario requires substantial bank financing. On the external front, the growth of traditional exports will be complemented by diversification both within and outside the EPZ, the promotion of nontraditional exports (precious stones, edible oil, industrial textiles, and electronic equipment), and integration in the cotton sector. The latter would require an improvement in the quality of the cotton fiber produced by the cotton company, HASYMA, to make it usable by the EPZ textile export firms.

B. The Macroeconomic Framework for 2003

15. The revised macroeconomic framework for 2003 is based on less optimistic growth and inflation prospects than were expected at the time of the discussion of the second review in October 2002. It seeks to achieve real GDP growth of 6 percent and contain the annual consumer price inflation rate at 7 percent (end-of-year basis). These targets reflect the worse-than-expected outturn for 2002, as noted above, and a slower rate of economic recovery, especially in tourism, construction, and EPZ activities. Some weakening of the Malagasy franc vis-à-vis the euro is expected as the pace of imports picks up. Nevertheless, the external current account deficit (excluding official transfers) is projected to widen by 1.2 percentage points to 7.3 percent of GDP (Table 8 and Figure 9), and would be financed by the expected larger inflows of foreign assistance. Several donors are expected to disburse both the amounts of foreign assistance committed for 2003 and those remaining undisbursed at the end of 2002. As a result, the BCM's net foreign assets are expected to grow by about SDR 40 million.

C. Fiscal Policy

16. **The discussions on fiscal policy for 2003 focused on the need to contain the deficit at a level consistent with the monetary program by increasing revenues, especially through customs and tax administration reforms, eliminating arrears, and strengthening expenditure and treasury management**. The overall budget deficit, on a commitment basis and excluding grants, is projected to decline slightly from 7.7 percent of GDP in 2002 to 7.6 percent of GDP. The projected cash deficit, including grants, of 4.3 percent of GDP is fully financed, with net foreign borrowing (3.6 percent of GDP, mainly from the World Bank), representing the main source of financing. Domestic financing (0.7 percent of GDP) will consist of the sales of TBs and proceeds from privatization.

17. **This fiscal outlook assumes that the revenue-to-GDP ratio will rebound to 10.6 percent in 2003, up from 8 percent in 2002 and 10 percent in 2001**. Achievement of this objective is essential to allow expenditure to recover from the unavoidable but disruptive drop in 2002. To enhance revenues, the authorities have begun to address the problems of inefficiency and corruption at the customs and tax departments, which are arguably the most important impediments to economic recovery and transparency. Key in this regard is the implementation of an ambitious action plan (which reflects the recommendations of a recent

FAD mission) under the supervision of a panel of private and public sector representatives appointed by the President in May 2003 (MEFP, paras. 15 and 16). In addition, excise taxes on cigarettes and motor oil have been increased and the tax base widened by the implementation of the unified tax on small businesses. On the other hand, the reduction of customs duties introduced in November 2002 is estimated to have a revenue-reducing impact of about 0.1 percent of GDP on an annual basis. Preliminary information until end-March indicates that domestic tax receipts were above target by about 15 percent. Looking ahead, the authorities intend to enact broad tax policy reforms in the context of 2004 budget, based on the recommendation of a forthcoming FAD technical assistance mission, with a view to raising the revenue-to-GDP ratio on a sustainable basis.

18. **The procedures for payment of the value-added tax (VAT) by investors and exporters will be streamlined** (MEFP, para. 17). The current procedures, whereby the VAT is first collected on imports by investors and exporters and then reimbursed to them once the goods have been exported or used for investment, have often resulted in long delays in reimbursement and disrupted the financial activities of the businesses concerned. The new procedures effectively obviate the obligation of these groups to pay the VAT, unless the imported goods are sold in the domestic market. The implementation of these procedures constitute a structural performance criterion for end-June 2003.

19. **Total expenditure in 2003 will reach 18.2 percent of GDP, up from 17.6 percent in 2001.**[4] The increase in base salaries—retroactive to January 1 but paid beginning in April—will be limited to 12 percent, somewhat below the year-on-year rate of inflation at end-2002. The ratio of the wage bill to GDP will increase by 0.7 percentage points. This increase reflects several other adjustments, including the payment of bonuses to teachers in rural areas (a priority need financed by HIPC Initiative resources), larger indemnities to security personnel, and the resumption of the suspended payments of allowances and emoluments to senior civil servants and parliamentarians, respectively. The authorities intend to prepare a civil service reform strategy aimed at linking salary increases to performance, improving the efficiency and transparency of public services, and curbing the growth of the wage bill over the medium term.

20. **Priority expenditures in the areas of education, health, rural roads, water, and sanitation, financed by HIPC Initiative debt relief, will amount to 1.1 percent of GDP in 2003.** Extensive consultations with the donor community have been held to better target these expenditures, and actions are under way to improve their tracking (Appendix II). Capital expenditures are projected to reach the equivalent of 7.3 percent of GDP, the same level as in 2001, following a sharp drop in 2002. Within this total, foreign-financed capital spending

[4] The cost of the relief and reconstruction operations in the aftermath of a cyclone that hit the mid-eastern part of the country in May 2003 will be covered under current budgetary allocations.

will increase by 37 percent from the 2001 level, as donors are committed to increasing the pace of disbursements on existing projects.

21. **A key priority remains the reduction of the stock of domestic arrears that is hampering the private sector, including export-oriented firms.** The government intends to clear all domestic arrears (including VAT-related arrears), which amounted to FMG 342 billion at end-2002, by end-September 2003. Clearance of the arrears on VAT reimbursements to EPZ operators, amounting to FMG 98 billion at end-December 2002, is a prior action for the third review. External commercial arrears to a preshipment inspection company amounting to FMG 88 billion (approximately US$12.2 million) were also cleared in April and May. Moreover, specific procedures are being put in place (including those for payment of the VAT) to minimize the likelihood of arrears accumulation (MEFP, paras. 17 and 22).

22. **A comprehensive effort will be made to improve treasury accounting, accelerate the execution of expenditure, and strengthen the monitoring of budget implementation (MEFP, paras. 18, 19, and 22), which are also key HIPC Initiative completion point triggers.** To these ends, (i) monthly treasury balances will be prepared on a timely basis; (ii) the prior approval of expenditure by the expenditure control directorate will be accelerated; and (iii) the provincial budgetary offices will be strengthened, with World Bank assistance, in order to centralize expenditure data and enable the preparation of quarterly budgetary execution reports. It is expected that six ministries will compile quarterly budgetary execution reports by end-2003, up from two ministries (Health and Education) at present, and that reports covering all ministries will be prepared in 2004.

D. Monetary Policy and Financial Sector Reforms

23. **The monetary program for 2003 is consistent with the revised growth and inflation objectives.** Broad money (M3, including foreign currency deposits) is programmed to increase by about 13 percent during the year, which would allow credit to the private sector to increase commensurate with GDP growth.[5] Base money declined during the first quarter of 2003, owing to a substantial buildup of government deposits at the BCM, reflecting, in turn, the proceeds from the sale of TBs. For the rest of the year, the BCM is expected to mop up the banks' excess reserves. As a result, base money is programmed to decline by 4.7 percent during the year.

24. **The main challenges in the area of monetary policy and financial sector reform are to improve the effectiveness of monetary policy as an anti-inflation instrument and to establish an institutional and regulatory framework conducive to bank lending, while safeguarding the soundness of banks.** To enhance monetary policy, the BCM will mop up

---

[5] Claims on the economy, including private sector and public enterprises, will decline in 2003 due to the assumption by the government of SOLIMA's debt to the BCM.

the banks' excess liquidity through the sale of treasury or central bank bills (MEFP, para. 31). Outstanding central bank holdings of government debt (for which no repayment schedule exists) will also be converted into marketable government securities of different maturities. These operations will create investment opportunities for banks' free reserves and foster the development of the money market. Moreover, the reduction of the excess reserves and the new investment opportunities are likely to enhance competition among banks for resources, thereby facilitating the emergence of positive real deposit rates and narrowing the interest rate spread. The authorities are also preparing for the introduction of a new currency (MEFP, para. 32). The replacement of the notes currently in circulation with the new currency notes in a way that would not disrupt economic activity will be an additional challenge during 2003. The authorities are mindful of the difficulties involved and will make adequate preparations before introducing the new currency, based on the recommendations of a technical assistance mission from Monetary and Financial Systems Department (MFD).

25. **To facilitate monetary policy implementation, better liquidity forecasting by the central bank is essential.** Reflecting the shortcomings in this area, the amounts of treasury bills allocated during the auctions have been consistently larger than the announced tender volumes, indicating a lack of information about the potential demand for these securities (Figure 11). Procedures for liquidity forecasting are being improved through closer coordination between the Malagasy Treasury and the BCM's Monetary Policy Committee (MEFP, para. 31).

26. **The authorities will continue their efforts to improve financial intermediation.** Impediments to bank lending (see para. 7) have constrained lending to the private sector and contributed to the creation of a structural liquidity surplus in the financial sector, thereby putting downward pressure on deposit rates. To address these impediments, a loan guarantee fund has been established and the government is preparing measures to improve the legal framework for microfinance operations and allow the use of land as collateral for bank loans. In particular, amendments to the Property Act will be presented to Parliament before end-December 2003 (MEFP, para. 33).

27. **A program for strengthening supervision and establishing an early warning system for bank fragility is being implemented with the assistance of the MFD.** This is particularly important, even though banks are well capitalized at present, as the share of nonperforming loans in banks' portfolios have grown (from 10 percent in 2001 to 19 percent in 2002) and profits before tax have fallen (from FMG 187 billion to FMG 85 billion during the same period; Box 1). Steps are also being taken to strengthen cooperation with supervisory agencies in banks' home countries. Furthermore, as proposed by MFD and the Legal Department (LEG) during 2003, the government will amend the relevant legislation to support a more forceful anti-money-laundering campaign.

Box 1. Madagascar: Bank Soundness Indicators, 1998-2002

	1998	1999	2000	2001	2002 Prov.
			(Ratio; in percent)		
Capital adequacy					
Regulatory capital to risk-weighted assets					
Lowest ratio	8.6	9.7	10.1	12.0	11.4
Highest ratio	41.9	28.7	32.2	34.1	38.7
Assets quality					
Nonperforming loans to total gross loans	21.1	8.4	8.4	10.3	19.2
Earnings and profitability					
Return on assets	3.2	4.3	4.0	2.8	1.2
Return on equity	91.0	53.0	47.0	39.0	16.0
Noninterest expenses to gross income	46.5	42.9	45.4	48.9	51.7
Personnel expenses to noninterest expenses	44.6	36.7	38.4	38.3	38.2
Liquidity					
Liquid assets to total assets	35.9	37.0	36.9	44.2	51.6
Liquid assets to short-term liabilities	61.9	61.2	62.2	70.0	77.4
			(In billions of Malagasy francs)		
Memorandum items:					
Total assets	4,229.1	4,930.6	5,667.6	6,723.4	6,984.8
Total profits before tax	137.2	214.0	226.5	186.6	84.6

Source: Commission de Supervision Bancaire et Financière.

28. **The authorities have begun to implement the main recommendations of the Stage One safeguards assessment (MEFP, para. 36).** In particular, the audit of reserve management and foreign exchange activities, a structural benchmark under the program, has begun with the assistance of the MFD. The authorities have indicated that the banking system will adopt the International Accounting Standards (IAS) by 2005, the deadline set by the National Accounting Board, for conversion to the new framework for all companies. To further promote the integrity of its balance sheet, the BCM will stop lending to the government in foreign exchange and convert the government's existing foreign exchange accounts not linked to loan agreements with foreign donors, into local currency accounts at prevailing market exchange rates. A repayment agreement was signed between the government and the BCM covering the SOLIMA debts vis-à-vis the BCM assumed by the government. The signing of this agreement was a prior action for the Third Review of the PRGF arrangement.

E. External Sector Issues

29. **The outlook for 2003 is for a widening of the current account deficit (excluding official transfers) from 6.1 percent of GDP in 2002 to 7.3 percent of GDP**. A strong rebound in exports is expected, and imports are due to grow as the economy continues to recover from the crisis. With the projected increase in external assistance, reserves are targeted to rise to SDR 324 million, from SDR 267 million in 2002; however, import cover will decline to just over 3.5 months.

30. **The government will maintain its flexible exchange rate policy.** The central bank will allow the exchange rate to respond to underlying exchange market pressures and intervene in the market only to dampen the effect of temporary shocks or meet the net foreign assets target under the program. For the exchange rate to be fully market determined, the current open outcry auction system will be replaced by a continuous interbank foreign exchange trading system by end-December 2003 (a structural benchmark under the program). This new arrangement will enable banks to trade foreign exchange freely and continuously among themselves within their net foreign exchange open position limits. In order to support the development of the market, the BCM's exchange operations directorate will be reorganized by end-June 2003, with technical assistance from the IMF, and foreign exchange control regulations will be revised by end-December 2003.

31. **The government is committed to regaining the export contracts lost in the wake of the 2002 political crisis and maintaining the competitiveness of Malagasy exports**. Private sector wages have remained stable and below those in competitor countries, and the authorities believe that productivity differentials between the Malagasy labor force and competitors have remained stable. However, the appreciating trend in the real effective exchange rate since 2000 raises concerns about the competitiveness of Malagasy exports at a time when the country is trying to regain its market share, which was eroded substantially due to the political crisis. In addition, looking ahead, the expiry of the World Trade Organization's (WTO's) Agreement on Textiles and Clothing by end-2004 could generate more competition for Madagascar's traditional exports. The authorities intend to respond to these challenges by pursuing prudent anti-inflation policies, allowing the exchange rate to reflect exchange market conditions, implementing structural reforms that raise the efficiency of the export sector, and reducing transaction costs of foreign trade through infrastructural improvements and simplifications of customs procedures.[6]

32. **The government is determined to increase active participation in regional integration and trade negotiations.** Madagascar stands to benefit from a range of external trade initiatives. The U.S. African Growth and Opportunity Act (AGOA) could hold benefits for Madagascar if it can maintain its tax-free status by using only African or U.S. cotton in its textile and apparel exports. Madagascar is already a member of the Common Market for

[6] Structural measures are discussed in BOX 2 and in paragraphs 36–37 below.

Eastern and Southern Africa (COMESA) and its free trade agreement. An interministerial task force has been set up to assess the status of regional trade agreements and, in particular, the consequences of joining both the Southern African Development Community (SADC) and the future COMESA Customs Union, in light of likely differences in openness between SADC's complex rules of origin (with no early transition to common external tariffs) and COMESA's plan to establish common external tariffs by 2004.

33. **Progress is being made in agreeing debt relief in the context of the enhanced HIPC Initiative, and most Paris Club bilateral agreements have been, or soon will be, finalized.** Agreement has been reached with the European Union/European Investment Bank on the provision of interim assistance, although the modalities have to be finalized. The authorities have contacted all non-PC creditors concerning provision of assistance under the HIPC Initiative. So far, Kuwait and China have agreed to provide such assistance (Table 11).

34. **The profile of external borrowing has changed little since Madagascar reached the HIPC Initiative decision point**. However, external debt indicators for the near term are now estimated to be somewhat higher than decision point estimates, as GDP, fiscal revenue, and exports all declined significantly in 2002 due to the crisis. Over the medium term, as the economy recovers, and exports and tax revenue rebound, the debt indicators all tend to converge towards the decision point projections (Table 9).

F. Public Enterprise Reforms and Governance

35. **The privatization and rehabilitation program for public enterprises is proceeding more slowly than expected.** As a result, the government will have to inject about FMG 146 billion (0.3 percent of GDP) into a number of enterprises in 2003 to keep them afloat. But steps are being taken to reduce such support. The authorities are optimistic that the privatization of the telecommunications company, TELMA, will be achieved, although the purchaser has asked for a new financial audit and may withdraw or impose new conditions depending on the findings of the audit. The electricity and water company, JIRAMA continues to be under financial stress owing mainly to management problems and inability to collect its utility bills regularly. With the assistance of the World Bank, the company will be placed under a management contract with a specialized foreign firm by the end of the year (MEFP, para. 45). As a first step toward this goal, an audit of the company's operations and financial condition will begin in mid-June (the commencement of the audit constitutes a prior action for the third review). The cotton company, HASYMA, continues to depend on government transfers, and suffers from management and quality control problems. Plans for its restructuring and eventual privatization are being debated and should be finalized before end-2003. In the sugar sector, the government is finalizing the strategy for opening the capital of the state sugar company, SIRAMA, to foreign participation. The strengthening of the cotton and sugar sectors remains key to promoting income growth and reducing poverty in some rural areas. The airline and railroad companies also continue to depend on government transfers. In the case of Air Madagascar, the government will have to inject a further US$7 million in 2003, in addition to the US$10 million provided in 2002. However, the new management (Lufthansa Consulting) has implemented measures to secure

a positive cash flow in 2003. These measures have started to reduce the company's stock of debt.

36. **The authorities recognize that a marked improvement in governance is essential to foster the confidence of the private sector, encourage the return of foreign investors, and attract new FDI flows.** Some progress has been made in the investigation and elimination of fraud, particularly at the tax and customs offices, and the authorities' commitment to the anticorruption campaign is evident from the recent changes at the highest levels of the customs and tax departments, and the suspension of a number of judges. Moreover, with the assistance of the World Bank, the state inspectorate general and the Audit Court are being strengthened.

III. Program Monitoring

37. The revised quantitative and structural performance criteria and indicative targets under the program are specified in the attached MEFP (Appendix III, Attachment I, Tables 1 and 2). The program for 2003 includes quantitative performance criteria for end-June and end-December, and indicative targets for end-September. Structural conditionality under the program and the areas of technical assistance supported by the World Bank, the African Development Bank, and the European Union are explained in Box 2. A revised technical memorandum of understanding (Appendix III, Attachment III) updates definitions and reporting requirements. The next semiannual review under the current arrangement is expected to be completed in December 2003. Relations with the Fund and the World Bank Group are summarized in Appendices IV and V, respectively.

IV. Data Issues and Technical Assistance

38. Madagascar has been receiving extensive technical assistance from multilateral and bilateral donors over the past several years. Most recently, the Fund's technical assistance has focused on securing improvements in tax and customs administration, public expenditure management and treasury accounting, international reserves management, central bank internal audit, banking supervision, and balance of payments and monetary statistics (Appendix IV, Section XI). The authorities have recently requested Fund assistance in the areas of tax policy, foreign exchange market development, anti-money-laundering legislation, and issuance of new currency. Assistance in these areas will be provided in the coming months.

Box 2. Structural Conditionality

Coverage of structural conditionality in the program for 2003
Structural performance criteria and benchmarks cover new regulations authorizing the deferment of VAT payments on capital goods imports; submission of budget execution laws to the Audit Court; preparation of treasury monthly balance sheets; drawing up of an activity plan for the central bank audit department; audit of the management of reserve by the BCM, examination of SOLIMA's 2001 accounts by the shareholders; and the replacement of the current system of exchange rate determination by an interbank foreign exchange trading system.

Status of structural conditionality in earlier programs
Under the 2001-02 PRGF-supported program, all measures covered by structural conditionality were implemented, except for the introduction of the more advanced version of the computerized customs information system, ASYCUDA++, which was delayed due to the late provision of technical assistance.

Structural areas covered by World Bank conditionality
The World Bank is providing assistance to implement several structural reforms relevant to the Fund-supported program, including (i) the privatization of TELMA and preparation of the strategy for the privatization of companies in the cotton and sugar sectors, as well as assistance in strengthening the management of the electricity and water company, JIRAMA; (ii) reforms in the mining sector, including implementation of the mining code and assistance to the mining land registry; (iii) reforms to bring about transparency in the licensing of fishing activities; (iv) the strengthening of the judicial system, the publication of legal compendiums, the simplification of judicial procedures, and the reform of the business law; (v) budget, treasury, and tax administration reforms, and (vi) strengthening the monitoring of social expenditures.

Structural areas covered by African Development Bank and European Union conditionality
The African Development Bank's structural adjustment credit of 2001 included conditionality on the adoption of a new civil service statute. An economic recovery credit, scheduled for 2004,will support reforms in the areas of customs and tax administration and public expenditure control. The European Union's emergency budgetary assistance conditionality relates to budgetary and public expenditure management and control, and social sector reforms.

Structural measures covered by HIPC Initiative completion point conditionality
The floating completion point conditionality includes the following measures relevant to the PRGF-supported program: (i) the strengthening of the budgetary control systems through adoption of appropriate legislative changes, and increased staffing and resources of the state inspectorate general, Audit Court, and the budgetary control directorate; (ii) the implementation of a system for monitoring the expenditure process (commitment, payments order, and payment) for at least six ministries, including those of Health and Education; (iii) the improvement of the consolidation procedures for the balances of all the principal treasuries as a step toward the establishment of reliable opening and closing treasury balances; (iv) the preparation during 2001-02 of the budgetary execution law for 1999 and 2000; and (v) the preparation of biannual reports on education and health sector activities, including budgetary execution and physical achievements.

39. Madagascar's economic and financial statistics are comprehensive but exhibit weaknesses with regards to the real sector, government finances, the balance of payments, and social indicators. These weaknesses do not, however, impede a meaningful assessment of economic policies or program monitoring. The authorities are aware of these deficiencies and are working, with technical assistance from the international community, including the Fund, to strengthen the statistical system. The authorities noted that the reactivation of the committee in charge of finalizing external trade statistics had already contributed to improvements in data collection and analysis. Progress has also been made in the implementation of banking sector surveys aimed at ensuring more comprehensive coverage of service transactions in the balance of payments. Statistical issues and the provision of core indicators to the Fund are further discussed in Appendix VI.

V. Staff Appraisal

40. **The crisis of 2002 has undermined the timely achievement of the main objectives of the program, requiring the government to redouble its efforts, in the face of formidable challenges, to return to the path of growth and price stability, and alleviate poverty.** The government has begun to lay the basis for improved economic performance in 2003 by resuming sound policy implementation and observing all the performance criteria for end-December under the program for 2002. Based on this renewed effort, the staff considers the macroeconomic objectives for 2003 to be achievable, provided the measures outlined in the MEFP are implemented in a timely fashion and foreign assistance flows materialize as projected.

41. **The fiscal stance for 2003 is in line with the macroeconomic objectives.** The budget includes ambitious yet realistic revenue objectives, allows for recovery of current and capital expenditure from the sharp declines in 2002, and envisages a substantial reduction in access to bank financing. The authorities should ensure that all budgeted social expenditures are carried out in a timely fashion, and that HIPC Initiative-related resources are used for their intended purposes. The staff welcomes the authorities' intention to contain the growth of the civil service wage bill and link salary increases to performance.

42. **The revenue target can be achieved only if the authorities address the problems of inefficiency and corruption at the customs and tax departments.** Despite the progress made so far in addressing these problems, the efforts need to be redoubled. The establishment of a joint public-private committee by the President to oversee the progress of customs and tax administration reforms is a step in the right direction. The authorities should ensure that the committee has the necessary authority to conduct its operations and impose sanctions in case of nonperformance. The staff supports the authorities' intention to enact broad tax reforms in the context of the 2004 budget.

43. **Structural reforms in the fiscal area are critical.** Despite some improvements, serious weaknesses in budget preparation, expenditure control, and treasury operations remain. These weaknesses should be addressed as soon as possible in order to avoid undermining budgetary control and prevent the accumulation of arrears. The new procedures,

especially those relating to VAT payments by exporters and investors, should be strictly followed to prevent future arrears. The authorities are to be commended for the speedy settlement of the external commercial arrears and for their commitment to clear all domestic arrears by end-September 2003.

