

February 5, 2020  
Approval: 2/12/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/21-2

4:10 p.m., March 22, 2019

**2. Republic of Madagascar—Fourth Review Under the Extended Credit Facility  
and Request for Modification of Performance Criteria**

Documents: EBS/19/13 and Supplement 1

Staff: Mills. AFR; Kramarenko, SPR

Length: 31 minutes

## Executive Board Attendance

M. Furusawa, Acting Chair

### Executive Directors Alternate Executive Directors

G. Gasasira-Manzi (AE), Temporary

H. Razafindramanana (AF)

J. Corvalan (AG), Temporary

J. Shin (AP), Temporary

F. Benoit (BR), Temporary

Z. Huang (CC), Temporary

A. Arevalo Arroyo (CE), Temporary

M. Sylvester (CO), Temporary

S. Benk (EC)

A. Castets (FF)

I. Fragin (GR), Temporary

S. Gokarn (IN)

T. Persico (IT), Temporary

M. Kaizuka (JA)

K. Osei-Yeboah (MD), Temporary

D. Fadhel (MI), Temporary

M. Tolici (NE), Temporary

N. Vaikla (NO), Temporary

P. Snisorenko (RU), Temporary

R. Alkhareif (SA)

P. Pham (ST), Temporary

P. Trabinski (SZ)

A. Grohovsky (US), Temporary

G. Tsibouris, Acting Secretary

J. Morco, Summing Up Officer

D. Jiang, Board Operations Officer

L. Nagy-Baker, Verbatim Reporting Officer

### Also Present

African Department: N. Carvalho, C. Cheptea, G. Leost, C. Mills, D. Robinson, C. Tsangarides. Fiscal Affairs Department: M. Kabanda. Finance Department: M. Mohlala. Legal Department: G. Otokwala, J. Purcell. Strategy, Policy, and Review Department: A. Behar, V. Kramarenko. World Bank Group: T. Buckley.

Executive Director: M. Raghani (AF). Alternate Executive Director: F. Sylla (AF). Senior Advisors to Executive Directors: T. Nguema-Affane (AF). Advisors to Executive Directors: M. Kikiolo (AP), H. Mori (JA), C. Wehrle (SZ), A. Zaborovskiy (EC).

**2. REPUBLIC OF MADAGASCAR—FOURTH REVIEW UNDER THE EXTENDED CREDIT FACILITY AND REQUEST FOR MODIFICATION OF PERFORMANCE CRITERIA**

Mr. Raghani, Mr. Razafindramanana and Mr. Alle submitted the following statement:

Our Malagasy authorities would like to thank the Board, Management and Staff for the Fund's continued engagement with Madagascar. The country has emerged from a highly anticipated presidential election which saw the victory of President Andry Rajoelina. The new President was sworn in on January 19<sup>th</sup> and appointed a new Government headed by the former consensual Prime Minister Christian Ntsay. The peaceful elections supported by the international community helped preserve the momentum of strong economic recovery.

Staff's recent visit to Antananarivo has provided the opportunity for the new Government to commit to the main reforms agreed on in late 2018 in the context of the fourth review under the Extended Credit Facility (ECF). Even more significantly, the newly-elected President has committed to pursuing