44. **The monetary program for 2003 is consistent with the aim of reducing inflation and achieving positive real interest rates.** The recent lowering of the reserve requirements could be justified on the grounds of their unremunerated nature and high levels. However, the policy was inconsistent with the need to reduce banks' excess reserves. The staff, therefore, welcomes the planned sale of treasury or central bank bills to mop up the excess liquidity.

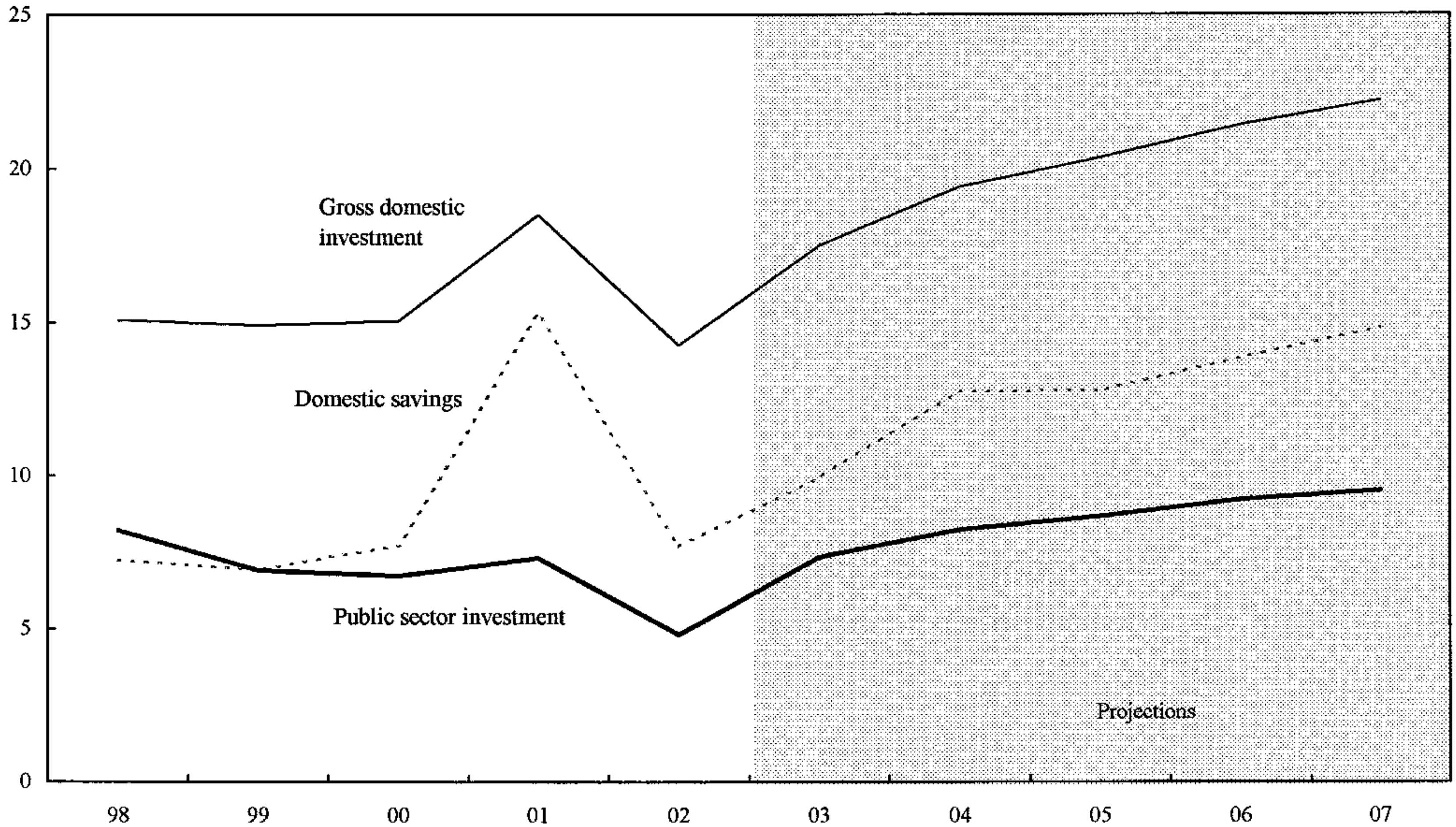
45. **Maintaining export competitiveness presents a challenge over the medium term.** The economy remains vulnerable to competition, especially in the apparel sector. To reduce vulnerabilities and rebuild its export market share, Madagascar should avoid real exchange rate appreciation by implementing prudent macroeconomic policies, as well as structural reforms aimed at maintaining low production costs, improving the efficiency of the cotton sector, and diversifying its exports.

46. **The staff welcomes the decision to establish a continuous interbank foreign exchange market by the end of 2003.** To this end, it is important to complete, as envisaged, the reorganization of the BCM's exchange operations department by mid-year, and the necessary revision of foreign exchange control regulations by the end of the year. The BCM should refrain from interventions in the foreign exchange market, except for the purposes of smoothing the impact of temporary shocks and meeting the net foreign assets target under the program.

47. **The privatization and rehabilitation of public enterprises are essential for improving the efficiency of the economy and enhancing export prospects.** In particular, improvement in the efficiency of the utility company, JIRAMA, and the cotton company, HASYMA, should be given a high priority.

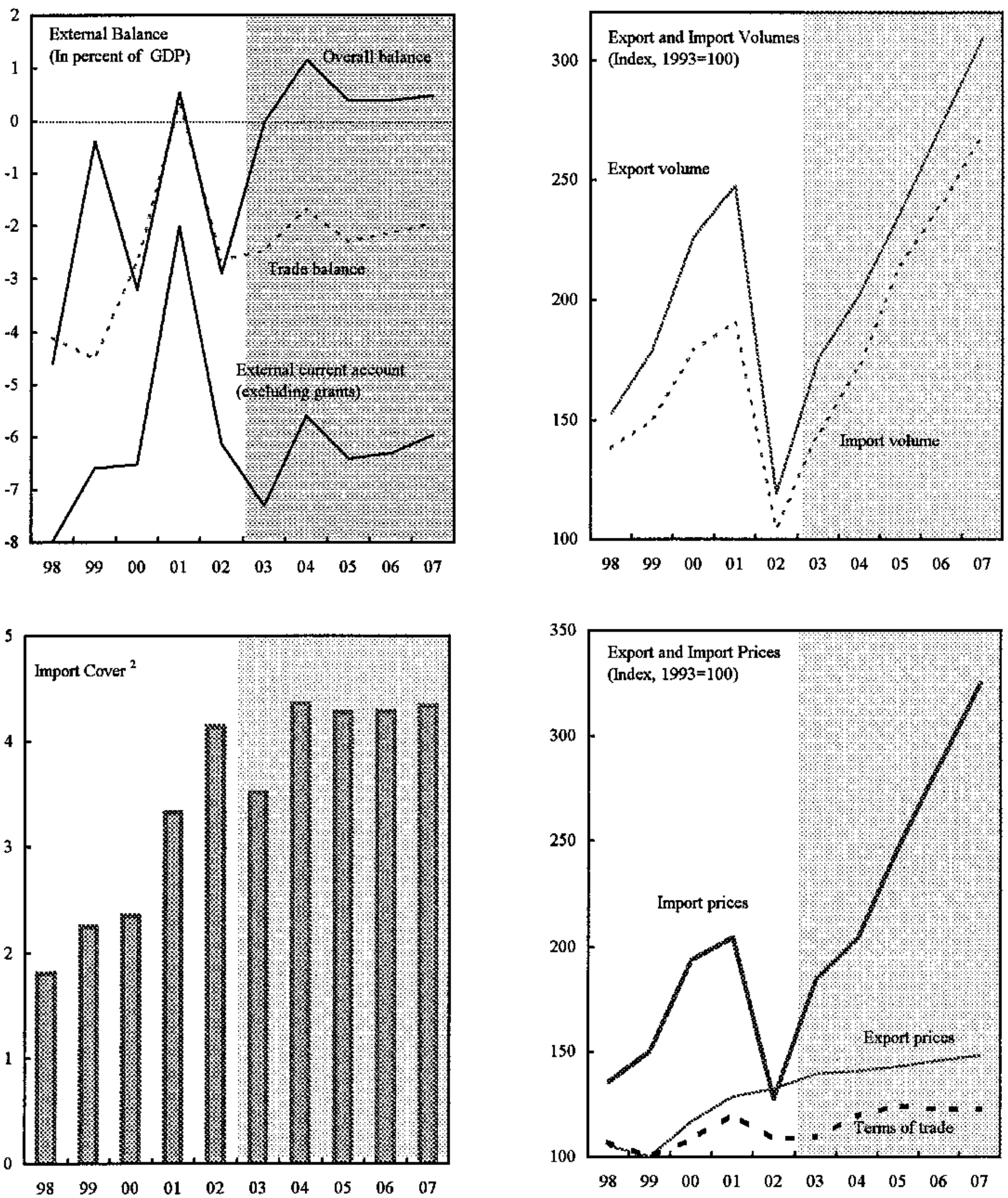
48. **The staff recommends the completion of the third review under the PRGF arrangement, although short-term risks remain.** The main risks include the possibility that the assumptions of a rebound in exports and rising budgetary revenue may turn out to be too optimistic, and that the inflows of foreign assistance may not materialize as projected. If realized, these risks would undermine the achievement of the program's objectives and require further fiscal adjustment and a rundown of international reserves. Although the likelihood of a sharp sustained increase in petroleum prices can now be discounted, such a development would also adversely affect inflation and growth outcomes. Implementing fundamental fiscal reforms, especially, in the area of tax and customs administration may also prove politically more difficult than expected, with adverse consequences for government revenue and the resumption of growth. Against these risks should be set the satisfactory implementation of the program since the second review, the strength of the authorities' program for 2003, the new government's initial actions in combating corruption, and its willingness to take additional measures as needed. Accordingly, the staff recommends the completion of the third review.

Figure 8. Madagascar: Savings and Investment, 1998-2007
(In percent of GDP)



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

Figure 9. Madagascar: External Sector Developments and Prospects, 1998-2007 [1]



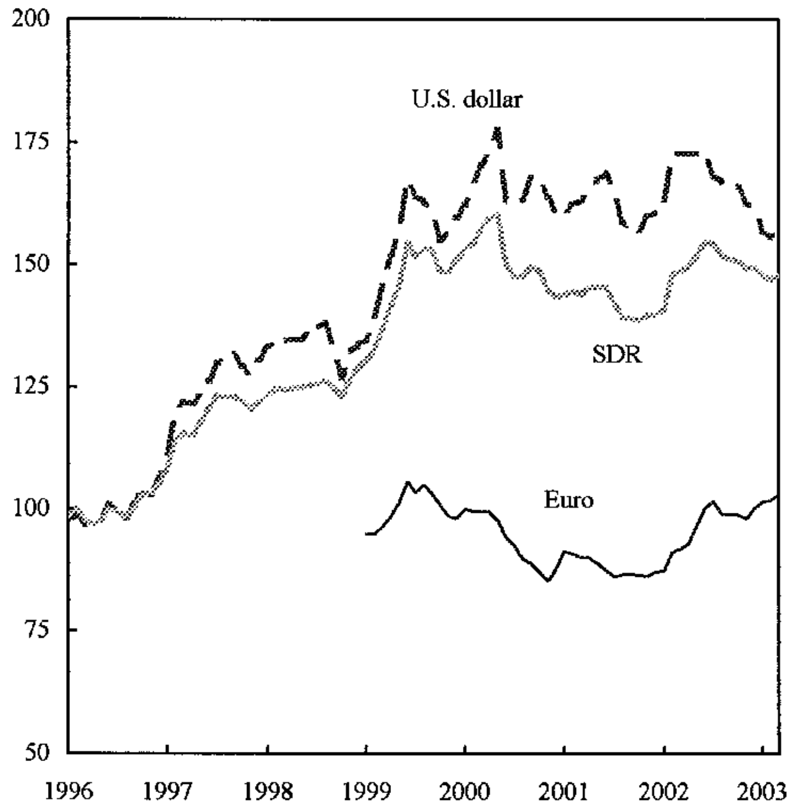
Source: Malagasy authorities; and Fund staff estimates and projections.

[1] Shaded area indicates projections.

[2] International reserves, in months of imports of goods and nonfactor services.

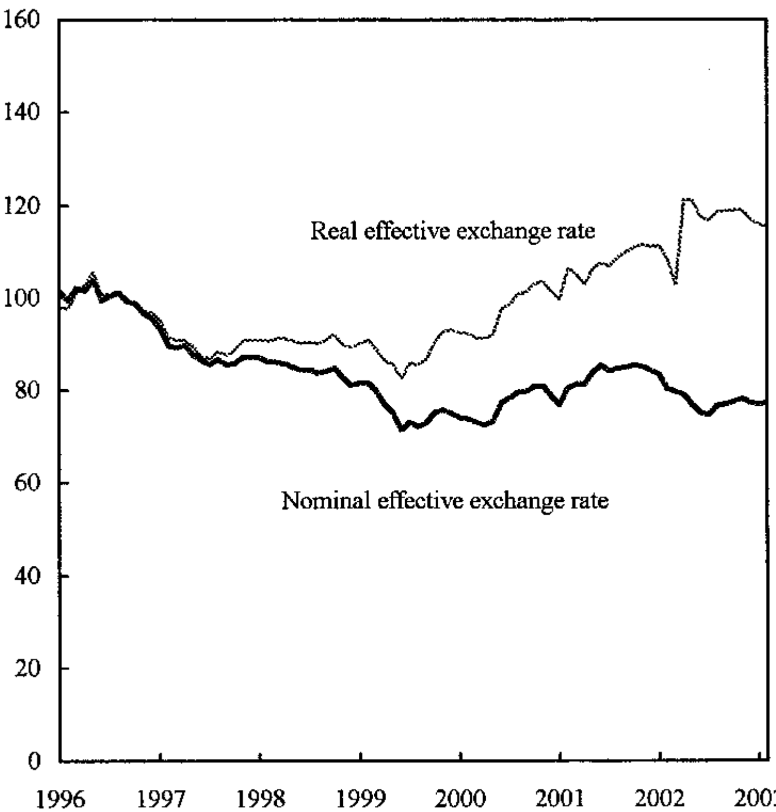
Figure 10. Madagascar: Exchange Rate Indicators, 1996-2003

Bilateral Exchange Rates: Malagasy Franc per U.S. Dollar, SDR, and Euro, January 1996 - March 2003
(Monthly average, 1996=100; for Euro 1999=100)



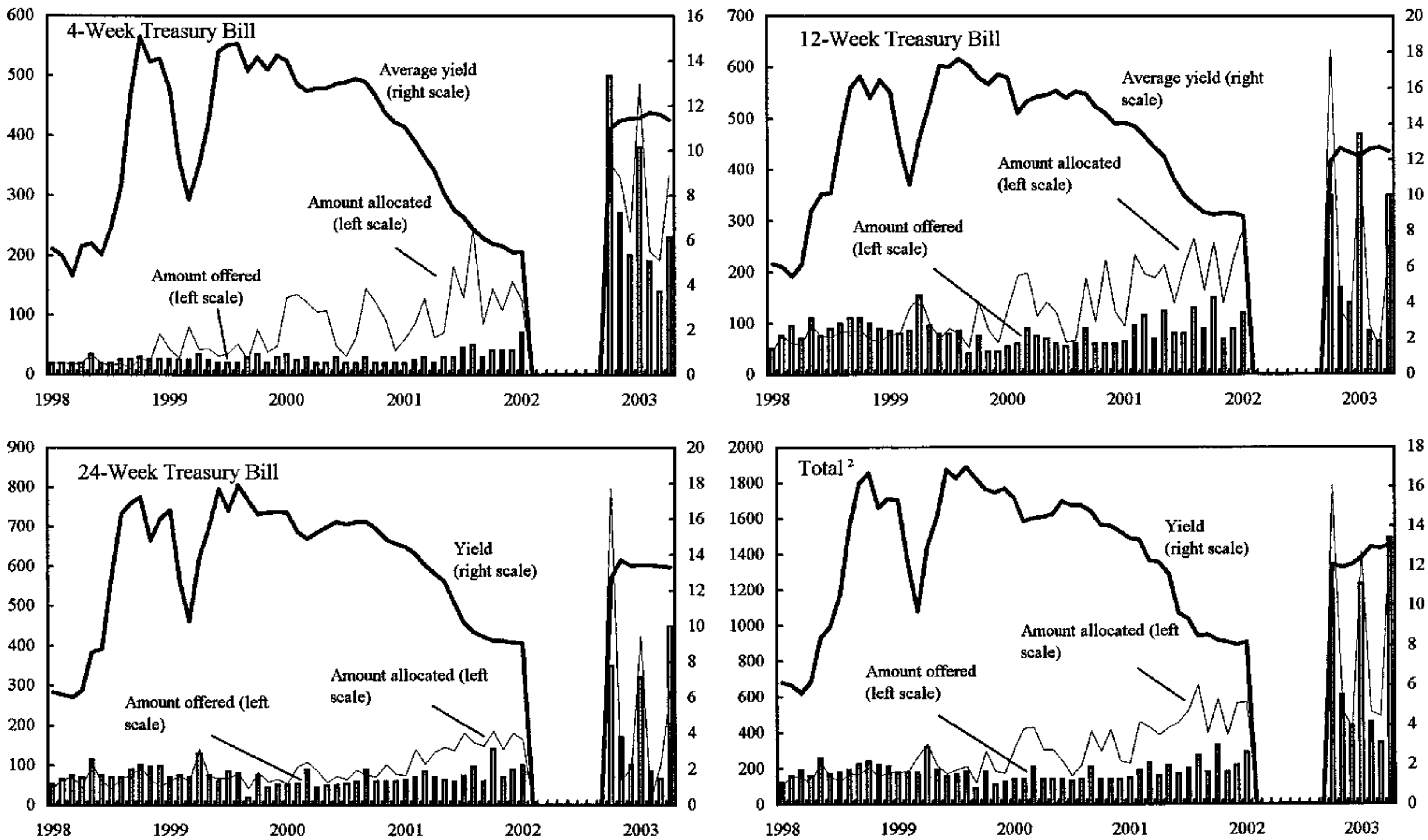
Source: IMF, International Financial Statistics.

Real and Nominal Exchange Rates, January 1996 - February 2003
(Monthly average, 1996=100)



Source: IMF, Information Notice System.

Figure 11. Madagascar: Treasury Bill Auctions, January 1998-April 2003[1]
(Left scale in billions of Malagasy francs; right scale in percent)



Source: Malagasy authorities.

[1] The treasury bill auctions were closed during March-September 2002.

[2] Sum of the 4-week, 12-week, 24-week and 52-week treasury bills.

Table 1. Madagascar: Tentative Work Program Under the Proposed Revised PRGF Arrangement, 2003–04

Date	Action	Disbursement
March 2003	Mission to conduct the third review under the PRGF arrangement.	
June 2003	Executive Board consideration of the third review under the PRGF arrangement and of new annual program. Submission of full poverty reduction strategy paper (PRSP) expected.	SDR 11.347 million
October 2003	Mission to conduct fourth review under the PRGF arrangement and discussion of program for 2004.	
December 2003	Executive Board consideration of the fourth review under the PRGF.	SDR 11.347 million
February 2004	Mission to conduct the fifth review under the PRGF arrangement.	
May 2004	Executive Board consideration of fifth review under the PRGF arrangement. Expected completion point under the Initiative for Heavily Indebted Poor Countries (HIPC Initiative).	SDR 11.347 million
September 2004	Mission to conduct the sixth review under the PRGF and discussions for Article IV consultation.	
November 2004	Executive Board consideration of sixth review under PRGF arrangement, and conclusion of the Article IV consultation. Arrangement expires.	SDR 11.348 million.

Table 2. Madagascar: Selected Economic and Financial Indicators, 2000-07 [1]

	2000	2001	2002 Prog. [2]	2002 Est.	2003 Prog. [2]	2003 Rev. Prog.	2004	2005	2006	2007
								Projections		
				(Annual percentage change, unless otherwise indicated)						
National income and prices										
Nominal GDP (in billions of Malagasy francs)	26,242	29,843	30,842	30,058	34,506	33,978	37,779	42,005	46,703	51,927
Real GDP growth	4.8	6.0	-11.9	-12.7	7.8	6.0	6.0	6.0	6.0	6.0
GDP per capita (in U.S. dollars)	250.3	284.6	285.5	278.3	321.0	298.2	312.7	326.0	340.1	355.1
GDP deflator	7.1	7.3	15.4	15.4	3.8	6.6	4.9	4.9	4.9	4.9
Consumer price index (period average)	11.9	7.4	15.8	15.8	6.2	8.0	5.0	5.0	5.0	5.0
Consumer price index (end of period)	8.7	4.8	12.0	13.5	5.0	7.0	5.0	5.0	5.0	5.0
External sector										
Export, f.o.b.	47.6	20.6	-46.5	-50.5	31.8	56.0	16.1	18.6	17.7	15.1
Imports, c.i.f.	29.0	5.5	-33.4	-37.6	32.1	45.0	10.3	21.1	15.8	13.6
Export volume	26.3	9.5	-46.9	-51.9	40.4	47.9	15.1	16.7	15.4	13.3
Import volume	19.3	6.6	-32.9	-45.3	32.6	38.4	19.5	24.3	11.9	11.8
Terms of trade (deterioration -) [3]	8.1	11.2	1.6	-9.7	-5.9	0.7	9.2	4.2	-1.4	0.0
Nominal effective exchange rate (depreciation -) [3]										
Average	1.3	8.1	-5.6	-6.5	...	...	...	...	...	...
End of period	4.9	7.0	-11.4	-10.0	...	...	...	...	...	...
Real effective exchange rate (depreciation -) [3]										
Average	10.1	10.4	7.2	8.0	...	...	...	...	...	...
End of period	8.4	9.6	10.6	5.2	...	...	...	...	...	...
Public finance										
Revenue (excluding grants)	15.0	-1.3	-25.7	-20.7	...	50.5	20.1	16.0	15.8	15.6
Total expenditure	10.0	26.2	-15.9	-10.5	...	31.4	11.7	12.5	12.6	11.6
Current expenditure	10.5	28.3	5.5	0.9	...	14.0	7.2	8.7	7.6	8.7
Investment expenditure and net lending	9.3	23.5	-37.1	-26.6	...	65.1	17.8	17.0	18.3	14.6
Money and credit [4]										
Broad money	19.3	24.4	11.9	7.8	12.5	13.4	15.0	14.5	14.5	14.5
Net foreign assets	22.5	29.8	2.1	-5.8	4.7	26.0	37.2	22.5	20.3	18.9
Net domestic assets	17.9	22.0	9.3	14.1	7.9	8.6	5.3	9.9	10.8	11.5
Credit to government [5]	0.2	31.0	9.1	32.2	3.6	17.0	3.2	0.0	0.0	0.0
Credit to the economy (incl. public enterprises) [5]	23.6	17.1	3.0	0.4	5.6	3.0	18.6	21.6	21.3	20.7
Velocity of money (GDP/end-of-period M3)	4.4	4.1	3.7	3.8	3.7	3.8	3.7	3.5	3.4	3.3
Treasury bill weighted-average auction rates										
(in percent; end of period)	14.6	10.0	...	12.1	...	...	...	...	...	...
					(In percent of GDP)					
Public finance										
Total revenue (excluding grants)	11.7	10.1	7.3	8.0	10.5	10.6	11.5	12.0	12.5	13.0
Of which: tax revenue	11.3	9.7	7.0	7.7	10.2	10.3	11.2	11.6	12.1	12.6
Total grants	3.6	3.9	2.8	2.2	3.2	4.3	3.0	3.0	2.9	2.9
Total expenditure	15.9	17.6	15.0	15.7	17.8	18.2	18.3	18.5	18.7	18.8
Overall balance (commitment basis, incl. grants)	-2.8	-4.3	-4.9	-5.5	-4.2	-3.3	-3.9	-3.6	-3.3	-2.9
Overall balance (commitment basis, excl. grants)	-6.4	-8.2	-8.7	-7.7	-7.4	-7.6	-6.9	-6.5	-6.2	-5.8
Domestic financing	0.5	1.9	2.2	2.4	0.9	0.4	0.8	0.5	0.4	0.4
Savings and investment										
Resource gap	-7.3	-3.2	-5.8	-6.6	-7.9	-7.6	-6.7	-7.6	-7.6	-7.4
Investment	15.0	18.5	11.1	14.3	15.2	17.5	19.4	20.4	21.4	22.2
Government	6.7	7.3	3.7	4.8	7.2	7.3	8.2	8.7	9.2	9.5
Nongovernment	8.3	11.2	7.3	9.4	8.0	10.2	11.2	11.7	12.2	12.7
Gross domestic savings	7.7	15.3	5.2	7.7	7.3	9.9	12.7	12.8	13.8	14.8
Gross national savings	9.4	17.2	6.6	8.3	9.5	12.9	14.8	14.9	16.1	17.2
Public	-2.8	-4.3	-1.9	-5.5	1.9	-3.3	-3.9	-3.6	-3.3	-2.9
Private	12.2	21.5	8.5	13.8	7.6	16.2	18.7	18.5	19.4	20.1
External sector, public debt, and debt service										
Current account balance (excluding grants)	-6.5	-2.0	-5.8	-6.1	-7.4	-7.3	-5.6	-6.4	-6.3	-6.0
Current account balance (including grants)	-5.6	-1.3	-4.5	-5.9	-5.7	-4.6	-4.6	-5.4	-5.4	-5.0
Net present value (NPV) of external debt [6, 7]	55.0	52.2	51.6	48.5	48.9	45.3	42.3	39.5	37.0	34.6
				(In percent of exports of goods and services)						
Scheduled external debt service [6]										
Before debt relief	13.5	11.7	21.8	23.6	16.3	15.4	14.2	12.1	12.1	10.2
After debt relief [7, 8, 9]	6.9	4.4	8.6	9.1	6.9	6.5	7.6	6.6	6.7	5.6
					(In units indicated)					
Gross official reserves (in millions of SDRs)	218.7	317.5	296.1	266.6	336.9	324.0	439.4	505.7	575.7	651.1
In months of imports of goods and nonfactor services	2.4	3.3	4.9	4.1	4.1	3.5	4.4	4.3	4.3	4.3
Exchange rates: Malagasy francs per SDR (period average)	8,951.0	8,391.0	...	8,774.3	...	...	...	...	...	...
Exchange rates: Malagasy francs per U.S. dollar (period average)	6,787.2	6,591.5	...	6,592.3	...	...	...	...	...	...

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

[1] Data may not add up due to rounding.
[2] EBS/02/209, (12/06/02).
[3] Based on 1993 trade weights.
[4] The composition of monetary growth in 2003 reflects reclassification of a public enterprise, SOLIMA, debt (FMG 350.4 billion) by the government.
[5] For 2003, include the takeover of SOLIMA debt by the government.
[6] Reflects Paris Club flow rescheduling on Naples terms obtained for the period January 1997 - November 2000 and assumes similar terms for non-Paris Club creditors.
[7] Provisional. NPVs of debt sustainability analysis (DSA), which assumes a stock-of-debt operation at end-1999.
[8] For 2001-03, the debt service is calculated assuming the full application of traditional debt-relief mechanism, as well as HIPC Initiative relief.
[9] Including grants.

Table 3. Madagascar: Quarterly Central Government Accounts, 2002-03
(In billions of Malagasy francs)

	2002				2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Actual				Revised Program			
Total revenue and grants	531.2	974.7	1,699.0	3,053.2	1,286.8	2,675.5	3,814.4	5,091.9
Total revenue	461.6	857.2	1,515.9	2,403.0	783.0	1,752.9	2,552.5	3,617.0
Of which: tax revenue	424.3	807.9	1,449.6	2,304.2	755.0	1,700.0	2,480.0	3,509.0
Grants	69.7	117.5	183.1	650.1	503.8	922.6	1,261.9	1,474.9
Current grants	69.7	117.5	183.1	249.6	358.2	629.3	818.8	879.7
Of which: HIPC assistance	50.8	86.5	141.1	183.7	63.1	103.0	164.8	206.3
Counterpart funds	18.9	31.0	35.3	48.5	11.7	23.9	40.6	52.9
Project grants	0.0	0.0	0.0	400.5	145.6	293.3	443.1	595.2
Total expenditure	580.0	1,444.1	2,317.7	4,709.6	1,469.1	3,160.1	4,593.7	6,187.0
Current expenditure	473.5	1,218.9	1,917.5	3,109.3	843.4	1,840.7	2,674.1	3,544.6
Budgetary expenditure	331.3	901.3	1,484.6	2,781.2	779.6	1,737.1	2,544.0	3,441.4
Personnel [1]	201.9	544.3	918.5	1,380.0	427.4	968.5	1,396.0	1,815.9
Of which: HIPC financed	0.0	0.0	7.0	71.4	29.9	59.9	89.8	119.8
Other noninterest expenditure	45.1	119.6	218.7	741.7	232.7	464.6	733.3	1,024.3
Of which: HIPC financed	0.0	0.0	0.0	108.0	23.9	51.3	89.8	119.7
Foreign interest obligations	68.2	191.8	253.0	407.7	67.7	202.7	265.4	399.4
Domestic interest obligations	16.2	45.5	94.5	251.8	51.8	101.2	149.4	201.8
Treasury operations (net) [2]	142.0	269.0	367.9	202.0	63.0	102.0	92.7	65.0
Emergency expenditure	0.0	48.2	64.0	122.2	0.0	0.0	35.0	35.0
Counterpart funds-financed operations	0.2	0.4	1.0	3.9	0.8	1.6	2.4	3.2
Capital expenditure	106.5	225.2	400.2	1,445.8	535.1	1,173.3	1,773.5	2,496.3
Domestic financing	7.7	15.7	85.6	559.7	120.0	334.7	500.0	800.0
Foreign financing	98.8	209.5	314.5	886.2	415.1	838.6	1,273.5	1,696.3
Of which: HIPC financed	0.0	0.0	0.0	121.2	30.4	63.6	102.7	123.7
Government on-lending to public enterprises	0.0	0.0	0.0	154.4	90.6	146.1	146.1	146.1
Net cost of structural reforms	3.0	4.2	5.8	5.8	-7.0	-16.0	-19.0	-17.1
Overall balance (commitment basis)								
Excluding grants	-115.4	-582.7	-796.0	-2,300.7	-693.1	-1,423.2	-2,060.2	-2,587.1
Including grants	-45.7	-465.1	-612.9	-1,650.6	-189.3	-500.5	-798.3	-1,112.2
Domestic balance (commitment basis) [3]	51.5	-181.3	-228.5	-1,006.9	-210.3	-381.8	-521.3	-491.4
Change in arrears [4]	-55.3	-73.9	-215.4	-212.6	-198.3	-290.0	-341.6	-341.6
Total overall balance (cash basis, excluding grants)	-170.7	-656.5	-1,011.4	-2,513.3	-891.4	-1,713.2	-2,401.8	-2,928.7
Total overall balance (cash basis, including grants)	-101.1	-539.0	-828.3	-1,863.2	-387.6	-790.5	-1,139.9	-1,453.7
Financing	101.1	539.0	828.3	1,863.2	387.6	790.5	1,139.9	1,453.7
Foreign (net)	276.8	438.0	458.6	1,094.2	293.1	642.5	915.2	1,221.0
Drawings	281.1	391.8	564.1	1,150.1	344.7	798.6	1,139.7	1,504.3
Budget	182.3	182.3	249.6	664.4	105.6	316.9	412.0	526.9
Projects	98.8	209.5	314.5	485.7	239.1	481.7	727.7	977.4
Amortization due	-173.9	-322.0	-484.1	-583.1	-189.8	-343.2	-460.5	-661.2
Change in external arrears [5]	38.7	103.1	0.0	0.0	0.0	-87.7	-87.7	-87.7
Debt relief	131.0	265.1	378.5	527.2	138.2	274.8	323.7	465.5
Current maturities	107.2	183.8	277.2	361.2	112.7	189.9	228.5	308.8
HIPC assistance	23.8	81.2	101.3	166.0	25.4	84.9	95.1	156.8
Domestic (net)	-181.9	85.2	323.2	722.6	94.5	126.6	151.5	149.3
Banking system [6]	-55.7	232.3	417.3	722.1	-61.1	88.2	80.6	75.3
Nonbanking system	-52.7	-53.0	-53.3	-71.8	150.6	28.4	55.9	54.0
Treasury correspondent accounts (net)	-73.5	-94.0	-40.7	72.3	5.0	10.0	15.0	20.0
Privatization receipts	6.2	15.8	46.5	46.5	0.0	21.4	73.2	83.5

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

[1] Personnel expenditures in 2002 were much lower than in the budget as the payment of a number of indemnities and allowances was suspended because of the revenue shortfall.

[2] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, and civil service retirement funds. Beginning in 2002, net correspondent account balances are classified as domestic financing.

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

[4] Representing the difference between expenditure committed and actual payments.

[5] Bilateral agreements on debt with non-Paris Club creditors, most of which is in arrears, were initially assumed to be finalized in 2001; however, such reschedulings are materializing at a slower pace than envisaged. For 2001, arrears were rescheduled with the Saudi Fund for Development and a commercial creditor, Itochu Bank (Hong Kong SAR).

[6] Excludes the assumption of state oil company (SOLIMA) debt by the government and the effect of exchange rate changes on net credit to government in foreign exchange.

Table 4. Madagascar: Central Government Accounts, 2000-07
(In billions of Malagasy francs)

	2000	2001	2002		2003		2004	2005	2006	2007
			Prog.	Act.	Prog.	Rev. Prog.	Projections			
Total revenue and grants	4,014.4	4,190.6	3,115.1	3,053.2	4,707.9	5,091.9	5,474.6	6,281.1	7,198.3	8,241.3
Total revenue	3,067.7	3,029.0	2,250.6	2,403.0	3,617.0	3,617.0	4,344.6	5,040.6	5,837.9	6,750.5
Of which: tax revenue	2,972.1	2,906.4	2,162.3	2,304.2	3,509.0	3,509.0	4,231.2	4,872.5	5,651.1	6,542.8
Grants	946.7	1,161.6	864.5	650.1	1,090.9	1,474.9	1,130.1	1,240.5	1,360.4	1,490.8
Current grants	178.9	427.7	498.5	249.6	498.9	879.7	287.0	315.1	345.5	378.6
Of which: HIPC assistance [1]	...	158.0	179.1	183.7	205.9	206.3	0.0	0.0	0.0	0.0
Project grants	767.8	733.9	366.0	400.5	592.0	595.2	843.0	925.4	1,014.9	1,112.1
Total expenditure	4,168.6	5,262.6	4,622.7	4,709.6	6,154.7	6,187.0	6,911.3	7,772.7	8,751.3	9,768.3
Current expenditure	2,402.5	3,081.7	3,250.7	3,109.3	3,547.9	3,544.6	3,798.3	4,129.2	4,442.1	4,829.2
Budgetary expenditure	2,416.5	3,001.0	2,823.4	2,781.2	3,444.7	3,441.4	3,750.3	4,081.2	4,394.1	4,781.2
Personnel [2]	1,042.4	1,337.6	1,399.4	1,380.0	1,815.9	1,815.9	1,926.7	2,100.2	2,241.8	2,440.6
Of which: HIPC financed	...	71.0	71.4	71.4	119.8	119.8	121.1	132.3	142.4	146.7
Other noninterest expenditure	761.8	1,071.5	771.2	741.7	1,024.3	1,024.3	1,322.3	1,470.2	1,634.6	1,817.5
Of which: HIPC financed	...	95.3	123.5	108.0	119.7	119.7	121.1	132.3	142.4	146.7
Foreign interest obligations	371.2	349.1	391.0	407.7	402.7	399.4	293.4	296.7	297.3	296.0
Domestic interest obligations	241.1	242.8	261.8	251.8	201.8	201.8	207.9	214.1	220.5	227.1
Treasury operations (net) [3]	-56.5	54.3	305.1	202.0	65.0	65.0	45.0	45.0	45.0	45.0
Emergency expenditure [4]	40.6	25.0	119.0	122.2	35.0	35.0	0.0	0.0	0.0	0.0
Of which elections	...	...	55.0	58.2	35.0	35.0	0.0	0.0	0.0	0.0
Counterpart funds-financed operations	2.0	1.4	3.2	3.9	3.2	3.2	3.0	3.0	3.0	3.0
Capital expenditure	1,766.1	2,180.9	1,149.0	1,445.8	2,495.7	2,496.3	3,113.0	3,643.5	4,309.1	4,939.1
Domestically financed	581.2	942.3	242.0	559.7	800.0	800.0	1,136.9	1,474.8	1,933.7	2,456.5
Foreign financed	1,184.9	1,238.6	907.0	886.2	1,695.7	1,696.3	1,976.1	2,168.6	2,375.5	2,482.6
Of which: HIPC financed	...	131.0	123.2	121.2	123.7	123.7	121.5	132.7	142.8	147.1
Government on-lending	...	...	223.0	154.4	111.1	146.1	0.0	0.0	0.0	0.0
Net cost of structural reforms [5]	-582.7	-223.1	9.5	5.8	-17.1	-17.1	-40.0	0.0	0.0	0.0
Overall balance (commitment basis)										
Excluding grants	-1,683.7	-2,456.7	-2,362.6	-2,300.7	-2,554.8	-2,587.1	-2,606.7	-2,732.1	-2,913.4	-3,017.8
Including grants	-737.0	-1,295.1	-1,498.1	-1,650.6	-1,463.9	-1,112.2	-1,476.6	-1,491.6	-1,553.0	-1,527.0
Domestic balance (commitment basis) [6]	-127.6	-868.9	-1064.6	-1,006.9	-456.4	-491.4	-337.1	-266.7	-240.6	-239.2
Change in arrears	-135.9	-27.0	-196.7	-212.6	-300.0	-341.6	0.0	0.0	0.0	0.0
Total overall balance (cash basis, excluding grants)	-1,819.5	-2,483.6	-2,559.3	-2,513.3	-2,854.8	-2,928.7	-2,606.7	-2,732.1	-2,913.4	-3,017.8
Total overall balance (cash basis, including grants)	-872.8	-1,322.0	-1,694.8	-1,863.2	-1,763.9	-1,453.7	-1,476.6	-1,491.6	-1,553.0	-1,527.0
Financing	872.8	1,322.0	1,694.8	1,863.2	1,763.9	1,453.7	1,476.6	1,491.6	1,553.0	1,527.0
Foreign (net)	704.7	637.0	967.3	1,094.2	1,306.7	1,221.0	1,176.6	1,291.6	1,353.0	1,327.0
Drawings	802.4	723.4	1,096.7	1,150.1	1,188.5	1,504.3	1,250.8	1,358.2	1,474.1	1,488.3
Budget	385.3	218.7	678.7	664.4	208.5	526.9	239.2	247.7	256.3	264.9
Of which: World Bank EERC	...	...	134.0	134.0	208.5	208.5	...	...	...	...
Projects	417.1	504.7	418.0	485.7	980.0	977.4	1,011.6	1,110.5	1,217.8	1,223.3
Amortization due	-621.5	-581.0	-640.6	-583.1	-660.6	-661.2	-437.8	-463.9	-548.6	-601.8
Change in external arrears	-49.5	-68.2	0.0	0.0	0.0	-87.7	0.0	0.0	0.0	0.0
External debt relief	573.2	562.7	511.2	527.2	466.0	465.5	363.7	397.3	427.5	440.5
Of which: HIPC assistance [7]	...	151.0	159.0	166.0	157.2	156.8	363.7	397.3	427.5	440.5
Domestic (net)	121.9	580.9	678.2	722.6	324.3	149.3	300.0	200.0	200.0	200.0
Banking system [8]	3.1	468.4	651.6	722.1	212.7	75.3	100.0	0.0	0.0	0.0
Nonbanking system	118.8	112.5	7.3	-71.8	91.6	54.0	200.0	200.0	200.0	200.0
Treasury correspondent accounts (net) [3]	...	...	19.3	72.3	20.0	20.0	0.0	0.0	0.0	0.0
Privatization receipts	46.3	104.1	49.4	46.5	132.9	83.5	0.0	0.0	0.0	0.0
Memorandum item:										
Total HIPC debt relief [9]	...	309.1	338.1	349.7	363.1	363.0	363.7	397.3	427.5	440.5

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

[1] Interim HIPC Initiative assistance of multilateral financial institutions for 2001-03.
[2] Personnel expenditures in 2002 have been much lower than in the budget as the payment of a number of indemnities and allowances was suspended because of the revenue shortfall.
[3] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities. Beginning in 2002, net correspondent account balances are classified as domestic financing.
[4] For 2000, the government budgeted FMG 69 billion to address exceptional developments related to the resurgence of a cholera epidemic and the devastating effects of three cyclones early in the year.
[5] The net cost of structural reforms comprise (i) as receipts, loan recovery by the debt-recovery unit that holds the nonperforming loans of the two (former) public banks (BFV and BTM) after their assets have been financially restructured; and (ii) as expenditures, those related to civil service reform (i.e., training, bonuses, and wage decompression); to the upgrading of pay and equipment in the justice services; to 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 indemnization payments to formerly expropriated owners); and to the capital transfers for the asset restructuring at the two insolvent banks (BFV and BTM).
[6] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.
[7] Interim HIPC Initiative assistance provided through Paris Club flow rescheduling on Cologne terms for 2001-03.
[8] Excludes the assumption of state oil company (SOLIMA) debt by the government and the effect of exchange rate changes on net credit to government in foreign exchange.
[9] HIPC grants received plus HIPC external debt relief.

Table 5. Madagascar: Central Government Accounts, 2000-07
(In percent of GDP, unless otherwise indicated)

	2000	2001	2002		2003		2004	2005	2006	2007
			Prog.	Act.	Prog.	Rev. Prog.		Projections		
Total revenue and grants	15.3	14.0	10.1	10.2	13.6	15.0	14.5	15.0	15.4	15.9
Total revenue	11.7	10.1	7.3	8.0	10.5	10.6	11.5	12.0	12.5	13.0
Of which: tax revenue	11.3	9.7	7.0	7.7	10.2	10.3	11.2	11.6	12.1	12.6
Grants	3.6	3.9	2.8	2.2	3.2	4.3	3.0	3.0	2.9	2.9
Current grants	0.7	1.4	1.6	0.8	1.4	2.6	0.8	0.8	0.7	0.7
Of which: HIPC assistance [1]	...	0.5	0.6	0.6	0.6	0.6	0.0	0.0	0.0	0.0
Project grants	2.9	2.5	1.2	1.3	1.7	1.8	2.2	2.2	2.2	2.1
Total expenditures	15.9	17.6	15.0	15.7	17.8	18.2	18.3	18.5	18.7	18.8
Current expenditure	9.2	10.3	10.5	10.3	10.3	10.4	10.1	9.8	9.5	9.3
Noninterest expenditure	6.9	8.1	7.0	7.1	8.2	8.4	8.6	8.5	8.3	8.2
Personnel	4.0	4.5	4.5	4.6	5.3	5.3	5.1	5.0	4.8	4.7
Of which: HIPC financed	...	0.2	0.2	0.2	0.3	0.4	0.0	0.0	0.0	0.0
Other noninterest expenditure	2.9	3.6	2.5	2.5	3.0	3.0	3.5	3.5	3.5	3.5
Of which: HIPC financed	...	0.3	0.4	0.4	0.3	0.4	0.0	0.0	0.0	0.0
Interest obligations	2.3	2.0	2.1	2.2	1.8	1.8	1.3	1.2	1.1	1.0
Treasury operations [2]	-0.2	0.2	1.0	0.7	0.2	0.2	0.1	0.1	0.1	0.1
Emergency expenditures [3]	0.2	0.1	0.4	0.4	0.1	0.1	0.0	0.0	0.0	0.0
Of which: elections	...	...	...	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Capital expenditure	6.7	7.3	3.7	4.8	7.2	7.3	8.2	8.7	9.2	9.5
Domestically financed expenditure	2.2	3.2	0.8	1.9	2.3	2.3	3.0	3.5	4.1	4.7
Foreign-financed expenditure	4.5	4.2	2.9	2.9	4.9	5.0	5.2	5.2	5.1	4.8
Of which: HIPC financed	...	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Government on-lending	...	...	0.7	0.5	0.3	0.4	0.0	0.0	0.0	0.0
Net cost of structural reforms [4]	-2.2	-0.7	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0	0.0
Primary balance	4.9	1.8	...	-0.2	2.0	2.0	2.8	3.4	4.1	4.7
Overall balance (commitment basis)										
Including grants	-2.8	-4.3	-4.9	-5.5	-4.2	-3.3	-3.9	-3.6	-3.3	-2.9
Excluding grants	-6.4	-8.2	-7.7	-7.7	-7.4	-7.6	-6.9	-6.5	-6.2	-5.8
Domestic balance (commitment basis) [5]	-0.5	-2.9	-3.5	-3.3	-1.3	-1.4	-0.9	-0.6	-0.5	-0.5
Change in arrears	-0.5	-0.1	-0.6	-0.7	-0.9	-1.0	0.0	0.0	0.0	0.0
Total overall balance (cash basis, excluding grants)	-6.9	-8.3	-8.3	-8.4	-8.3	-8.6	-6.9	-6.5	-6.2	-5.8
Total overall balance (cash basis, including grants)	-3.3	-4.4	-5.5	-6.2	-5.1	-4.3	-3.9	-3.6	-3.3	-2.9
Financing	3.3	4.4	5.5	6.2	5.1	4.3	3.9	3.6	3.3	2.9
Foreign (net)	2.7	2.1	3.1	3.6	3.8	3.6	3.1	3.1	2.9	2.6
Drawings	3.1	2.4	3.6	3.8	3.4	4.4	3.3	3.2	3.2	2.9
Budget	1.5	0.7	2.2	2.2	0.6	1.6	0.6	0.6	0.5	0.5
Of which: World Bank EERC	...	...	0.4	0.4	0.6	0.6	0.0	0.0	0.0	0.0
Projects	1.6	1.7	1.4	1.6	2.8	2.9	2.7	2.6	2.6	2.4
Amortization due	-2.4	-1.9	-2.1	-1.9	-1.9	-1.9	-1.2	-1.1	-1.2	-1.2
Change in external arrears	-0.2	-0.2	0.0	0.0	0.0	-0.3	0.0	0.0	0.0	0.0
External debt relief	2.2	1.9	1.7	1.8	1.4	1.4	1.0	0.9	0.9	0.8
Of which: HIPC assistance [6]	...	0.5	0.5	0.6	0.5	0.5	1.0	0.9	0.9	0.8
Domestic (net)	0.5	1.9	2.2	2.4	0.9	0.4	0.8	0.5	0.4	0.4
Of which: banking system [7]	0.0	1.6	2.1	2.4	0.6	0.2	0.3	0.0	0.0	0.0
Privatization receipts	0.2	0.3	0.2	0.2	0.4	0.2	0.0	0.0	0.0	0.0
Memorandum items:										
Total HIPC debt relief	...	1.0	1.0	1.1	1.1	1.1	1.0	0.9	0.9	0.8
Education expenditure, after HIPC	2.9	2.9	2.8	2.8	...	...	...	...	...	...
Health expenditure, after HIPC	1.8	1.5	0.9	0.9	...	...	...	...	...	...
Nominal GDP (in billions of Malagasy francs)	26,242	29,843	30,842	30,058	34,506	33,978	37,779	42,005	46,703	51,927

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

[1] Interim HIPC assistance of multilateral financial institutions for 2001-03.
[2] Includes annexed budgets of quasi-public entities, including port authorities, the post office, government printing office, civil service retirement funds, and correspondent accounts of local authorities. Beginning in 2002, net correspondent account balances are classified as domestic financing.
[3] For 2000, the government budgetized FMG 69 billion to address exceptional developments related to the resurgence of a cholera epidemic and the devastating effects of three cyclones early in the year.
[4] The net cost of structural reforms comprise (i) as receipts, loan recovery by the debt-recovery unit that holds the nonperforming loans of the two (former) public banks (BFV and BTM) after their assets have been financially restructured; and (ii) as expenditures, those related to civil service reform (i.e., training, bonuses, and wage decompression); to the upgrading of pay and equipment in the justice services; to 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 indemnization payments to formerly expropriated owners); and to the capital transfers for the asset restructuring at the two insolvent banks (BFV and BTM).
[5] Overall balance, excluding grants, foreign-financed capital expenditures, and foreign interest payments.
[6] Interim HIPC assistance provided through Paris Club flow rescheduling on Cologne terms for 2001-03.
[7] Excludes the assumption of state oil company (SOLIMA) debt by the government and the effect of exchange rate changes on net credit to government in foreign exchange.

Table 6. Madagascar: Monetary Survey, 2000-03
(In billions of Malagasy francs; unless otherwise indicated)

	2000	2001	2002 Dec. Prog.	2002 Dec. Act.	2003 Mar. Rev. Prog.	2003 Mar. Act.	2003 Jun	2003 Sep	2003 Dec
							Revised Program		
Net foreign assets	1,777.1	2,306.9	2,499.7	2,172.3	2,398.7	2,300.9	2,378.9	2,531.4	2,737.0
Net foreign assets (BCM)	1,002.9	1,638.7	1,496.4	1,286.1	1,382.8	1,345.5	1,270.0	1,360.0	1,773.1
Net foreign assets (deposit money banks)	774.1	668.2	1,003.3	886.1	1,015.8	955.4	1,108.9	1,171.4	963.9
Net domestic assets	4,138.0	5,050.3	5,733.1	5,760.7	5,847.7	5,675.9	6,159.1	6,218.8	6,259.0
Domestic credit	4,271.0	5,305.0	6,138.9	6,008.4	6,134.7	5,821.0	6,398.4	6,484.0	6,553.2
Net credit to government (budget) 1/	1,563.3	2,047.8	2,710.2	2,706.8	2,663.4	2,362.5	3,168.0	3,166.4	3,167.6
Other claims on public sector	293.2	429.2	433.4	461.3	461.3	428.4	461.3	461.3	461.3
Credit to the economy	2,414.5	2,828.0	2,995.3	2,840.3	3,009.9	3,030.1	2,769.1	2,856.2	2,924.3
Credit to public enterprises 1/	111.2	327.2	366.3	405.8	405.3	409.6	62.5	62.5	62.5
Credit to private sector	2,303.3	2,500.8	2,629.0	2,434.5	2,604.7	2,620.5	2,706.6	2,793.8	2,861.9
Other items (net; assets +)	-133.0	-254.7	-405.8	-247.6	-287.0	-145.1	-239.3	-265.2	-294.2
M3	5,915.0	7,357.3	8,232.8	7,933.0	8,246.3	7,976.8	8,538.0	8,750.3	8,996.0
Foreign currency deposits	841.3	773.7	958.4	878.9	1,059.1	1,028.0	1,028.0	1,028.0	1,028.0
M2	5,073.7	6,583.6	7,274.4	7,054.1	7,187.2	6,948.8	7,510.0	7,722.3	7,968.0
Currency in circulation	1,786.6	2,159.6	2,321.6	2,330.1	2,407.9	2,318.8	2,527.2	2,590.1	2,698.8
Deposits in local currency 2/	3,117.8	4,251.2	4,751.8	4,546.7	4,603.0	4,446.4	4,799.2	4,948.6	5,085.7
Short-term obligations of commercial banks	169.3	172.7	201.0	177.4	176.2	183.5	183.5	183.5	183.5
Memorandum items:		(Percent change since the end of the previous year, unless otherwise indicated)							
M3	19.3	24.4	11.9	7.8	4.0	0.6	7.6	10.3	13.4
M2	16.6	29.8	10.5	7.1	1.9	-1.5	6.5	9.5	13.0
Domestic credit	16.4	24.2	15.7	13.3	2.1	-3.1	6.5	7.9	9.1
Credit to the private sector	18.9	8.6	5.1	-2.6	7.0	7.6	11.2	14.8	17.6
Net credit to government 1/	0.2	31.0	32.3	32.2	-1.6	-12.7	17.0	17.0	17.0
Reserve money	12.4	29.7	12.3	4.4	6.3	-13.1	-7.4	-6.7	-4.7
Currency/M3 (in percent)	30.2	29.4	28.2	29.4	29.2	29.1	29.6	29.6	30.0
Reserve money multiplier (M3/reserves)	2.3	2.2	2.2	2.2	2.5	2.6	2.6	2.7	2.7
Velocity of money (GDP/end-of-period M3)	4.4	4.1	3.7	3.8	...	...	...	...	3.8
Exchange rate (Malagasy francs per SDR; end of period)	8,537.8	8,327.5	8,972.0	8,746.0	...	8,848.4	...	...	...

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

1/ 2003 includes the takeover of state oil company (SOLIMA) debt (FMG 350.4 billion) by the government.
2/ Includes CCP/CEM deposit accounts.

Table 7. Madagascar: Balance Sheet of the Central Bank and Consolidated Balance Sheet of Commercial Banks, 2000-03
(In billions of Malagasy francs, unless otherwise indicated)

	2000	2001	2002 Dec. Prog.	2002 Dec. Act.	2003 Mar. Rev. Prog.	2003 Mar. Act.	2003 Jun.	2003 Sep.	2003 Dec.
							Revised Program		
Central bank (BCM)									
Net foreign assets	1,002.9	1,638.7	1,496.4	1,286.1	1,382.8	1,345.5	1,270.0	1,360.0	1,773.1
Net domestic assets	1,607.1	1,746.1	2,303.7	2,248.9	1,913.9	1,725.1	2,002.0	1,938.6	1,596.9
Overall credit to government (net)	1,162.7	1,207.8	1,870.2	1,585.2	1,079.7	883.4	1,588.4	1,550.8	1,237.9
Liquidity operations 1/	0.0	0.0	0.0	0.0	0.0	0.0	-369.8	-413.5	-732.8
Net credit to government (budget) 2/	1,162.7	1,207.8	1,870.2	1,585.2	1,079.7	883.4	1,958.2	1,964.2	1,970.7
Claims on public enterprises 2/	111.2	276.4	366.3	364.1	368.3	371.2	20.8	20.8	20.8
Credit to banks	59.5	40.4	9.1	27.2	27.2	26.5	26.5	26.5	26.5
Other items (net; assets +)	273.7	221.5	58.1	272.3	438.7	444.0	366.3	340.6	311.6
Of which: valuation account (losses -)	85.5	-56.0	94.0	54.5	97.7	20.9	-77.6	-103.4	-132.3
Reserve money	2,610.0	3,384.9	3,800.1	3,535.0	3,296.7	3,070.6	3,272.0	3,298.6	3,370.0
Currency outside banks	1,786.6	2,159.6	2,321.6	2,330.1	2,407.9	2,318.8	2,527.2	2,590.1	2,698.8
Bank reserves	823.4	1,225.3	1,478.5	1,204.9	888.8	751.8	744.8	708.5	671.2
Currency in banks	78.4	84.9	116.1	122.6	122.6	102.3	102.3	102.3	102.3
Deposits	745.0	1,140.4	1,362.4	1,082.3	766.2	649.4	642.4	606.2	568.8
Deposit money banks (DMBs)									
Net foreign assets	774.1	668.2	1,003.3	886.1	1,015.8	955.4	1,108.9	1,171.4	963.9
Net domestic assets	3,354.3	4,529.4	4,907.9	4,716.8	4,822.6	4,702.6	4,901.9	4,988.7	5,333.3
Bank reserves	823.4	1,225.3	1,478.5	1,204.9	888.8	751.8	744.8	708.5	671.2
Liabilities to BCM	-59.5	-40.4	-9.1	-27.2	-27.2	-26.5	-26.5	-26.5	-26.5
Credit to government (net)	400.6	840.0	840.0	1,121.6	1,583.8	1,479.1	1,579.6	1,615.7	1,929.6
Purchase of liquidity paper 1/	0.0	0.0	0.0	0.0	0.0	0.0	369.8	413.5	732.8
Net credit to government (budget)	400.6	840.0	0.0	1,121.6	1,583.8	1,479.1	1,209.8	1,202.2	1,196.9
Other claims on public sector	293.2	429.2	433.4	461.3	461.3	428.4	461.3	461.3	461.3
Claims on public enterprises	...	50.8	0.0	41.6	36.9	38.3	41.6	41.6	41.6
Credit to private sector	2,303.3	2,500.8	2,629.0	2,434.5	2,604.7	2,620.5	2,706.6	2,793.8	2,861.9
Other items (net; assets +)	-406.7	-476.2	-463.9	-520.0	-725.7	-589.0	-605.6	-605.7	-605.9
Deposits	3,959.1	5,024.9	5,710.2	5,425.5	5,662.2	5,474.4	5,827.2	5,976.6	6,113.7
Deposits in local currency 3/	3,117.8	4,251.2	4,751.8	4,546.7	4,603.0	4,446.4	4,799.2	4,948.6	5,085.7
Deposits in foreign currency (time deposits)	841.3	773.7	958.4	878.9	1,059.1	1,028.0	1,028.0	1,028.0	1,028.0
(in millions of SDRs)	98.5	92.9	106.8	100.5	116.3	116.2	111.2	109.7	108.1
Short-term bonds (liabilities)	169.3	172.7	201.0	177.4	176.2	183.5	183.5	183.5	183.5

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

1/ Sales of treasury bills for monetary policy purposes.
2/ 2003 includes the takeover of state oil company (SOLIMA) debt (FMG 350.4 billion) by the government.
3/ Includes CCP/CEM deposit accounts.

Table 8. Madagascar: Balance of Payments, 2000-07
(In millions of SDRs; unless otherwise indicated)

	2000	2001	2002		2003		2004	2005	2006	2007
			Prog.	Prel.	Prog.	Rev. Prog.	Projections			
Current account	-165.4	-46.4	-155.0	-203.5	-211.1	-168.6	-181.0	-230.4	-243.9	-246.7
Goods and services	-214.8	-114.3	-202.4	-224.8	-292.5	-275.9	-263.3	-321.9	-345.6	-362.5
Trade balance	-78.6	11.6	-91.3	-90.5	-122.0	-90.1	-65.9	-97.2	-96.8	-95.8
Exports	628.5	757.9	406.0	375.0	535.0	584.9	678.9	805.0	947.6	1,090.6
Of which: export processing zones	248.1	267.2	...	78.1	...	120.1	176.2	249.3	327.1	396.6
Imports	-707.1	-746.3	-497.3	-465.5	-657.0	-675.0	-744.8	-902.2	-1,044.4	-1,186.4
Net services (net)	-136.2	-125.9	-111.1	-134.3	-170.5	-185.8	-197.4	-224.7	-248.8	-266.7
Services, receipts	270.9	276.3	181.1	173.1	240.7	247.3	268.9	292.9	319.6	349.2
Services, payments	-407.1	-402.2	-292.3	-307.4	-411.2	-433.1	-466.3	-517.6	-568.4	-615.9
Income (net)	-53.3	-46.7	-58.5	-53.0	-53.9	-56.4	-42.2	-42.6	-42.9	-40.1
Receipts	16.6	18.7	15.5	20.1	19.5	19.3	20.0	20.6	21.4	22.1
Payments	-69.9	-65.4	-74.0	-73.1	-73.3	-75.7	-62.2	-63.3	-64.2	-62.2
Of which: government interest [1]	-39.6	-41.4	-43.9	-43.1	-43.2	-42.9	-30.7	-29.9	-29.0	-27.9
Current transfers	102.6	114.6	105.9	74.2	135.2	163.6	124.5	134.1	144.5	155.9
Government	25.5	24.9	44.9	6.2	62.6	98.3	39.5	41.3	43.2	45.2
Budget aid	16.5	36.7	51.3	22.1	53.1	88.8	30.0	31.8	33.7	35.7
HIPC relief [2]	0.0	18.8	20.2	20.2	22.2	22.2	0.0	0.0	0.0	0.0
Grants	16.5	17.9	31.1	1.9	31.0	66.7	30.0	31.8	33.7	35.7
Other (net) [3]	9.0	-11.8	-6.4	-15.9	9.5	9.5	9.5	9.5	9.5	9.5
Private	77.1	89.7	61.0	68.0	72.6	65.3	85.0	92.8	101.3	110.6
Capital and financial account	71.6	65.9	67.5	104.1	150.7	168.2	226.8	246.8	261.9	270.3
Capital account	87.0	88.6	40.4	44.7	63.5	63.9	88.1	93.4	99.0	104.9
Of which: government project grants	87.0	88.6	40.4	44.7	63.5	63.9	88.1	93.4	99.0	104.9
Financial account	34.0	90.9	27.1	25.5	87.2	104.2	138.6	153.4	162.9	165.4
Direct investment	52.9	73.1	5.0	6.4	33.4	13.1	52.0	60.6	70.6	82.3
Of which: privatization receipts	5.3	10.9	3.0	3.3	16.0	3.7	0.0	0.0	0.0	0.0
Other	-18.9	17.8	22.1	19.1	53.8	91.1	86.6	92.8	92.3	83.0
Government	6.1	21.5	54.6	48.1	62.7	96.6	92.0	97.3	97.3	90.7
Drawing	86.9	90.2	126.7	120.3	133.7	167.6	137.7	144.1	150.8	147.4
Project drawings	46.2	60.4	47.4	54.6	105.0	105.0	105.7	112.1	118.8	115.4
Budgetary support	39.3	26.8	79.3	65.7	22.7	56.6	25.0	25.0	25.0	25.0
Of which: SAC II and PRSC	25.8	0.0	56.5	54.1	0.0	0.0	20.0	20.0	20.0	20.0
Nongovernment	1.4	3.0	0.0	0.0	6.0	6.0	7.0	7.0	7.0	7.0
Amortization [1]	-80.8	-68.7	-72.1	-72.2	-71.0	-71.0	-45.8	-46.8	-53.5	-56.8
Private sector	0.0	-7.5	-7.5	-7.9	-8.9	-5.4	-5.3	-4.4	-5.0	-7.6
Of which: amortization	0.0	-7.5	0.0	-7.9	-8.9	-5.4	-5.3	-4.4	-5.0	-7.6
Banks, net	-25.0	3.8	-25.0	-21.1	0.0	0.0	0.0	0.0	0.0	0.0
Other (incl. errors and omissions) [4]	-49.4	-113.6	0.0	33.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-93.8	19.6	-87.5	-99.4	-60.4	-0.4	45.8	16.5	17.9	23.6
Financing	93.8	-19.6	87.5	99.4	60.4	0.4	-45.8	-16.5	-17.9	-23.6
Net foreign assets (increase -)	28.4	-76.9	30.0	40.0	-23.5	-40.1	-98.1	-71.7	-75.4	-80.9
Use of Fund credit (net)	34.2	21.4	8.6	8.6	17.3	17.3	17.3	-5.4	-5.4	-5.4
Disbursements	38.0	22.7	11.4	11.4	22.7	22.7	22.7	0.0	0.0	0.0
Repayments	-3.8	-1.3	-2.7	-2.7	-5.4	-5.4	-5.4	-5.4	-5.4	-5.4
Other assets, net (increase -)	-5.7	-98.3	21.4	31.4	-40.8	-57.4	-115.4	-66.3	-70.0	-75.5
Net change in arrears (excluding central bank) [5]	5.8	1.6	0.0	1.5	0.0	-9.5	0.0	0.0	0.0	0.0
Debt relief and cancellation [6,7]	59.6	55.8	57.5	57.9	50.1	50.0	52.4	55.3	57.5	57.3
Residual financing gap	0.0	0.0	0.0	0.0	33.8	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Grants (in percent of GDP)	3.8	3.2	2.5	1.5	3.4	4.4	3.2	3.2	3.1	3.1
Loans (in percent of GDP)	0.2	0.6	1.6	1.4	1.7	2.6	2.3	2.3	2.1	1.9
Direct investment (in percent of GDP)	1.8	2.1	0.1	0.2	0.9	0.4	1.3	1.4	1.5	1.7
Current account (in percent of GDP)										
Excluding net official transfers	-6.5	-2.0	-5.8	-6.1	-7.4	-7.3	-5.6	-6.4	-6.3	-6.0
Including net official transfers	-5.6	-1.3	-4.5	-5.9	-5.7	-4.6	-4.6	-5.4	-5.4	-5.0
Debt service-to exports ratio (in percent; before debt relief) [8]	13.5	11.7	21.8	23.6	16.3	15.4	14.2	12.1	12.1	10.2
Debt service-to exports ratio (in percent; after debt relief) [8]	6.9	4.4	8.6	9.1	6.9	6.5	7.6	6.6	6.7	5.6
Debt service-to revenue ratio (in percent; before debt relief) [9]	35.5	33.4	51.6	47.3	32.3	32.9	29.6	26.1	27.0	23.1
Debt service-to revenue ratio (in percent; after debt relief) [9]	18.1	12.7	20.3	18.2	13.7	13.9	16.0	14.3	15.0	12.7
Annual percentage changes										
Export volume	26.3	9.5	-46.9	-51.9	40.4	47.9	15.1	16.7	15.4	13.3
Import volume	19.3	6.6	-32.9	-45.3	32.6	38.4	19.5	24.3	11.9	11.8
Real GDP	4.8	6.0	-11.8	-12.7	7.8	6.0	6.0	6.0	6.0	6.0
Gross official reserves	218.7	317.5	296.1	266.6	336.9	324.0	439.4	505.7	575.7	651.1
(months of current goods and nonfactor services imports)	2.4	3.3	4.9	4.1	4.1	3.5	4.4	4.3	4.3	4.3
Exchange rates										
Malagasy francs per SDR (period average)	8,951.0	8,391.0	8,895.0	8,774.3	...	...	...	...	...	...
Malagasy francs per U.S. dollar (period average)	6,787.2	6,591.5	6,880.1	6,592.3	...	...	...	...	...	...

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

[1] Interest and amortization payments assume Paris Club stock-of-debt reduction will occur at the completion point, envisaged to be in 2004.

[2] Interim relief provided by the African Development Bank Group (AfDB), IDA, and the IMF for 2001-03. The distribution of interim relief among these years differs from the original program due to AfDB's choice of a different delivery option than assumed at the time of the decision point.

[3] Other official grants less payments due to scholarships and contributions to international organizations.

[4] Includes commercial credits received or granted.

[5] From 2000 onward, includes external commercial arrears.

[6] Bilateral agreements on debt with non-Paris Club creditors, most of which is in arrears, were initially assumed to be finalized in 2001; however, such reschedulings are materializing at a slower pace than envisaged. For 2001, arrears were rescheduled with the Saudi Fund and a commercial creditor, CITOH Bank (Hong Kong SAR).

[7] Assuming a Paris Club flow rescheduling on Cologne terms agreed in 2001, of which a part is attributable to HIPC relief.

[8] In percent of exports of goods and nonfactor services.

[9] In percent of government revenue.

Table 9. Madagascar: External Debt Sustainability Indicators, 2000-19

	2000	2001	2002	2003	2004	2005	2006	2007	Average 2000-09	Average 2010-19
					(In percent)					
After traditional debt relief										
Current estimates										
Net present value (NPV) of debt-to-exports ratio	220.4	192.7	211.3	223.3	233.3	193.8	174.2	156.7	178.2	99.1
NPV of debt-to-revenue ratio	470.7	476.8	624.7	443.9	395.5	365.4	337.7	312.0	382.7	182.3
NPV of debt-to-GDP ratio	55.0	48.4	49.9	47.3	45.5	43.8	42.2	40.6	43.8	29.8
Debt service-to-exports ratio	12.9	10.6	11.9	11.8	12.5	9.9	9.4	8.4	9.7	4.4
Debt service-to-revenue ratio	27.6	26.2	35.2	23.5	21.1	18.6	18.2	16.7	20.8	8.1
Decision point estimates										
NPV of debt-to-exports ratio	239.7	229.0	220.4	210.0	194.4	180.7	168.5	159.9	182.0	111.0
NPV of debt-to-revenue ratio	435.6	409.4	375.4	343.1	313.3	286.3	262.1	240.3	285.0	127.8
NPV of debt-to-GDP ratio	55.0	52.2	48.5	45.3	42.3	39.5	37.0	34.6	39.6	21.6
Debt service-to-exports ratio	11.7	11.2	10.2	9.8	9.3	9.0	9.5	9.2	9.8	7.3
Debt service-to-revenue ratio	23.1	21.4	18.8	17.4	16.7	15.5	15.9	14.9	17.1	9.4
After enhanced HIPC assistance										
Current estimates [1]										
NPV of debt-to-exports ratio	259.2	182.6	129.7	140.9	150.8	127.9	117.5	108.0	131.2	80.4
NPV of debt-to-revenue ratio	553.5	451.8	383.3	280.0	255.6	241.2	227.8	214.9	281.8	147.8
NPV of debt-to-GDP ratio	64.7	45.9	30.6	29.8	29.4	28.9	28.5	27.9	32.2	24.1
Debt service-to-exports ratio	6.7	3.9	4.7	5.0	6.8	5.5	5.1	4.6	4.9	1.9
Debt service-to-revenue ratio	14.4	9.8	13.8	10.0	11.6	10.4	10.0	9.2	10.5	3.4
Decision point estimates [2]										
NPV of debt-to-exports ratio	281.6	217.2	136.7	133.1	125.1	118.3	112.0	108.1	128.4	89.3
NPV of debt-to-revenue ratio	511.6	388.4	232.8	217.5	201.6	187.3	174.3	162.5	206.5	106.3
NPV of debt-to-GDP ratio	64.5	49.5	30.1	28.7	27.2	25.9	24.6	23.4	28.1	17.6
Debt service-to-exports ratio	11.7	6.2	5.0	5.5	5.6	5.3	6.0	6.0	5.7	4.9
Debt service-to-revenue ratio	21.2	11.8	9.2	9.7	10.0	9.3	10.1	9.7	9.8	6.3
					(In millions of U.S. dollars)					
Memorandum items:										
GDP										
Current estimates	3,866	4,527	4,560	5,030	5,441	5,842	6,278	6,752	5,738	11,955
Decision point estimates	3,906	4,283	4,773	5,291	5,806	6,376	6,960	7,598	6,234	15,138
Exports (three-year moving average)										
Current estimates	965	1,137	1,077	1,064	1,061	1,322	1,522	1,748	1,409	3,589
Decision point estimates	896	976	1,051	1,141	1,263	1,394	1,527	1,645	1,358	2,941
Exports (current year)										
Current estimates	1,186	1,316	730	1,147	1,306	1,513	1,746	1,984	1,556	3,899
Decision point estimates	972	1,046	1,135	1,242	1,412	1,528	1,641	1,767	1,472	3,160
Revenue, excluding grants										
Current estimates	452	460	365	535	626	701	785	878	656	1,952
Decision point estimates	493	546	617	699	784	880	982	1,094	867	2,553
NPV of debt (after traditional debt relief)										
Current estimates	2,127	2,191	2,277	2,377	2,475	2,561	2,650	2,739	2,512	3,558
Decision point estimates	2,147	2,235	2,316	2,397	2,456	2,519	2,573	2,630	2,472	3,264
Debt service (after traditional debt relief)										
Current estimates	125	120	128	126	132	131	143	147	137	157
Decision point estimates	114	117	116	122	131	137	156	163	141	229
NPV of debt (after enhanced HIPC assistance)										
Current estimates	2,502	2,076	1,397	1,499	1,600	1,691	1,788	1,887	1,850	2,885
Decision point estimates	2,521	2,120	1,436	1,519	1,581	1,649	1,711	1,778	1,810	2,591
Debt service (after enhanced HIPC assistance)										
Current estimates [3]	65	45	50	54	73	73	78	81	69	67
Decision point estimates	105	64	56	68	79	82	99	106	89	156

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

[1] Assumes that the completion point is reached in May 2004; HIPC Initiative assistance is assumed to be committed and delivered unconditionally from then on.

[2] The decision point document assumes that the completion point is reached in December 2002.

[3] Current numbers for 2000-01 are on a cash basis, and so do not need to be consistent with decision point estimates.

Table 10. Madagascar: Sources and Uses of Resources, 2000-07

	2000	2001	2002		2003		2004	2005	2006	2007
			Prog.	Prel.	Prog.	Rev. Prog.	Projections			
	(In billions of Malagasy francs)									
GDP	26,242.0	29,843.0	30,842.0	30,057.9	34,506.0	33,978.2	37,778.9	42,004.7	46,703.1	51,927.2
Consumption	24,216.3	25,281.2	29,232.0	27,745.4	31,984.0	30,599.9	32,965.2	36,645.6	40,246.1	44,238.8
Public	1,790.3	2,489.8	3,251.0	2,449.8	3,548.0	2,943.4	3,297.0	3,618.4	3,924.4	4,306.0
Private	22,426.1	22,791.3	25,981.0	25,295.6	28,436.0	27,656.5	29,668.2	33,027.2	36,321.8	39,932.8
Investment	3,948.1	5,520.9	3,411.0	4,284.8	5,252.0	5,946.3	7,332.6	8,548.3	9,999.7	11,529.9
Domestic investment	3,948.1	5,520.9	3,411.0	4,284.8	5,252.0	5,946.3	7,332.6	8,548.3	9,999.7	11,529.9
Government	1,766.1	2,180.9	1,149.0	1,445.8	2,496.0	2,496.3	3,113.0	3,643.5	4,309.1	4,939.1
Private	2,182.0	3,340.0	2,262.0	2,839.0	2,757.0	3,450.0	4,219.6	4,904.8	5,690.6	6,590.7
Of which: direct foreign investment (flow)	473.5	613.4	...	56.2	...	121.9	497.5	600.4	723.7	872.4
Changes in stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Resource gap	-1,922.4	-959.0	-1,800.0	-1,972.4	-2,731.0	-2,568.0	-2,518.9	-3,189.2	-3,542.7	-3,841.5
Exports of goods and nonfactor services	8,050.9	8,677.9	5,223.0	4,809.2	7,241.0	7,747.0	9,068.0	10,877.8	12,990.0	15,258.3
Of which: exports of goods	5,625.9	6,359.5	3,611.0	3,290.4	4,994.0	5,444.6	6,495.5	7,975.6	9,713.8	11,557.8
Imports of goods and nonfactor services	9,973.3	9,637.0	7,023.0	6,781.6	9,972.0	10,315.0	11,586.9	14,067.0	16,532.7	19,099.8
Of which: imports of goods	6,329.2	6,262.1	4,423.0	4,084.4	6,133.0	6,283.3	7,125.7	8,938.7	10,705.7	12,573.0
	(In percent of GDP)									
Consumption	92.3	84.7	94.8	92.3	92.7	90.1	87.3	87.2	86.2	85.2
Public	6.8	8.3	10.5	8.2	10.3	8.7	8.7	8.6	8.4	8.3
Private	85.5	76.4	84.2	84.2	82.4	81.4	78.5	78.6	77.8	76.9
Investment	15.0	18.5	11.1	14.3	15.2	17.5	19.4	20.4	21.4	22.2
Domestic investment	15.0	18.5	11.1	14.3	15.2	17.5	19.4	20.4	21.4	22.2
Government	6.7	7.3	3.7	4.8	7.2	7.3	8.2	8.7	9.2	9.5
Private	8.3	11.2	7.3	9.4	8.0	10.2	11.2	11.7	12.2	12.7
Of which: direct foreign investment (flow)	1.8	2.1	...	0.2	...	0.4	1.3	1.4	1.5	1.7
Changes in stocks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Resource gap	-7.3	-3.2	-5.8	-6.6	-7.9	-7.6	-6.7	-7.6	-7.6	-7.4
Exports of goods and nonfactor services	30.7	29.1	16.9	16.0	21.0	22.8	24.0	25.9	27.8	29.4
Of which: exports of goods	21.4	21.3	11.7	10.9	14.5	16.0	17.2	19.0	20.8	22.3
Imports of goods and nonfactor services	38.0	32.3	22.8	22.6	28.9	30.4	30.7	33.5	35.4	36.8
Of which: imports of goods	24.1	21.0	14.3	13.6	17.8	18.5	18.9	21.3	22.9	24.2
Gross domestic savings	7.7	15.3	5.2	7.7	7.3	9.9	12.7	12.8	13.8	14.8
Government	4.9	1.8	-3.2	-1.2	0.2	2.0	2.8	3.4	4.1	4.7
Nongovernment	2.9	13.5	8.5	8.8	7.1	8.0	10.0	9.4	9.7	10.1
Current account										
Excluding grants	-6.5	-2.0	-5.8	-6.1	-7.4	-7.3	-5.6	-6.4	-6.3	-6.0
Including grants	-5.6	-1.3	-4.5	-5.9	-5.7	-4.6	-4.6	-5.4	-5.4	-5.0
Gross national savings	9.4	17.2	6.6	8.3	9.5	12.9	14.8	14.9	16.1	17.2
Government	-2.8	-4.3	-1.9	-5.5	1.9	-3.3	-3.9	-3.6	-3.3	-2.9
Nongovernment	12.2	21.5	8.5	13.8	7.6	16.2	18.7	18.5	19.4	20.1

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

Table 11. Madagascar: Tracking Delivery of HIPC Assistance

	Contact with Creditor	Agreement to Provide HIPC Assistance		Agreement to Provide Interim Assistance		Delivery of Interim Assistance		Delivery of Completion Pt. Assist.
	Date	Status	Date	Status	Date	Status	Date	Comments
Multilateral creditors [1]								
IMF	18-Dec-00	yes	18-Apr-01	yes		yes		
IDA	21-Dec-00	yes	27-Dec-00	yes		yes		
AfDB/AfDF	19-Feb-01	yes	24-Apr-01	yes		yes		
IFAD	19-Feb-01	yes	19-Oct-01	no		no		Assistance will be provided at completion point.
EU/EIB	19-Feb-01	yes	16-Jan-03	yes		no		Modalities to be agreed.
OPEC	19-Feb-01	yes	26-Feb-02	limited		yes		Agreement.
BADEA	19-Feb-01	yes	15-Apr-01	no		no		Assistance will be provided at completion point.
Paris Club creditors [2,3]								
Austria		yes	10-Oct-01	yes		yes		Agreement on Cologne terms.
Belgium		yes	7-Mar-01	yes		yes		
Canada	21-Dec-00	yes	7-Mar-01	yes	5-Nov-02	yes		Letter on December 21, 2000 providing moratorium; agreement on September 25, 2002.
France		yes	7-Mar-01	yes		yes		Accords with Compagnie Francaise d'Assurance pour le Commerce Exterieur (COFACE), BDF, and AFD to be signed April 2003.
Germany		yes	2-Jul-02	yes	2-Jul-02	yes		Agreement on July 02, 2002: stock and flow. Agreement with Hermes, January 31, 2003.
Israel		yes	7-Mar-01	yes		yes		Being finalized.
Italy		yes	22-May-01	yes	22-May-01	yes		Letter # 1712 announcing decision to cancel 100 percent of debt.
Japan		yes	7-Mar-01	yes		yes		
Russia		yes	7-Mar-01	yes		yes	6-Dec-01	Letter on post-cutoff-date debt on December 06, 2001: flow and stock. Agreement February 27, 2003.
Spain		yes	20-Sep-01	yes		yes		Agreement on Cologne terms.
Switzerland		yes	18-Oct-01	yes	22-May-01	yes	18-Oct-01	Agreement: cancellation of 100 percent of restructured debt under Paris Club 9.
Sweden		yes	7-Mar-01	yes		yes		
United Kingdom		yes	7-Mar-01	yes		yes		Ambassador's announcement on July 29, 2002 on moratorium.
United States		yes	7-Mar-01	yes		yes		
Non-Paris Club bilateral creditors								
Algeria	5-Nov-01	no		no		no		
Angola	8-Nov-01	no		no		no		
China	5-Nov-01	yes		yes		yes	12-Nov-01	Agreement: relief of 25.94 percent of the total stock of debt; the government is still requesting further cancellation.
Iraq	5-Nov-01	no		no		no		
Kuwait	5-Nov-01	yes		no		no	27-Sep-99	Negotiations under way.
Libya	5-Nov-01	no		no		no		
United Arab Emirates	5-Nov-01	no		no		no		
Saudi Arabia	5-Nov-01	no		no		no	24-Jan-01	
Commercial creditors								
Creditors include:								
Italian Petroleum Authority (AGIP)								
ENI International Lt Bank								
Hong Kong CITOH Bank				yes	27-Apr-01	yes		Agreement.
London Club debt								

Sources: Malagsy authorities; and IMF staff.

[1] AfDB/AfDF=African Development Bank/Fund; IFAD=International Fund for Agriculture Development; EU/EIB=European Union/European Investment Bank; OPEC=Organization of Petroleum Exporting Countries; and BADEA=Arab Bank for Economic Development in Africa.

[2] Paris Club agreed minutes on restructuring from December 2000 to HIPC floating completion point.

[3] Letter sent to Malagasy authorities on September 25, 2002, notifying them of the missed implementation of the second phase of the Paris Club agreed minutes pending the second review of the PRGF arrangement with IMF.

Table 12. Madagascar: Regional Poverty by Area of Residence, 1993-2001 [1]
(In percent)

	Head Count				Depths of Poverty		
	1993	1997	1999	2001	1993	1997	1999
Urban Poverty							
Total	50.1	63.2	52.1	50.0	17.5	29.6	21.4
Antananarivo	42.4	52.0	43.3	...	15.9	23.0	17.5
Fianarantsoa	64.9	83.1	55.8	...	22.4	42.0	25.2
Taomasina	55.8	76.3	52.6	...	18.5	39.9	21.1
Mahajanga	37.3	68.2	65.2	...	11.6	23.2	25.3
Toliara	66.9	69.1	66.5	...	25.0	37.3	29.8
Antsiranana	49.5	27.0	31.3	...	14.3	6.2	7.8
Rural poverty							
Total	74.5	76.0	76.7	74.9	33.1	34.7	36.1
Antananarivo	76.2	72.1	69.3	...	31.6	31.5	29.5
Fianarantsoa	75.3	73.6	85.9	...	35.3	30.1	43.1
Taomasina	81.1	80.8	76.4	...	36.0	39.2	35.7
Mahajanga	56.7	75.1	78.8	...	20.2	30.6	39.4
Toliara	84.2	84.9	73.1	...	46.5	48.5	34.8
Antsiranana	63.7	69.5	80.6	...	24.5	27.5	36.7
National Poverty	70.0	73.3	71.3	69.2	30.3	33.6	32.9

Source: INSTAT, Cornell University; and World Bank staff estimates from household survey data.

[1] Head count measures the share of population with per capita consumption below the poverty line. Based on a household surveys conducted in 1993, 1997, 1999, and 2001, the poor are defined as those who spent FMG 313,945 (US$164) per capita or less in 1993.

Table 13. Madagascar: Basic Social and Demographic Indicators [1]

Land area (square kilometers)	581,540
Population	
Total (in millions) (2001)	16.0
Urban population (percent of total)	30.0
Population density (people per sq. km.)	26.7
Population density, rural (people per sq. km. of arable land) (1998)	407.6
Population growth (annual percentage change)	3.1
GNI per capita (in U.S. dollars, *World Bank Atlas* method, 2001)	260.0
Life expectancy at birth (in years) (2001)	
Overall	55.0
Women	55.8
Men	52.8
Crude birth rate (per 1,000) (1999)	40.7
Crude death rate (per 1,000) (1999)	12.1
Fertility rate (percent) (1999)	5.4
Infant mortality rate (per 1,000) (2001)	92.0
Child (under 5 years) mortality rate (per 1,000)	143.9
Stunting among children under 5 years (1997)	48.3
Education	
Illiteracy rate, adult total (percentage of people over 15) (2001)	33.0
Primary education, pupils (in thousands) (1998)	1,889.9
Secondary education, general pupils (in thousands) (1997)	356.6
Secondary education, vocational pupils (in thousands) (1992)	8.1
Primary school gross enrollment rate (percentage of relevant age group) (2001)	102.0
Secondary school gross enrollment rate (percentage of relevant age group) (1999) [2]	19.4
Tertiary school gross enrollment rate (percentage of relevant age group) (1995)	2.2
Health	
Hospital beds (per 1,000) (1999)	0.5
Physicians (per 1,000) (1999) [2]	0.1
Safe water (percentage of population with access) (2001)	47.0
Rural	31.0
Urban	85.0
Sanitation (percentage of population with access) (1999)	
Rural	30.0
Urban	70.0
Child immunization (under 12 months, percent) (1999)	
DPT	54.7
Measles	55.1
HIV prevalence (percent) (1999) [2]	0.15

Sources: World Bank, *World Development Indicators,* 2001, available on CD-ROM; and Malagasy authorities.

[1] Most recent estimates available, unless otherwise indicated.

[2] Source is the authorities' interim PRSP (EBD/00/105, 12/4/00).

Progress Toward HIPC Initiative Completion Point Triggers

The triggers for the floating completion point under the enhanced HIPC Initiative are reported in Box 8 of EBS/00/251(12/5/00). The specific triggers (in addition to the implementation of a full PRSP for at least one year, the use of budgetary savings from interim debt-service relief in accordance with the criteria set at the decision point, and the maintenance of macroeconomic stability through satisfactory implementation of the PRGF-supported program) include the following: **(A) actions in the area of financial monitoring and control; (B) the establishment of a public and transparent information system for the granting of licenses in mining, fishing, and forestry sector; and (C) the improved delivery of basic services.**

Triggers	Status
A1. Improve financial monitoring and control as follows:	
(a) Strengthen control systems through: (i) adoption of an appropriate legal and constitutional framework; (ii) adoption of procedures and internal control systems that conform to international technical standards; and (iii) an increase in staffing and resources of the State Inspectorate General (IGE) and the Commitment Control Office (CDE).	A comprehensive study was completed by an independent consultant in April 2001, covering also the Audit Court (Chambre des Comptes) and the Procurement Commission (Commission des Marchés); the report's recommendations were adopted by the government in June 2001. The related plan of action centers on reforming the statutes governing these agencies, including assigning external auditing functions to the Procurement Commission and internal auditing functions to the State Inspectorate General. The preparation of detailed procedural manuals, increased reporting obligations of public institutions, and reinforcement of equipment and staffing of control agencies is well advanced. The project is scheduled to be completed towards the end of 2003 when legislative approval and governmental adoption of revised legislative texts are expected to be formally adopted. Initial actions have included the recruitment of additional staff for the agencies during 2001. Additional resources have been assigned to the agencies in the budget since 2002.
(b) Designed a monitoring system for the budgetary cycle (engagement, liquidation, mandatement, paiement) and implemented in at least six ministries, including the Ministries of Basic Education and Health.	The budget monitoring system is presently operational for the Ministries of Health and Basic Education. It will be expanded in early 2003 to cover the Ministries of Public Works, Rural Development, Forestry and Water, and Justice.
(c) Improve centralization procedures and consolidation of all balances of the principal treasury offices by the Central Treasury Accounting Office (ACCT), through the formation of a consolidation unit, constituting a step toward the establishment of general balance sheet statements and of reliable opening and closing accounting balances.	In 2001, all the 22 principal treasury offices were computerized; initial and closing balances have been established for the period 1993-98. The balances for 1999 and 2000 were established before end-2002, and those for 2001and 2002 are on track to be established by June and November 2003, respectively; by early 2004 the accounting system will be current.

Progress Toward HIPC Initiative Completion Point Triggers (concluded)	
A2. **Preparation of biannual reports on education and health sector activities** at the central and decentralized level, including (i) budgetary allocation and expenditure execution; and (ii) physical achievements.	Quarterly budgetary allocation reports are being regularly compiled. No physical outcome reports have yet been prepared.
B. Establishment of public and transparent information system on granting licenses (beneficiary list, geographical zone, and amount) in the mining, forestry, and fishing sectors, and publication of the beneficiary list biannually.	For the mining and fishery sectors, the information on licenses exists, but is not readily accessible to the public.
C1. Expand teacher availability in rural areas by (i) formalizing and implementing new financial incentives for teachers to serve in rural public primary schools; and (ii) recruiting at least 3,500 new teachers from 2000 onward for public primary schools and deploying at least 60 percent of them to schools with contractual teachers or with a ratio of pupils to publicly paid teachers in excess of 50.	In 2001, 4000 teachers were recruited and assigned to the rural areas; the system of financial incentive has been established.
C2. Make operational the generic essential drug supply system of district pharmacies, including the start-up of generic drug supply for hospital outpatients).	At present, the central agency is operational; however, its functioning was not satisfactory in 2001, with delays in launching the tenders for the generic drugs. Improvements have been made in the second half of 2002.
C3. Cover current road maintenance needs (100 percent) through the Road Maintenance Fund, of which at least 10 percent are used for rural roads.	The functioning of the Road Maintenance Fund was unsatisfactory in 2001, with government transfers irregular. The financing of the fund was strengthened in August 2002 with the increase of the special levy for its budget in the price structure of petroleum prices.

Madagascar: Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending (Draft Proposals, To be Discussed with the Authorities)

	Actions	Timing (S/M)[1]	Status (FI/II/ NS)[2]	Date Achieved	Comments
Actions to strengthen budget formulation					
1	Define budget aggregates along several poverty categories ('high, medium, or low poverty reduction relevance') of the existing functional budget classification using as much as possible the information on the incidence of expenditures by population poverty groups	S	NS		
2	Derive baseline of budget distribution along poverty classification for most recent year possible	S	NS		
3	Introduce a fully-functioning integrated financial management system linking the treasury, the budget general directorates, the financial comptroller office, line ministries, and control organs.	M	NS		
4	Draft plan on how the medium term orientation of the budget can be improved. A multi-year expenditure forecast should be derived from a macro-economic projection model, be consistent with sectoral policies and include both current and capital expenditures.	S	NS		
5	Introduce, in stages, a medium-term expenditure planning framework	M	NS		
6	Continue education of higher level staff (inspecteurs des tresor) at the Institute Malagasy for Technical Planning	M	II		This is an ongoing activity
Actions to strengthen budget execution					
7	Design and implement a monitoring system for the entire budgetary cycle (*engagement, liquidation, mandatement, paiement*) at least six ministries of special importance to poverty reduction, including the ministries of basic education and health	S	II		System implemented for Health and education Ministries.
8	Prepare biannual reports on education and health sector activities at the central and decentralized level including: (i) budgetary allocation and expenditure execution; (ii) physical achievements	S	NS		
9	Install and use Asycuda 3++ software for customs operations in at least 6 priority sites.	M	II		

Madagascar: Status of Actions to Strengthen Tracking of Poverty-Reducing Public Spending (Draft Proposals, To be Discussed with the Authorities) (concluded)

	Actions	Timing (S/M)[1]	Status (FI/II/ NS)[2]	Date Achieved	Comments
10	In the context of the new Organic Law on Public Finances to be presented to the Parliament by end-2003, simplify the budget execution structure by combining the functions of the *gestionnaires de crédit* and the *sous-ordonnateurs* in the ministries	S	NS		Organic Law on Public Finance currently being drafted.
11	Implement a quantitative study showing what factors are responsible for the slow implementation of the execution of the investment budget in the social sectors	S	NS		
12	Review, update and simplify the rules and regulations for the complete budgetary cycle (public procurement, inventory assessment and nomenclature of documentary evidence) based on diagnostic studies, including the Country Fiduciary Assessment	S	NS		
13	Transform the auditor general office into an independent Court (*Cour des Comptes*)	S	FS	12/02	
Actions to strengthen budget reporting					
14	Regular publication in the official Government journal of all 'virement des credits' (transfers between credit lines carried out after the budget law is passed by the parliament)	S	NS		
15	Improve the centralization procedures and consolidation of all balances of the Principal Treasurers by the central treasury accounting office (ACCT) through the formation of a consolidation and audit unit, constituting a step towards the establishment of general balance sheet statements and of reliable opening and closing accounting balances.	S	II		Balances for 2001 and 2002 to be prepared before end-2003
16	Complete and validate the Government report on the strengthening and the capacity of control organs	S	II		Reports to be considered by government before end-2003
17	Adopt an ethic code for control organs based on authority of decision, independence of judgment, as well as moral and intellectual integrity	S	II		Codes to be considered by government before end-2003
18	Adopt procedures and internal control systems that conform to international technical standards	S	II		Reports to be considered by government before end-2003
19	Increase in staffing and resources of IGE, CDE and the Chambre de Comptes	S	II		
20	Install, by end 2003, the treasury computer system for all main 22 treasury offices	S	FI	11/01	
21	Prepare the 2000 and 2001 budgetary execution laws (loi de règlement) during 2003	S	II		

[1]S=Short-term action; M = medium-term action.

[2]FI=fully implemented; II= implementation initiated; NS=not started.

Antananarivo, June 10, 2003

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. The attached memorandum on economic and financial policies describes the policies and measures that the government of Madagascar has adopted and pursued since October 2002, in the wake of the severe political crisis that affected the country in the first half of 2002, and describes in detail Madagascar's economic and financial policies for the remainder of 2003. All the performance criteria for end-2002 were observed. The government requests that this document serve as the basis for the Fund's completion of the third review under the Poverty Reduction and Growth Facility (PRGF) approved on March 1, 2001.

2. The fourth review of the arrangement is expected to be completed by end-December 2003, with subsequent reviews occurring every six months. The government of Madagascar will continue to provide the Fund with any information deemed necessary to monitor program implementation.

3. The government of Madagascar believes that the policies described in the attached memorandum are sufficient to achieve the program objectives, but is prepared to take any additional steps that may become necessary to achieve these objectives.

Sincerely yours,

Benjamin Andriamparany Radavidson
Minister of Economy, Finance, and the Budget

Gaston Ravelojaona
Governor
Central Bank of Madagascar

MADAGASCAR

Memorandum on Economic and Financial Policies for 2003

June 10, 2003

I. INTRODUCTION AND ECONOMIC AND FINANCIAL DEVELOPMENTS IN 2002

1. For several years, the government of Madagascar has been implementing a program of macroeconomic and structural reforms supported by the PRGF and aimed at restoring domestic and external viability, boosting growth, and reducing poverty. The program was interrupted by a serious political crisis in 2002, which was triggered by the presidential elections of December 2001 and led to a serious economic setback and an increase in poverty. However, the new government began a recovery effort, with a view to making up for the delays in program implementation. It endeavored to restore the confidence of economic agents and the users of public services, and to lay the groundwork for sustainable development that will produce a significant reduction in poverty. Moreover, the government strengthened the consultation and participation framework so as to enhance program ownership.

2. Macroeconomic performance for 2002, which was seriously affected by the crisis, was unsatisfactory, and it was not possible to achieve the original program objectives, although all the revised performance criteria for December 2002 were observed. Real GDP declined by 12.7 percent, while inflation, as measured by the consumer price index (CPI), rose to 13.5 percent on a year-on-year basis at end-2002. The external current account deficit (including official transfers) increased from 1.3 percent of GDP in 2001 to 5.9 percent of GDP in 2002, following a sharp decline in exports (of 50.5 percent in SDR terms). Disbursements by donors, including the World Bank and the European Union, were smaller than projected, and foreign direct investment inflows dropped sharply. The central bank's external reserves decreased from SDR 317.5 million at end-2001 to SDR 266.6 million at end-2002 (the equivalent of 4.1 months of 2002 imports).

A. Public Finance

3. Fiscal developments in 2002 were gravely affected by the crisis, but were in line with the program. However, at end-2002 budgetary revenue amounted to the equivalent of 8 percent of GDP (FMG 2,403 billion), exceeding the program target of 7.3 percent of GDP. Current nonpayroll expenditure remained below the program projections. Capital expenditure remained well below initial forecasts (4.8 percent of GDP, as against the original forecast of 11.2 percent of GDP), both in respect of the domestically financed component and the externally financed component. The fiscal deficit (on a commitments basis, excluding grants) was reduced from 8.2 percent of GDP in 2001 to 7.7 percent of GDP in 2002, in line with the program.

4. The level of domestic arrears was substantially reduced by payments amounting to about FMG 455 billion, notwithstanding the faster pace of commitments following the opening of budget appropriations. Net repayments amounted to FMG 212.6 billion, compared with the program projection of FMG 197 billion. However, outstanding arrears of about FMG 244 billion remained at end-2002.

5. As regards structural commitments for 2002, the draft budget execution law for 1999 was submitted to the Audit Court, treasury balances for 2000 were completed as planned, and the program to computerize the Treasury was completed.In early 2003, a contract with the preshipment inspection firm (SGS) was signed, and the company began its activities on April 1, 2003.

6. The 2002 crisis had a severe impact on the most vulnerable population groups and reduced their access to health care and education. To limit this negative social impact, the government eliminated school fees for a six-month period beginning in October. Essential care and medications at public health facilities are also being provided free of charge for a six-month period. The cost of these measures, estimated at FMG 64 billion (0.2 percent of GDP), is covered by the Initiative for Heavily Indebted Poor Countries (HIPC Initiative) budget.

B. Money and Credit

7. As a result of a greater-than-projected reduction in net international reserves and a weak expansion of credit to the government by the central bank, the annual growth of reserve money in 2002 was 4.4 percent, as against the projected 12.3 percent, while the growth of broad money (including deposits in foreign exchange) was contained at 7.8 percent, compared with a target of 11.9 percent. Credit to the private sector declined by 2.6 percent, owing, in particular, to the crisis and the banks' concerns regarding the deterioration in the quality of their assets. The weighted-average auction rate on treasury bills rose from 8 percent at end-2001 to 12 percent in December 2002.

8. The nonperforming loans in banks' portfolios increased (to 19.2 percent of loans at end-2002 from 10.3 percent at end-2001), reflecting the downturn in private sector economic activity. As a result, there was an increase in net provisions against doubtful debts (to FMG 84 billion in 2002 from FMG 40 billion in 2001) and a contraction in bank profits after tax (from FMG 129 billion in 2001 to FMG 61 billion in 2002).

9. The monetary authorities continued to pursue a flexible exchange rate policy. During 2002, the exchange rate remained relatively stable after a correction immediately prior to the reopening of the foreign exchange market in July. The adjustment resulted in a depreciation of the currency to FMG 6,800 against the euro, compared with FMG 6,114 during the crisis.

II. THE PROGRAM FOR 2003

A. Macroeconomic Objectives for 2003

10. The government has established the following macroeconomic objectives for 2003: real GDP growth of about 6 percent; a decline in CPI inflation to below 7 percent by December 2003, on a year-on-year basis; a narrowing of the external current account deficit (including grants) to 4.6 percent of GDP; and an increase in the central bank's gross official reserves by about SDR 57 million (to 3.5 months of projected imports). The main components of the government's economic policy aimed at achieving these objectives are described in the following paragraphs. The government recognizes that the Malagasy economy cannot be insulated from the prevailing global economic climate, and especially possible increases in oil prices (assumed to remain at $31 per barrel during 2003). If such an increase materializes, policies will be adjusted to ensure attainment of the government's macroeconomic objectives.

B. Public Finance

11. Fiscal policy will play an essential role in achieving macroeconomic objectives in 2003. The overall deficit (on a commitments basis, including the cost of structural reforms) will be limited to 7.6 percent of GDP, and recourse to banking system credit is programmed not to exceed 0.2 percent of GDP. As indicated in the paragraphs below, concerted efforts will be made to increase government revenue by broadening the tax base, improving tax policy, and increasing tax collections, particularly through administrative reforms. Expenditure control and treasury cash-flow management will be strengthened in order to enhance budget execution and facilitate the monitoring and reduction of arrears, both at the treasury and ministry levels, thereby increasing the likelihood that poverty reduction expenditures will be carried out as planned.

Tax policy

12. The 2003 budget law introduced two important tax measures aimed at promoting economic recovery: the marginal rates on income tax for individuals and companies (IBS and INRS) were reduced from 35 percent to 30 percent; and tariffs on fertilizers, agricultural inputs and equipment, iron, steel, cement, selected other construction materials, paper, and inputs used by the textile sector (fabrics, thread, accessories, and capital equipment) were eliminated. The net impact of these measures on 2003 tax receipts is estimated at FMG 28 billion . To achieve the program objectives, including raising the tax ratio, the government will implement the recommendations of the recent technical assistance mission from the IMF (delineated below). The temporary tax relief measures announced in 2002 have now expired.

13. In addition, a duty on mining transactions (DSTM) has been introduced to replace the current extremely high royalties imposed on the sector, which had yielded little revenue. The new tax is aimed also at curtailing illegal exports of precious stones from Madagascar.

14. The government believes that there is room for improvement of the tax system. It has requested IMF technical assistance to examine the structure of external tariffs and domestic taxation, including the investment incentives system. The government would like to conduct the review before end-October 2003, so as to incorporate necessary changes into the 2004 budget law. In addition, the government will submit a new draft of the Organic Law on Public Finance to Parliament by end-2003, which is aimed at modernizing budgetary preparation and control procedures, treasury accounting, and audit functions.

Tax administration reform

15. The government recognizes that the bottlenecks and inefficiencies that continue to characterize the tax and customs administrations constitute major obstacles to the resumption of growth. In particular, these inefficiencies reduce tax receipts and lengthen the time required for customs clearance, as they increase the costs incurred by the private sector, hindering project implementation. An action plan will be introduced, with a view to improving the efficiency of tax and customs administration. For tax administration, the priority will be to ensure that the Large Enterprise Directorate (formerly the SGE) has been reorganized and strengthened. In the customs area, the focus will be on reducing fraud while accelerating customs clearance procedures. The action plan, drawing on the preliminary recommendations of an IMF technical assistance mission, is attached as Attachment II.

16. The following measures have been taken to ensure proper implementation of the action plan: a committee composed of six private sector representatives and six government representatives, chaired by the Minister of Finance, was established by presidential decree in May 2003 to monitor implementation of the action plan for the tax and customs administrations. The committee, which will be in place for two years, has already approved the action plan for these reforms, and a number of measures in the action plan are being implemented, including the wider use of the computerized customs information system (ASYCUDA) at the Tamatave pilot office and the installation of ASYCUDA++, with UN Conference on Trade and Development (UNCTAD) assistance, by end-2003. To ensure that the reforms will be carried out, the following procedures will be implemented:

- The Directors General of the Customs and Tax Departments are to submit weekly reports to the committee on progress or delays in the implementation of the reforms, indicating the actions taken and, if appropriate, the reasons for delays; a copy of the weekly report will be sent to the IMF Resident Representative;

- The Directors General of the Customs and Tax Departments will be personally accountable for the strict implementation of the specific measures indicated in the reform program and must notify the committee as soon as they encounter any problems in implementation;

- The committee will prepare reports on officials of the Customs or Tax Departments whose actions may have impeded implementation of reforms; any such reports will be submitted to the government for the application of the appropriate administrative sanctions;

- The committee itself will be accountable and report to the President of the Republic; and

- The composition, authority, and responsibilities of the committee, as well as the action plan it has approved, have been broadly disseminated by the print and broadcast media.

17. The 2003 budget measure eliminating value-added tax (VAT) reimbursement for exporters and investors will be revoked. Accounting for the VAT on imports of capital goods valued in excess of the established threshold payable by enterprises, including those in the export processing zone (EPZ), will be deferred until the exporters' next VAT returns, beginning in April 2003. EPZ operators will be required to make VAT payments only after verification by the tax authorities that imported goods have not been used in exports or are not still being held in inventory at the EPZ's local establishments. This system will effectively obviate the need for EPZ operators to pay VAT on their imported inputs, unless the final product has been sold on the domestic market.

Expenditure control

18. To improve monitoring of budget execution at the stages when services are rendered (liquidation) and payment orders are issued (*ordonnancement*), the provincial budget directorates will be strengthened with the support of the World Bank and other donors. The quarterly "flash" reports on budget execution, currently limited to the Ministries of Education and Health, will be extended during 2003 to cover the Office of the Deputy Prime Minister in charge of Economic Programs, Transportation, Public Works, and Territorial Development, the Ministry of Agriculture, Livestock, and Fisheries, the Ministry of the Environment, Water, and Forests, and the Ministry of Justice. Quarterly HIPC expenditure execution reports will be drawn up as well, beginning with the report covering 2002.

19. The Treasury is moving forward with its efforts to accelerate the preparation of annual treasury balances. Balances for 2001 and 2002 will be prepared in 2003. From the beginning of 2004 onward, balance sheets will be drawn up within the regulatory deadline of three months. Furthermore, the delays in the preparation of budget execution laws will be made up: the draft budget execution law for 1999 was submitted to the Audit Court, and the draft laws for 2000 and 2001 will be submitted during 2003.

Arrears

20. A major factor behind the accumulation of arrears has been the shortage of budgetary resources to cover expenditure commitments known at the time of budget preparation. As a result of this shortcoming, those payment orders for the expenditures incurred that exceed budgetary allocations are frequently held by the spending ministries instead of being forwarded to the treasury for payment. To resolve this problem, the full amount of known

expenditure commitments will be budgeted first before other expenditure items are budgeted. This procedure will be strictly applied beginning with the 2004 budget.

21. In view of the relatively lengthy reimbursement practices, all non-VAT-related arrears (FMG 244 billion at end-December 2002) will be paid by September 30, 2003. All VAT credit reimbursement arrears to the free zone, which amounted to FMG 92 billion at end-March 2003, have been cleared. The arrears to a preshipment inspection company operating in Madagascar until April 1, 2003 have also been cleared.

22. A new mechanism for monitoring the availability of resources relative to the expenses authorized on a monthly basis will be instituted before end-May 2003. In case available resources are deemed inadequate to cover the authorized expenditure, measures will be announced to block some expenditures by the ministries in order to avoid an accumulation of arrears. In addition, the integrated public finance management system installed in Tamatave will be gradually extended to three other areas in 2003 and another three in 2004.

Fiscal performance

23. In view of the potential impact of the fiscal measures, the latest projections for 2003 indicate that the budget deficit, on a commitments basis and including grants, will amount to about 3.3 percent of GDP; the deficit on a cash basis is expected to amount to 4.3 percent of GDP, and should be financed by external resources equivalent to 3.6 percent of GDP and domestic resources of 0.7 percent of GDP, including privatization receipts of 0.2 percent of GDP. Tax revenue is expected to total 10.6 percent of GDP, as compared to 8 percent in 2002. Capital expenditure is expected to be substantially higher than in 2002, amounting to 7.3 percent of GDP compared with 4.8 percent in 2002. Current expenditure will be maintained at 10.4 percent of GDP, including priority expenditure provided in the total expenditures of about FMG 360 billion, or 1.1 percent of GDP, under the HIPC Initiative.

24. Personnel expenditure reflects a 12 percent increase in wages. This increase, planned under the 2003 budget law and agreed during the discussions on the second program review in October 2002, will enable the government to honor its commitments to improve the compensation of military personnel, which has not changed in years. In general, the government's wage policy is to grant increases on the basis of merit and resource availability.

C. Balance of Payments and External Debt

Developments

25. Exports are expected to increase by roughly 56 percent in SDR terms in 2003, thanks to a rebound in the activities of EPZ enterprises and an anticipated increase in the volume of vanilla exports. The increase in imports in SDR terms could amount to 45 percent, in particular as a result of purchases of capital goods and petroleum products. Gross external aid, including debt relief, is expected to total SDR 387 million.

Medium-term trade strategy

26. The medium-term strategy aims at enabling Madagascar to regain the market share it lost because of the political crisis and to reduce vulnerabilities by diversifying the export base within the EPZ and promoting the growth of non-EPZ exports. The latter action is of particular importance for the future growth of government revenue, which itself is essential in order to reduce the country's dependence on external assistance in the medium term.

27. The government recognizes that it is essential to preserve the competitiveness of Madagascar's exports and to restore Madagascar's reputation as a country that welcomes foreign investment. To give the country a sustainable competitive advantage, the government will implement a strategy aimed at (i) reducing transaction costs of foreign trade, which are high owing to the inadequate industrial infrastructure and the dysfunctional nature of customs administration; (ii) broaden the range of exports through diversification and integration; (iii) facilitate access to industrial land and manufacturing facilities; and (iv) provide incentives to improve the quality of human resources. Moreover, to ensure that textile exports continue to benefit from the U.S. African Growth and Opportunity Act (AGOA), it will be necessary to restructure Madagascar's cotton sector (as indicated in para. 44), in particular by privatizing the major components of the supply chain while attracting strategic investors.

Exchange rate

28. The government will continue to maintain its flexible exchange rate policy. The central bank (BCM) will intervene on the exchange market solely to dampen temporary shocks and to achieve its external reserves objectives in the context of the PRGF-supported program. For the exchange rate to be fully market determined, the BCM will reform the interbank foreign exchange market. The current open outcry system will be replaced by a continuous interbank trading system by end-December 2003. This new arrangement will enable banks to trade foreign exchange freely and continuously among themselves within their foreign exchange exposure limits. Moreover, the foreign exchange control regulations will be revised by end-December 2003, and the BCM will be entrusted with full responsibility for foreign exchange policy. Its Exchange Operations Directorate will be reorganized by end-June 2003 with technical assistance from the IMF in order to support the interbank market.

External debt

29. As regards the provision of assistance under the HIPC Initiative, the government has finalized most of the bilateral agreements with Paris Club creditors on the basis of the Agreed Minutes of March 1997 and March 2001. It will continue its contacts with non-Paris Club creditors, with a view to concluding similar agreements. An agreement on easing the government's debt vis-à-vis the European Union is being finalized. Interim assistance has

been received from the World Bank, the African Development Bank, the Paris Club, and the IMF.

D. Monetary Policy and the Banking System

30. The monetary policy objective for 2003 is to reduce inflation while ensuring adequate scope for the expansion of credit to the economy, which is essential for recovery. Accordingly, broad money growth (M3, including deposits in foreign exchange) will be limited to 13.4 percent, with a view to achieving the growth and inflation targets set for 2003. Taking into account the expected increase in the net foreign assets of the banking system, net credit to the government will remain at moderate levels in order to permit a 17.6 percent expansion in credit to the private sector, which is in line with the projected growth of nominal GDP.

Liquidity management and forecasting

31. Measures will be taken in 2003 to strengthen monetary management and to set the stage for the active use of monetary policy as an effective anti-inflation instrument. The BCM will mop up excess bank liquidity through sales of its own bills or treasury bills of various maturities; the latter in close consultation with the Minister of Finance. The resources obtained through the sales of treasury bills for mopping-up purposes will not be used by the government. In this regard, the central bank is determined to enhance the efficiency of its liquidity forecasting unit. The treasury will provide its monthly cash-flow forecasts to the BCM's liquidity forecasting unit beginning in April. The BCM's Foreign Department will provide the liquidity forecasting unit with daily information on foreign exchange purchases and sales, as well as its own forecasts. In addition, the bimonthly meetings of the monetary committee, which had been suspended, resumed in April 2003. This committee will henceforth take the liquidity forecasts into account when recommending monetary policy initiatives.

32. In 2003, the government intends to reintroduce currency notes denominated in ariary, the old currency of Madagascar, which continues to be legal tender. One ariary is equivalent to five Malagasy francs. The old and new notes will circulate freely in parallel for a sufficiently long period to ensure full familiarity of the public with the new currency. Preparations are being made for the conversion with technical assistance from the IMF, on the basis of which the date for the introduction of the new currency will be decided.

Credit availability and bank soundness

33. The following measures will be taken to promote financial intermediation. The Credit Guarantee Fund, financed in part by external resources, will cover bank lending risks and facilitate access to credit on the part of small and medium-sized enterprises. A proposal will be made to Parliament by year's end to amend the Property Act, enabling the banks to accept real estate as collateral. A draft law establishing the legal framework for microfinance operations will be prepared shortly.

34. At present, the banks are well capitalized, but their profits are falling and nonperforming loans rising. This deterioration is a source of concern and poses a challenge to banking supervision. The Banking and Financial Supervision Commission will remain vigilant in its surveillance of banks' financial viability and ensure that they establish adequate provisions against loan losses. It will also ensure that the activities of the Credit Guarantee Fund do not lead to less rigorous loan appraisals on the part of financial institutions. In addition, the commission will obtain adequate data and information on banks and enhance the technical skills of its personnel, so that they can detect and control excessive risk taking by bank. It will also establish an early warning system for bank fragility by end-September 2003.

Transparency of the BCM and CCP balance sheets

35. In order to regularize financial relations between the central bank and the government and to improve the transparency of the central bank's balance sheet, an action plan to securitize government debt to the BCM (amounting to FMG 2,137.4 billion at end-2002, of which FMG 1,100 billion in special bonds with little remuneration and FMG 524 billion in foreign currency) will be developed by end-May 2003. The securitization will be completed by end-January 2004. In addition, the central bank will discontinue granting foreign exchange loans to the government. Outstanding government debt to the BCM in foreign exchange and the government's foreign exchange deposits at the central bank not associated with donor agreements will be converted at the market exchange rate. These measures will also enable the central bank to enjoy a measure of independence vis-à-vis the government and to conduct monetary policy using indirect instruments, as well as to stimulate transactions on the money market.

36. With assistance from the Monetary and Financial Systems Department of the Fund, the central bank has begun to implement the main recommendations of Stage One safeguards assessment report. The internal audit of the central bank's foreign exchange reserves management, originally scheduled for completion by end-June 2003, has already been completed. The banking system will adopt International Accounting Standards (IAS) by 2005, the deadline set by the Malagasy High Council on Accounting for adoption of the new framework by all enterprises. In the meantime, the central bank will publish its financial statements for 2002, together with explanatory notes on the differences between its accounting method and the IAS.

37. The members of the BCM Board of Directors were named on March 20, 2003. The board has recently reviewed the BCM accounts for fiscal years 2000 and 2001, and the accounts for 2002 will be reviewed before end 2003. The central bank will create an audit committee that will approve, before end-June 2003, the action plan for the internal audit department. In addition, with technical assistance from the IMF's Legal Department, the government will submit to the Parliament, by end-2003, a new law to strengthen the regulatory framework for combating money laundering.

38. A financial and operational audit of the Postal Savings Bank (CCP) will be initiated by end-June 2003. The purpose of the audit will be to make recommendations on the management of CCPs, including separation of the CCP funds from those of the post office, and any other measures necessary to ensure the viability of the CCP system.

E. Structural Reforms

39. The financial position of the major public enterprises has weakened because of the crisis of early 2002 and serious management deficiencies. The restructuring program for the key enterprises will be pursued vigorously, aiming at opening up their capital or rehabilitating them. These enterprises play a key role in the priority areas of transportation and rural development.

40. The debts of the state oil company (SOLIMA) to the central bank amounted to FMG 338 billion at end-December 2002. The 2003 budget law provides for the assumption of these debts by the government. A repayment agreement between the government and the BCM will be drawn up by end-June 2003. SOLIMA's accounts for 2000 will be closed, finalized, and examined by the company's auditors by end-March 2003. The general meeting of the company's shareholders will examine the accounts for that year by end-April 2003, and the 2001 accounts before end-July 2003.

41. Regarding Air Madagascar, management was turned over in September 2002, in consultation with the World Bank, to a team from Lufthansa Consulting. In the framework of a two-year agreement, measures have been taken to improve management, and a different aircraft was leased at a lower cost in April when the current lease contract expired. For its part, the government will transfer an additional US$7 million to the company (in addition to the US$10 million provided in 2002).

42. The northern railroad system is being operated by a concession company. The government's contribution for rehabilitation investments and severance pay amounted to FMG 55 billion in 2002. An additional contribution of FMG 32 billion is planned in 2003. The concession holder was expected to begin operations in June 2003. The southern railroad system will be included in the management concession for the port of Manakara.

43. The successful bidder for purchase of the telecommunications company, TELMA, has been chosen. Discussions on the final terms of the sale agreement are under way. However, the privatization process runs the risk of being delayed or even reconsidered in view of a number of conditions laid down by the purchaser. In the event the process is reconsidered, other solutions for completing the privatization of this firm will be considered.

44. The government assumed the debt of the cotton company (HASYMA) to farmers, amounting to FMG 13 billion in 2002 and FMG 10 billion in 2003, to facilitate the operations of the 2002/03 crop season. A foreign company has expressed interest in taking over HASYMA's capital. In the meantime, a strategy for restructuring and privatizing HASYMA will be developed by end-June 2003.

45. The financial position of the electricity and water company (JIRAMA) has been weakened by its inability to recover claims on public entities, and by management inefficiencies. The government provided FMG 55 billion in December 2002 to settle oil companies' claims on JIRAMA. Plans are being finalized to place the company under contract with a specialized foreign firm. An audit of the company's operations and financial condition will begin by June 15, 2003 and be completed by mid-August. The audit firm has been chosen, and financing secured by the World Bank. The contract for the management of the company will be put up for tender by early September 2003, and the selection process will be terminated by the end of the year. The company will be placed under new management in January 2004. Several foreign firms have expressed interest in managing JIRAMA, and a speedy selection process is expected. In the meantime, a consultant has been recruited with World Bank assistance to study JIRAMA's tariff structure. JIRAMA's tariffs will be adjusted on the basis of the findings of this study.

46. A medium-term civil service reform strategy will be prepared by end-2003. Civil service reform is essential to enhance the efficiency and transparency of public services, and it may also contribute to curbing the growth of this sector's wage bill in the medium term.

III. Preparation of the Poverty Reduction Strategy Paper

47. The poverty reduction strategy paper (PRSP) has been finalized. It presents an in-depth diagnostic analysis of poverty trends in recent years, the main areas of focus, the key medium-term objectives, and the costs of the programs required to achieve them. The objectives and actions have been prioritized in light of resource availability. The government hopes to be able to attain the completion point under the HIPC Initiative in 2004, after one year of implementation of the PRSP.

48. Two medium-term scenarios are outlined in the PRSP. The high-growth scenario seeks to achieve a growth rate of 7 percent a year on average during 2004–06. Under this scenario, the private sector savings rate will be substantially higher than in the recent past, and the country's absorptive capacity will expand sufficiently to allow productive utilization of the larger resources. The low-growth scenario assumes average annual growth during 2004–06 will be 4.5 percent, almost the same as that during 1998–2001.

IV. Program Monitoring

49. The program supported by the IMF under the PRGF will be monitored through the semiannual reviews and quantitative and structural performance criteria, indicative targets, structural benchmarks, and quarterly monitoring indicators shown in Tables 1 and 2. The performance criteria for end-June 2003 and end-December 2003 relate to the net foreign and domestic assets of the BCM, domestic financing of the budget deficit (bank financing, nonbank financing, net change in the deposits of treasury correspondents, privatization receipts, and the net accumulation of domestic arrears), tax receipts, the nonaccumulation of external arrears (to be followed on a continuous basis), and a ceiling on nonconcessional

external government borrowing. The targets for these variables for end-September 2003 constitute benchmarks for program monitoring.

50. The following measures constitute prior actions for completing the third review under the PRGF arrangement with the IMF: (i) VAT reimbursement arrears to the free zone in the amount of FMG 92 billion (as of end March 2003) will be settled; (ii) external commercial arrears to a preshipment inspection company will be settled; (iii) a bipartite (private-public) committee will be established by presidential decree to monitor implementation of the action plan for the reform of the tax and customs administration (Appendix III, Attachment II); (iv) an audit of JIRAMA's operations and financial condition will be initiated; (v) the general shareholders' meeting of the oil company (SOLIMA) will examine the accounts for fiscal 2000; and (vi) a repayment agreement will be reached between the government and the BCM covering SOLIMA's debt for petroleum imports to the BCM assumed by the government.

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets for 2002-03 under the PRGF Arrangement
(In billions of Malagasy francs, unless otherwise indicated) 1/

	2002			2003			
	December			March	June	September	December
	Performance Criteria	Adjusted	Actual	Indicative Targets	Performance Criteria	Indicative Targets	Performance Criteria
I. Indicative targets and performance criteria							
Ceiling on external arrears (in millions of SDRs) 2/ 3/	0.0		0.0	0.0	0.0	0.0	0.0
Floor on net foreign assets (NFA) of the central bank 2/ 4/ 5/ 6/	-142.3	-455.3	-319.3	59.4	-16.1	73.9	487.0
Ceiling on net domestic assets (NDA) of the central bank 2/ 5/ 6/ 7/	707.7	1,020.8	514.9	-448.3	-114.7	-152.3	-465.2
Ceiling on domestic financing of the government 7/ 8/ 9/	530.9	843.9	556.5	-103.8	-142.0	-116.9	-108.8
Ceiling on contracting or guaranteeing of external debt on nonconcessional terms 10/	0.0		0.0	0.0	0.0	0.0	0.0
Floor on tax revenue	2,162.3		2,304.2	755.0	1,700.0	2,480.0	3,509.0
II. Indicative limits							
Ceiling on reserve money 2/	415.3		150.2	-464.4	-263.0	-236.4	-165.0
Ceiling on broad money (including foreign currency deposits) (M3) 2/	875.1		575.7	43.8	605.0	817.3	1,063.0
Floor on arrears payments				198.3	290.0	341.6	341.6
Ceiling on accumulation of domestic arrears				0.0	0.0	0.0	0.0
III. Memorandum items:							
Budget support grants and loans (in millions of SDRs)	110.4		67.7	42.7	89.3	111.3	123.3
Cash debt service (in millions of SDRs)	38.3		31.2	6.2	18.2	25.3	40.9
Privatization proceeds	49.4		46.5	0.0	21.4	73.2	83.5
Privatization related costs	9.5		0.0	0.0	0.0	0.0	0.0

1/ Cumulative change since end-December.
2/ Based on actual central bank data for end-March 2003.
3/ Excludes all debt service outstanding that is subject to rescheduling. During the program period, the government will not accumulate any new arrears.
4/ Defined as gross reserves minus all foreign liabilities of the BCM, both long and short term, including use of Fund credit, evaluated at the program exchange rate.
5/ Adjusted for any excess disbursements of external budget support (grants and loans; in millions of SDRs) relative to the cumulative amounts indicated in III.
6/ Adjusted for any deviation from programmed amounts of privatization receipts from abroad, net of privatization-related outlays.
7/ Adjusted for the impact of exchange rate changes.
8/ Excludes the assumption by the government of debt of the state petroleum company SOLIMA toward the BCM.
9/ Defined as bank and nonbank financing plus treasury correspondent account (net), privatization receipts, and net accumulation of arrears.
10/ Excluding normal import-related credits.

Table 2. Performance Criteria, Structural Benchmarks, and Prior Actions
Under the 2002/03 PRGF-Supported Program

Performance criteria, benchmarks, and prior actions	Timing	Status
I. Structural performance criteria		
a. New regulations will be adopted, in consultation with the Fiscal Affairs Department of the Fund, introducing a system authorizing the deferment of the VAT payment obligations on capital goods imports until the monthly declaration following the import.	By June 2003	
b. Draft budget execution laws for 2000 and 2001 will be submitted to the Audit Court	By end-December 2003	
II. Structural benchmarks		
a. Treasury's monthly balance sheets up to end 2001 will be prepared.	By end-June 2003	
b. An activity plan will be drawn up for the central bank's internal audit department, along with an organizational chart for internal audit supervision by the various components of the bank;	By end-March 2003	Done
c. The general shareholders meeting of the oil company SOLIMA will examine the accounts for fiscal 2001.	By end-July 2003	
d. An internal audit of the management of central bank reserves will be conducted.	By end-June 2003	
e. The existing system of exchange rate determination will be replaced by a continuous interbank trading system.	By end-December 2003	
III. Prior actions		
a. VAT reimbursement arrears, amounting to FMG 92.5 billion at end-March 2003, will be settled.	By end-May 2003	Done
b. External commercial arrears to a preshipment inspection company will be settled.	By May 2003	Done
c. A bipartite committee (private-public) will be established by presidential decree to monitor implementation of the action plan for the reform of the tax and customs administrations.	By end-May 2003	Done
d. An audit of JIRAMA's operations and financial condition will begin.	By June 15, 2003	
e. The general shareholders meeting of the oil company SOLIMA will examine the accounts for fiscal 2000.	By end-May 2003	Done
f. A repayment agreement will be signed between the government and the BCM covering the SOLIMA debts vis-à-vis the BCM assumed by the government.	By end-May 2003	Done

Rehabilitation of Tax and Customs Administrations

Draft Timetable

Recommended action	Implementation date
1. Customs administration	
• Establish a surveillance committee	March 2003
• Improve morale of customs staff	
- Create a central anticorruption unit in the DGD	May 2003
- Record complaints	Immediate
- Dismiss staff found guilty of corruption	Immediate
- Provide each staff member with a professional ethics code	April 2003
• Management and supervision of staff	
- Strengthen supervision through instructions and management indicators	April 2003
- Strengthen the internal audit and inspection unit	May 2003
- Define the responsibilities of unit chiefs	May 2003
• Comprehensive use of ASYCUDA system Simultaneous introduction of new declaration channels	
- At Toamasina-Port and Toamasina-Petroleum pilot offices	May 2003
- At Antanimena and in SCRS [Standing Committee on Research and Statistics] units	September 2003
• Securing procedures and collections	
- Introduce obligation to pay by draft	June 2003
- Secure effective receipt, using airport example	April 2003
- Develop and disseminate values file	March 2003
- Have administrative assistants monitor certificates of origin	March 2003
- Enhance professionalism of investigative and surveillance staff	May 2003
• Simplification and acceleration of customs clearance	
- Eliminate systematic physical inspections	April 2003
- Enhance ex post controls	April 2003
• Preinspection of goods	
- Develop a partnership relationship with inspection company	April 2003
- Emphasize valuation checks and transfer of authority	April 2003
2. Tax administration	
• Rehabilitation of the large taxpayer unit (SGE)	
- Reorganize the SGE	February-May 2003
- Strengthen pursuit of tax delinquents	Immediate
- Introduce a procedure for payment by bank draft	March-September 2003
- Improve the selection and training of staff	March-December 2003
• Staff organization and monitoring	
- Introduction of management indicators	February-April 2003
- Redefine the role of central offices	February-March 2003

Rehabilitation of Tax and Customs Administrations
Draft Timetable

Recommended action	Implementation date
• Enterprise registration	
- Modify the registration procedure (decentralization, elimination of duplications, etc.) and create a central file	April-December 2003
- Eliminate provisional tax identification numbers (NIFs)	April-June 2003
• Taxpayer information and education	
- Establish a committee made up of representatives of the DGI and economic agents	June 2003
- Develop an enterprise education program	March-December 2003
- Create a taxpayer outreach office within the SGE	June 2003
• Pursuit of tax delinquents and collection proceedings	
- Systematically pursue tax delinquents	Immediate
- Prepare and implement a program to strengthen proceedings to collect: * balances unpaid for more than 18 months	February-June 2003
* balances unpaid for less than 18 months	By December 2003
• Strengthen tax auditing	
- Increase tax auditing staff in order to permit the auditing of 25-30 percent of enterprises	March 2003-June 2004
- Introduce a selective procedure for information gathering by the investigative team	June 2003
- Simplify the procedure for seeking collection of tax adjustments	February-April 2003
• Extension of SGE methods and procedures to other units	June-December 2003
3. **Measures to improve administration of the tax system**	
• VAT exemptions	
- Reduce VAT exemptions	Next budget law
- Introduce the system for deferred VAT payment	March-July 2003
• Reimbursement of VAT credits	
- Revoke the measure precluding reimbursement for exporters and investors	July 2003

MADAGASCAR

Technical Memorandum on Monitoring the 2002-2003 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 benchmarks for the program, how they are calculated, and any adjustments deemed necessary. It also explains the monitoring variables, that is, anticipated balance of payments assistance and direct investment flows connected with the privatization of public enterprises. Unless otherwise indicated, in the case of stocks variables for end-December 2002 are expressed as cumulative variations from December 31, 2001, and in the case of flows as cumulative flows from January 1, 2002. Variables for 2003 are expressed as cumulated variations from December 31, 2002 in case of stocks, and cumulated flows from January 1, 2003 in case of flows. The objectives for end-March and end-September 2003 are benchmarks; those for end-June 2003, and end-December 2003 are performance criteria.

I. Quantitative Criteria

A. Ceiling on External Payments Arrears

2. This variable is expressed in terms of the stock of arrears. These arrears will consist of all overdue debt-service obligations (i.e., payments of principal and interest) arising in respect of loans contracted or guaranteed by the government or the BCM including unpaid penalties or interest charges associated with these arrears, excluding arrears resulting from nonpayment of debt service for which rescheduling negotiations are under way. This performance criterion should be observed on a continuous basis.

B. Ceiling on Nonconcessional External Borrowing

Definition

3. The nonaccumulation of nonconcessional debt contracted or guaranteed by the government is a performance criterion. 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 government of Madagascar or guaranteed by the government of Madagascar, but excludes debt contracted under rescheduling agreements and normal import-related credits of less than one year.

Calculation method

4. Calculation of the degree of concessionality of new external borrowing is based on the 10-year average of the OECD's commercial interest reference rate (CIRR) for loans with maturities greater than 15 years and the six-month average CIRR for loans 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 difference between gross international reserves and all foreign liabilities of the Central Bank of Madagascar (BCM), including debt to the IMF and other short- and long-term liabilities of the BCM. Gross international reserves are defined as assets in convertible currency which readily available to and controlled by the BCM for financing payments imbalances, excluding assets that are pledged, collateralized, or otherwise encumbered.

Calculation method

6. For purposes of calculating this criterion, NFA must be converted into Malagasy francs (FMG) at the program exchange rate.

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

Definition

7. The BCM's NDA include net credit to the government, credit to enterprises and individuals, claims on banks, liabilities to banks in the form of central bank deposit auctions (*appels d'offres négatifs*), and the other items net, excluding the foreign exchange adjustment item.

8. Foreign exchange deposits must be converted into FMG at the program exchange rate.

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

Definition

9. Net domestic financing requirements of the central government are defined as the sum of (a) the variation in the stock of the central government's domestic debt to the banking system and nonbank, and variation in net debt to treasury correspondents; (b) domestic or foreign receipts from privatization operations as defined in Section III-B of this Technical

Memorandum; and (c) the variation in central government domestic arrears. Central government (CG) corresponds to the scope of operations of the treasury as indicated in the Overall Treasury Operations table (*Opérations globales du Trésor, or* OGT) .The change in deposits of the treasury correspondents (*correspondants du Trésor)* is considered a component of domestic financing.

10. The variation in the stock of domestic payments arrears consists of the amount to be recommitted and net payments delays (clearings, items in process of payment, expenditure committed but with no payment orders issued), as defined in the OGT.

11. Net bank claims consist of BCM and commercial bank claims on the CG, including auctioned treasury bills (BTAs) and other treasury bills and liabilities, net of CG deposits with the BCM and commercial banks, including foreign currency deposits. The change in net bank claims is defined excluding the impact of exchange rate changes on net bank claims on the government.

12. Nonbank claims consist of BTAs and other treasury bills (BTs) and bonds placed with nonbank institutions and the public. The valuation of nonbank claims is based on the change in outstanding conventional treasury bills (maturities of 1 to 5 years), auctioned treasury bills (maturities of 1 month to 3 years), and outstanding domestic government loans (Lova and Hasimbola).

Calculation method

13. Deposits in foreign exchange must be converted into FMG at the program exchange rate.

14. BTAs must be posted at their net value at time of initial issue.

F. Floor on Tax Revenue

15. Tax revenue includes that received by the treasury, but also suspense items, including those related to the public investment program.

II. Indicative Limits or Ceilings

A. Ceiling on Reserve Money

Definition

16. Reserve money consists of notes and coins issued and demand deposits of commercial banks with the BCM (including both required and excess reserves).

17. Central bank deposit auctions (*appels d'offres négatifs*) are excluded from reserve money and are classified in NDA.

B. Ceiling on Broad Money

Definition

18. Broad money (M3) includes notes and coins in circulation, demand and time deposits with banks, including foreign currency deposits of residents, and bonds issued by banks.

Calculation method

19. Foreign currency deposits must be converted into FMG at the program exchange rate.

C. Floor on Payment of and Ceiling on Accumulation of Payments Arrears

Definition

20. Payments arrears consist of (1) all expenditure for which payment orders have been issued but have not been paid by the treasury within three months, and (2) the amount of VAT reimbursable to taxpayers which has not been reimbursed after three months.

III. Monitoring Variables and Memorandum Items

A. Projected Balance of Payments Assistance

Definition

21. External balance of payments assistance is defined as loans and grants (nonproject) provided as structural adjustment financing and resulting in funds available to the treasury. It excludes the assistance that gives rise to counterpart funds for the treasury with a delay longer than one year.

Calculation method

22. Financial assistance in foreign exchange must be converted into FMG at the program exchange rate. Assistance in kind must be posted when the counterpart funds are deposited with the treasury.

B. Projected Investment Flows Connected with the Privatization of Public Enterprises

Definition

23. The cost of privatization operations is included above the line in central government operations. Apart from covering reform-related costs, **gross receipts from the privatization of public enterprises (PEs)** will be used to reduce outstanding domestic debt.

IV. Adjusters

A. Excess/Shortfall in Balance of Payments Assistance

24. In the event that net external financing (balance of payments assistance less public debt service on a cash basis) exceeds the amount programmed: (i) the floor on the BCM's NFA will be adjusted upward (the adjustment will be converted at the program exchange rate); (ii) the ceiling on the BCM's NDA will be adjusted downward (the adjustment will be converted into FMG at the exchange rate used in the operation); and (iii) the ceiling on the net domestic financing requirements of the central government will be adjusted downward (the adjustment will be converted into FMG at the exchange rate used in the operation).

25. In the event of a shortfall in net external financing at end-March, end-June, end-September, or end-December 2003 against the programmed amount for the corresponding period of 2003, the floors and ceilings will be adjusted as follows: by a maximum of SDR 12 million for the first quarter 2003; by a maximum of SDR 45 million for the first half of 2003; and by a maximum of SDR 55 million for the first nine months of 2003 and for the full year 2003, according to the following method: (i) the floor on the BCM's NFA will be adjusted downward by the amount indicated above (the adjustment will be converted at the program exchange rate); (ii) the ceiling on the BCM's NDA will be adjusted upward by the same amount (the adjustment will be converted into FMG at the program exchange rate); and (iii) the ceiling on the central government's net domestic financing requirements will be adjusted upward and capped at the above-mentioned maximum amount (the adjustment will be converted into FMG at the program exchange rate).

B. Privatization-Related Transactions

26. Adjustments will be made for any deviation in (a) privatization receipts; and (b) current privatization-related expenditure. **The floor on net foreign assets** will be adjusted upward or downward by a maximum of SDR 12 million from the programmed floor if net disbursed foreign resources from privatizations are higher or lower than programmed. The adjustment will be limited to a maximum of SDR 5 million for the periods from end-2002 to end-March, end-June, end-September, and end-December 2003. Similarly, the BCM's NDA will be adjusted downward or upward (at the average exchange rate of the pertinent quarter). **The ceiling on domestic government financing** will be adjusted to take account of any discrepancies between actual privatization-related expenditures and those

programmed (upward adjustment if expenditure exceeds the amount programmed and downward, in the opposite case, up to the difference reported).

C. Program Exchange Rate

27. Amounts of balance of payments assistance and debt service denominated in SDRs will be converted into FMG at the FMG/SDR exchange rate of FMG 9,108, FMG 9,240, FMG 9,372, or FMG 9,514=SDR 1 for each of the four quarters of 2003, respectively. Corresponding amounts denominated in U.S. dollars and in euro will be converted by applying the rate of US$1.38=SDR 1 and US$1.09=€1, and the FMG/SDR rate indicated above.

V. Consultations with Fund Staff on the Performance Criterion for NFA and the Broad Money Benchmark

28. In the event that demand for money is stronger than expected and the exchange rate appreciates, the central bank should intervene on the interbank foreign exchange market (MID) to offset this appreciation, taking into account programmed limits (floor/ceiling) on the accumulation of net foreign assets and the level of broad money. Given the program limits on these criteria and benchmarks, if broad money growth since end-December 2002 exceeds 15 percent and/or if the level of net foreign assets exceeds the programmed level by more than 5 percent of broad money at end-2002, the authorities will consult Fund staff on measures to be taken in the context of exchange market and monetary policy management.

VI. Information and Data to be Supplied to Fund Staff

29. The Malagasy authorities will provide Fund staff with the following information and data according to the schedule provided, either directly (e-mail or facsimile) or through the Fund's resident mission.

A. The Central Bank of Madagascar will report the following statistics:

30. 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;
- information on monetary developments, as required by the Statistics Department of the International Monetary Fund (STA);
- monthly balances 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 (required reserves and free reserves);
- the foreign exchange cash flow table, including foreign debt operations; and
- table of interbank foreign exchange operations on the interbank foreign exchange market (MID);

31. Quarterly:

- data on foreign trade (exports and imports).

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

32. Weekly:

Weekly report of the customs and tax directors to the committee monitoring the customs and tax administration reforms.

33. Monthly:

- OGT data on a cash and commitment basis and the related tables;
- expenditure on structural reform;
- central government revenue and expenditure, including short-term treasury on-lending;
- treasury liabilities (statutory advances and operations on the treasury bill market);
- central government capital expenditure;
- external public debt operations (debt contracted and publicly guaranteed, settlement of arrears, and operations of public enterprises) and debt service paid;
- the consumer price indexes; and
- indicators of sectoral economic activity.

34. 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 will be reported to Fund staff on a timely basis for consultation or information, as appropriate.

/s/

Gaston Ravelojaona
Governor
Central Bank of Madagascar
Antananarivo, Madagascar

/s/

Henri Bernard Razakariasa
Secretary General
Ministry of Economy, Finance,
and Budget
Antananarivo, Madagascar

/s/

Reza Vaez-Zadeh
Assistant Director
African Department
International Monetary Fund

Madagascar: Relations with the Fund
(As of April 30, 2003)

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

II. **General Resources Account**:	**SDR Millions**	**% 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 Millions**	**% Allocation**
Net cumulative allocation	19.27	100.00
Holdings	0.11	0.56

IV. **Outstanding Purchases and Loans**:	**SDR Millions**	**% Quota**
Poverty Reduction and Growth Facility (PRGF) arrangements	108.65	88.91

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR millions)	Amount Drawn (SDR millions)
PRGF	03/01/01	11/30/04	79.43	34.04
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 (without HIPC Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	4.07	5.42	8.14	16.87	17.56
Charge/Interest	0.79	0.85	0.81	0.74	0.66
Total	4.86	6.27	8.95	17.62	18.22

Projected Payments to Fund (with Board-approved HIPC Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	1.90	5.42	8.14	16.87	17.56
Charges/Interest	0.79	0.85	0.81	0.74	0.66
Total	2.69	6.27	8.95	17.61	18.22

VII. Implementation of HIPC Initiative:

Commitment of HIPC assistance	Enhanced framework
Decision point date	12/21/2000
Assistance committed (NPV terms)	
Total assistance (US$ Million)[1]	814.00
Of which: Fund assistance (US$ million)	21.60
(SDR equivalent in millions)	16.60
Completion point date	Floating
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to the member	5.01
Interim assistance	5.01
Completion point balance	--
Additional disbursement of interest income[2]	--
Total disbursements	5.01

VIII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the Central Bank of Madagascar (CBM), is subject to a full Stage One safeguards assessment with respect to the PRGF arrangement, which was approved on March 1, 2001 and is scheduled to expire on November 30, 2004. An off-site safeguards assessment of the CBM was completed on November 12, 2001. The assessment concluded that an on-site assessment was not necessary, but identified certain weaknesses and made appropriate recommendations, as reported in EBS/01/193, November 21, 2001. These weaknesses are being addressed with the assistance of MFD.

IX. 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

---

[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.

[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.

ceased the practice of adjusting the exchange rate to offset inflation differentials with key trading partners. Since May 9, 1994, the Malagasy franc has been determined through an open outcry auction system. The exchange rate in terms of the SDR at end-March 2003 was FMG 8,840 = 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.

X. Last Article IV Consultation:

Madagascar's consultation cycle is governed by the decision approved by the Executive Board on July 15, 2002. This decision stipulates that, subject to certain exceptions, an Article IV consultation with a member receiving financial assistance under a Fund arrangement is expected to be completed within 24 months of the conclusion of the previous Article IV consultation. The 2002 Article IV consultation discussions with Madagascar were held during October 7-12 in Antananarivo and during November 11-13 at headquarters. The staff report was discussed by the Executive Board on December 23, 2002.

XI. 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.

Department	Dates	Purposes	Results of Missions
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.
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 preshipment inspection company and the customs department, the computerization strategy, and organizational issues.

Department	Dates	Purposes	Results of Missions
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	February-March 2003	Examine and assess tax and customs administrations	Awaiting final report. Action plan and oversight committee established.
MAE	August 1993–99	Assign a bank supervision advisor and assist in the adoption of an interbank foreign exchange market.	Supervisory agency strengthened.
MAE	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.
MAE	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.
MAE	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.

Department	Dates	Purposes	Results of Missions
MAE	December 1998	Prepare the change to the euro as pivot currency.	Euro introduced as scheduled.
MAE	May-June 1999	Prepare for introduction of continuous-quotation foreign exchange market, including procedures manual and market rules.	To be implemented by end-2003.
MAE	October-November 1999	Assess exchange regulations and Compliance with the Core Principles for effective banking supervision.	Recommendations on banking regulation to be adopted.
MAE	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.
MAE	November 2002	Take an inventory of microfinance institutions and define a strategy for their supervision.	Recommendations being implemented.
MAE	November 2002	Assess management of foreign reserves and propose concrete steps for its improvement.	Recommendations being implemented.
MAE	March 2003	Review of central bank internal audit functions.	Awaiting final report.
MAE	March 2003	Microfinance regulation.	Awaiting final report.
MAE	June 2003	Currency Reform	Mission's recommendations being formulated

Department	Dates	Purposes	Results of Missions
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 currently being adopted.
STA	July-August 2001	Review money and banking statistics.	Recommendations for data improvements accepted and are being adopted.

XII. Resident Representative:

Madagascar has had a Fund Resident Representative since September 1989. Mr. Gregory Dahl took up the post as Senior Resident Representative at end-August 2000.

Madagascar: Relations with the World Bank
(As of April 6, 2003)

Partnership in Madagascar's post-crisis recovery

1. With the resolution of the political crisis in July 2002, the World Bank was in a position to accelerate its assistance because suspension of projects had been avoided during the crisis. As an immediate response to the crisis, the World Bank prepared an Interim Country Assistance Strategy (I-CAS), centered around the (i) restructuring of the project portfolio to better align project with post-crisis recovery needs; (ii) preparation of an Emergency Economic Recovery Credit (EERC) in the amount of US$50 million; and (iii) preparation of a Rural Transport Project in the amount of US$80 million. The Bank's interim objective until the end of 2003 is to limit and reverse the impact of the crisis on the poor by supporting the government's reconstruction and recovery program. Particular emphasis is given to (i) supporting a safety net for the poor; (ii) assisting the private sector to restart production; and (iii) ensuring a minimum of public service delivery.

2. The political crisis ended in July 2002, but the social and economic impact is extremely pronounced, especially on a country with a GNP per capita of US$260 (in 2000), one of the poorest in the world even before the crisis had commenced. The direct negative impact on national income for 2002 was estimated at half a billion dollars. The total economic cost is much larger, taking into account the loss of confidence, foregone direct investments, foregone exports and physical destruction.

3. On July 26, 2002, the new government presented its reconstruction and development program to the 'Friends of Madagascar' conference organized by the United Nations Development Program, the European Commission and the World Bank at the Bank's Paris Office. Representatives of 17 countries and 19 organizations attended the conference. Donors expressed strong support for the economic and social program of the government of Madagascar and underlined the importance of adhering to principles of good governance, promoting development of a strong private sector, and reducing poverty. In addition, participants emphasized the importance of formulating a poverty reduction strategy in an inclusive way. To support these objectives, donors pledged approximately US$2.3 billion over a period of four years.

Bank Group Strategy and lending operations

4. The Bank's portfolio consists of 16 projects with total commitments of around US$748 million, of which about US$277 million was disbursed as of April 6, 2003. Of total commitments, around 36 percent are in the social sectors, 20 percent in infrastructure, transport, energy and mining, 16 percent in rural development and environment, 10 percent in institutional development, and 18 percent correspond to macro-economic adjustment. In December 2001, before the crisis started, implementation of all projects but one was rated satisfactory.

5. Portfolio implementation during the crisis greatly suffered because: (i) counterpart funds were not available (which is not a new phenomenon but worsened during the crisis); (ii) procurement of certain goods and works was stopped due to problems within the relevant government agencies; (iii) decision-making authority was unclear; (iv) sector ministries were unable to function; and (v) project activities could not be carried out in certain areas of the country. During the crisis, the implementation performance of 16 projects out of 19 was rated unsatisfactory. But since the end of the crisis, almost all projects have readjusted their work plans and have recommenced normal – and in most cases accelerated – implementation.

6. In response to the end of the political crisis, the World Bank prepared an Interim Country Assistance Strategy (I-CAS) which was presented to the Board of Executive Directors in November, 2002. The I-CAS' objective is to assist the government to mitigate the impact of the crisis on the poor by supporting selected areas of the government's program. Bank instruments used in response to crises include: portfolio restructuring (including a measure which waves the provision of nontax counterpart funds for selected projects until the end of 2003), new lending (including an emergency credit) and policy advice. The mix of these instruments is determined by (i) the Bank's objective of limiting the impact on the poor; and (ii) the activity of other partner organizations in Madagascar. Table 1 outlines the planned instruments by objective. Together with the Interim Country Assistance Strategy, the Board of Executive Directors of the World Bank approved the Emergency Recovery Credit and the Rural Transport project which have since commenced operation.

TABLE 1: GOVERNMENT STRATEGY AND BANK INSTRUMENTS

	Support to Most Vulnerable	*Assisting Private Sector in Recovery*	*Ensuring Minimum of Public Service Delivery*	*Improving Governance and reducing corruption*
Portfolio Restructuring	Child Nutrition, Community Development, Micro-finance	PSD-2, Transport	Health, Education, Rural Development	Second Structural Adjustment Credit
New Lending	Rural Transport ($80 million)	EERC ($50 million)		Mining ($30 million)
Policy Advice/ AAA	Rural Development and Poverty, Poverty monitoring w/ partners	Tourism Sector Note, EPZ study	Decentralization Study	Country Procurement Assessment, Country Financial Accountability Assessment

7. As outlined in Table 1, the Bank is planning to support the new government through analytical work and policy dialogue in several areas. Most of the studies had already commenced before the crisis and are now re-orientated to meet urgent information needs. Policy notes have already been produced on recent poverty developments, the economic cost of the crisis and priorities for reconstruction, as well as on short-term policy to strengthen communities. In addition to the ongoing work on poverty monitoring, the Bank plans to

continue working on six formal analytical studies which will also feed into the preparation of the PRSP and will be future building blocks for a possible next adjustment operation. The work includes a report on rural development and poverty reduction, a decentralization study, a study on measures to revive the EPZ, a tourism study, a financial management review, and a country procurement review. A report on poverty developments was completed in FY02. Thus, all of IDA's core economic diagnostic work is expected to be up to date by the end of FY03 with the exception of a public expenditure review and a Country Economic Memorandum which the Bank intends to carry out in FY04 and FY05, respectively. The program of analytical work also provides the basis for a future Poverty Reduction Strategy Credit (PRSC), which is foreseen during the CAS period following this interim CAS.

8. For the period November 2002-June 2003, the interim CAS foresees three new lending operations for a total of about $160 million:

(i) *Emergency Economic Recovery Credit (US$50 million).* To address urgent financing needs for the next 12 months that cannot be provided through the existing Bank portfolio, this credit over US$50 million will help Madagascar relaunch its economy and support the country's most urgent needs (approved November, 2002);

(ii) *Rural Transport Project ($80 million).* Poverty in Madagascar is closely linked to isolation from markets and social services. The project will help lower the access costs of rural communities to markets, schools, health centers and other economic and social infrastructure; and enhance the mobility of the rural population to improve their quality of life. This project is part of a sector-wide program co-financed by the European Union, the African Development Bank and the Arab Bank for Economic Development in Africa (approved November, 2002);

(iii) *Mineral Resources Governance Project ($30 million).* Severe governance problems have characterized Madagascar's mining sector for years but the crisis offers the possibility to decisively reduce illegal activities in the sector. The objectives of the Mineral Resources Governance Project are to (i) strengthen transparency and governance in the management of mineral resources, with special emphasis on small-scale and artisanal mining, (ii) support key institutional reforms for the decentralized management of mineral resources; and (iii) promote private investments and value-added in the mining sector (expected Board presentation May, 2003).

IMF-World Bank Collaboration in Specific Areas

9. IMF and World Bank staff maintain a close working relationship, especially with respect to (i) completion of the full Poverty Reduction Strategy Paper; (ii) reforms set out at the decision point of the Highly Indebted Poor Countries Initiatives; (iii) analyses and reforms in public financial management; (iv) other governance reforms, including customs; (v) support of the privatization program; and (vi) participation in the integrated framework

trade project. Table 2 includes a short description of each of the areas and specific support from the two institutions with respect to policy advice.

TABLE 2: BANK/FUND COLLABORATION

Area	*Description*	*Specialized Advice/ Reforms Supported by Fund*	*Specialized Advice/ Reforms Supported by Bank*
Completion of full PRSP	Together with multi- and bilateral donors, Bank/Fund work provide continuous technical assistance toward completion of full PRSP, planned in 2003	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	Expenditure monitoring and analysis, especially in sectors important for poverty reduction
Other governance reforms	New government has embarked on large governance reform agenda; Bank/Fund staff work closely with UNDP/EU/BAfD staffs on assisting development of implementation plans	Customs	Anti-corruption agenda, decentralization, judicial sector reform
Privatization Program	Close joint monitoring of government's large privatization program comprising four major and several dozen smaller public enterprises	All sectors, especially monitoring of privatization receipts of large enterprises (petroleum, telecom)	All sectors. Reforms in petroleum, telecom, and air transport sector are linked to ongoing adjustment program.
Integrated Framework/ Trade Analytical Work	Draft Integrated Framework paper completed beginning 2002; validation workshops to be organized till end-2002	Macro projections for IF framework paper	Sectoral analysis for IF framework paper

10. Areas where the **Fund takes the lead role** relate to policy advice and reforms with respect to (i) overall economic policy advice and targets for macroeconomic 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. The government has requested a tax policy technical assistance mission from the Fiscal Affairs Department, which is planned for the beginning of 2003.

11. 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 to a number of analytical studies that are currently being completed (see paragraph 7 above): a poverty assessment, a study on the Export Processing Zone, on the tourist sector, a rural development review as well as two important diagnostics for future budget support operations: a Country Procurement Review and a Country Financial Accountability Analysis (CFAA). The Procurement Review and the CFAA are both expected to be completed by mid-2003. Further, the Bank is starting a Public Expenditure Review during which much consultation with the Fund team will take place.

12. **Joint responsibility** for policy advice between the Bank and the Fund concern (i) budgetary procedures, including expenditure execution; (ii) the functioning of internal and external budget control institutions; (iii) reform of customs; (iv) trade policy; and (v) monitoring and continuation of the privatization program. Further, the two institutions jointly support the PRSP process, the HIPC process, and the completion of the Integrated Framework trade initiative (see Table 2 above).

TABLE 3: MADAGASCAR: FINANCIAL RELATIONS WITH THE WORLD BANK GROUP

Statement of active IDA credits (as of April 6, 2003 in millions of US$)

ID	Project	Net Commited	Total Disbursed	Closing Date
P055166	Community development project	110.0	28.8	30-Jun-07
P051922	Rural development support project	89.1	8.9	30-Jun-07
P051741	Second health sector support project	40.0	11.9	31-Dec-06
P052208	Transport sector reform and rehabilitation	65.0	28.6	31-Jul-05
P052186	Micro finance	16.4	7.7	31-Dec-04
P001568	Nutrition II	27.6	20.9	31-Jan-04
P001564	Rural water sector pilot	17.3	7.2	31-Dec-03
P001559	Education sector development	65.0	29.1	31-Oct-03
P001533	Energy sector development project	46.0	35.2	30-Jun-03
P048697	Urban infrastructure	35.0	16.6	30-Jun-04
P001537	Environment II	30.0	30.0	30-Jun-03
P080345	EERC	50.0	15.8	31-Dec-03
P073689	Rural Transport	80.0	0.0	30-Jun-09
P072160	Private Sector Development II	23.8	0.8	30-Jun-06
P064305	Social Fund III	33.1	33.1	30-Jun-03
P072987	Multisectoral STI/HIV/AIDS	20.0	2.0	31-Dec-06

13. Questions may be referred to Mr. Willem van Eeghen (473-2399), Country Program Coordinator for Madagascar at the World Bank.

Madagascar: Statistical Issues

1. Madagascar's database remains weak, particularly the real sector, government finances, the balance of payments, and social indicators. 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 taking steps to participate in the General Data Dissemination System (GDDS). To this end a GDDS coordinator has been approved and metadata are under preparation. STA balance of payments and monetary and financial statistics technical assistance missions visited Antananarivo in June and July 2001, respectively.

Real sector

2. The introduction in 1996 of a system of regular business surveys has contributed somewhat to an improvement in the compilation of national accounts data. However, data remain weak and incomplete, particularly for the agricultural sector. Data on the use of resources are also inadequate, and data for changes in inventories are not reported. Short-term indicators of economic activity, are not generally available. Significantly, in January 2002, the publication of a quarterly index of industrial production by export processing zone (EPZ) enterprises was introduced, with external technical and financial assistance. There are plans to begin developing a quarterly industrial production index (covering non-EPZ enterprises), should discussions concerning UNDP financial assistance be completed early. Plans to revise the national accounts methodology and update national accounts on the basis of the 1995 input-output table have been delayed for several months due to the political crisis.

3. A revamped consumer price index (CPI), with weights based on the1993 household survey and covering four principal cities, was introduced in July 2000. The CPI is generally reported to Fund staff on a timely basis; however, during the period January-August 2002, the compilation of the price index was disrupted and reporting delayed; timely reporting resumed in September. Data on producer prices and nationwide employment are not available.

Government finance

4. The latest government finance statistics (GFS) data reported to STA for publication in the *GFS Yearbook* are for 2000 and cover the consolidated central government. However, many classification problems remain (requiring extensive use of adjustment entries to current expenditure) and detailed information is missing in the time series since 1996 for budgetary and nonbudgetary breakdowns and for central government debt. Madagascar does not report sub-annual data for publication in *International Finance Statistics.*

Balance of payments

5. Since 1984, the Central Bank of Madagascar (CBM) 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 are affected by inadequate coverage at the level of recording procedures, and by large amounts of smuggling, particularly in the mining sector. Moreover, the customs processing system has experienced numerous technical disruptions since 1998. As a result, the external 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 of the customs offices. There are plans to upgrade the customs processing system to ASYCUDA ++.

6. The accuracy of other balance of payments items is still hindered by inadequate data collection from commercial banks, which continue to use categories and definitions from the *BPM4*, which impede the proper classification of reported data. In addition, as exchange controls have been eased, collected data cover a shrinking part of the total transactions. As a result, critical balance of payments data (e.g., foreign direct investment, commercial bank assets and liabilities, transportation, construction and other services to enterprises, private transfers) are underreported.

7. Against this background, a balance of payments statistics mission (June 5-20, 2001) reviewed the compilation system within the framework of the *BPM5*. The mission assisted the authorities in integrating customs data in the balance of payments statistics, reviewed the commercial banks data collection system, and drafted surveys to cover nonreported transactions. In addition, the mission instructed the central bank staff on the methodologies outlined in the *BPM5* and provided guidance to the authorities in participating the GDDS. The mission recommended other measures aimed at improving the existing compilation system, including institutional reforms within the CBM and measures to improve interagency cooperation, which are being implemented. In November 2002, the authorities indicated that the committee in charge of finalizing external trade statistics had been reactivated and was contributing to improved data collection and analysis. In 2002, significant progress was also made on the implementation of banking sector surveys, aimed at ensuring comprehensive coverage of service transactions in the balance of payments

8. The compilation of external debt statistics is generally satisfactory, and the authorities are benefiting from technical assistance by the United Nations Conference on Trade and Development (UNCTAD) in 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 remain to be installed by UNCTAD technicians.

Monetary statistics

9. A STA monetary and financial statistics mission visited Antananarivo in July 2001 to follow up on the recommendations of the 1995 mission, assist the staff of the CBM in addressing data collection, compilation, and dissemination issues, initiate work toward introduction of the methodology in the *Monetary and Financial Statistics Manual*, and assist in drafting GDDS metadata for the financial sector. The 2001 mission found that the CBM implemented most of the recommendations of the monetary and financial statistics mission of 1995, including the reclassification of some accounts of the monetary authorities and commercial banks and the revision of valuation procedures for foreign-currency-denominated accounts. The 2001 monetary and financial statistics mission specifically recommended: (1) the widening of statistical coverage to microfinance institutions; (2) the inclusion of the Savings Bank and Postal Administration in the other depository corporations subsector; and (3) the improvement in the timeliness of the CBM's balance sheet. An action plan for the implementation of the mission's recommendations has been agreed with the authorities. Beginning in August 2001, monetary data for publication in *International Financial Statistics (IFS)* have been reported to STA regularly by e-mail. During the 2002 political crisis the timeliness of monetary data reporting had been uneven; however there had been an improvement starting mid-year. Data for the monetary authorities and deposit money banks through March 2003 have been published in the *IFS*.

Madagascar: Core Statistical Indicators
(As of May 19, 2003)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/Debt Service
Date of latest observation	4/11/03	3/31/03	3/31/03	3/31/03	3/31/03	4/30/03	3/2003	2002	2002	12/2002	2002	2002
Date received	4/11/03	4/11/03	4/11/03	4/11/03	4/11/03	5/14/03	4/15/03	3/10/03	3/10/03	3/10/03	3/10/03	3/10/03
Frequency of data	D	M	M	M	M	M	M	A	A	M	A	A
Frequency of reporting	W	M	M	M	M	M	M	V	V	M	V	A
Source of update	A	A	A	A	A	A	A	A	A	A	A	A
Mode of reporting	M	M	M	M	M	M	M	V	V	M	V	V
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C

Notes: Frequency of data: D=daily; M=monthly; Q=Quarterly; A=annual.
Frequency of reporting: W=weekly; M=monthly; Q=quarterly; A=annually; V=irregularly in conjunction with staff visits.
Source of update: A=direct reporting by the Central Bank of Madagascar, Ministry of Finance and Economics, or other official agency.
Mode of reporting: M=mail (including e-mail); V=staff visits.
Confidentiality: C=unrestricted use.

Statement by the IMF Staff Representative
June 30, 2003

1. The following supplementary information has become available since the issuance of the staff report. The thrust of the staff's assessment remains unchanged.

- The prior action regarding the audit of the utility company, JIRAMA, has been fulfilled. The contract for the audit of its operations and financial conditions was signed on June 11, 2003, and the audit started on June 16, 2003. It is expected to be completed within two months.

- Preliminary price data indicate that inflation is on a downward trend. The consumer price index declined by about 1 percent in May and about 2 percent during the first five months of the year. Interest rates and the exchange rate remained relatively stable.

- As noted in the staff report, the authorities intend to reintroduce new currency notes denominated in "ariary," the old currency of Madagascar. An MFD mission visited Antananarivo during June 14–21, 2003, to provide advice on the currency conversion. The mission agreed with the authorities' two-step approach to the currency conversion: (1) introduction of the ariary notes into circulation (fiduciary conversion); and (2) adoption of the ariary as a unit of account (scriptural conversion). The mission found that the authorities' preparations for the fiduciary conversion are adequate, but that an information campaign needs to be launched and completed and a timetable for scriptural conversion prepared, before the new notes can be introduced. The mission also suggested that: (i) the old and new currencies be allowed to circulate together for at least 12 months to reduce conversion costs, (ii) following the dual circulation period, a period of 6 months be envisaged for the conversion of old currency notes into ariary notes at the commercial banks, followed by another 10 years for exchanges at the central bank, and (iii) no administrative or other restrictions be placed on the exchange of the two currencies. It further proposed that scriptural conversion, which involves conversion of accounts into the new currency, be envisaged for no later than January 1, 2005. The authorities have agreed with these recommendations.

- The authorities submitted the full PRSP to the IMF and the World Bank on June 11, 2003. The document will be circulated to the Board as soon as the authorities complete its translation into English. A joint staff assessment (JSA) will be issued to the Board in September 2003.

Press Release No. 03/99
FOR IMMEDIATE RELEASE
June 30, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Third Review of Madagascar's PRGF-Supported Program, Approves US$15.9 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Madagascar's performance under an SDR 79.4 million (about US$111.3 million) Poverty Reduction and Growth Facility (PRGF) arrangement, and approved a disbursement amounting to SDR 11.3 million (about US$15.9 million).

Madagascar's three-year program was approved on March 1, 2001 (see Press Release No. 01/7), and was extended on December 23, 2002 (see News Brief No. 02/133) until end-November 2004 from end-February 2004. So far, Madagascar has drawn SDR 34.0 million (about US$47.7 million) under the PRGF arrangement.

The PRGF is the IMF's concessional facility for low income countries. 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 5 ½-year period on principal payments.

Following the Executive Board's discussion of Madagascar, Anne Krueger, First Deputy Managing Director and Acting Chair, stated:

"Implementation of the program supported by the Poverty Reduction and Growth Facility has been satisfactory. However, as a result of the political crisis, the authorities' macroeconomic objectives for 2002 were not fully achieved and poverty deepened. The challenge for the authorities in the period ahead is to stabilize the economy, strengthen the business climate to encourage private investment, and diversify the export base to strengthen exports and economic growth.

"The budget for 2003 seeks to boost revenue to permit a recovery of expenditure while containing the fiscal deficit. To this end, the authorities are addressing problems of inefficiency and corruption in public administration, especially in the customs and tax departments, and have established a committee to oversee the reform of customs and tax administration. The authorities also intend to curb the growth of the civil service wage bill and link salary increases to job performance. Further reforms are needed to remove weaknesses in budget preparation, expenditure control, and treasury operations, in order to strengthen the budgetary process and prevent the accumulation of arrears.

"The monetary program for 2003 is consistent with the aim of reducing inflation and achieving positive real interest rates. Structural impediments to bank lending need to be removed, particularly through the amendment of the Property Act in order to allow the use of land as collateral for bank loans. Efforts are underway to strengthen the legal and institutional framework for banking supervision and to establish an early warning system for bank fragility; and the legal framework for microfinance operations is also to be improved.

"It will be important to maintain export competitiveness in order to reduce external vulnerability and boost exports. Madagascar should avoid real exchange rate appreciation by implementing prudent macroeconomic policies and structural reforms aimed at maintaining low production costs, improving the efficiency of the cotton sector, and diversifying exports.

"The authorities are committed to the privatization and rehabilitation of public enterprises in order to increase economic efficiency, private investment, and economic growth. These reforms could play an important role in raising income and reducing poverty in rural areas.

"The authorities have completed a Poverty Reduction Strategy Paper through a broad-based consultative process. They would need to decisively implement the strategy, and should also give priority to completing all other actions serving as HIPC Initiative completion point triggers so that Madagascar can benefit from additional debt relief as soon as possible," Ms. Krueger stated.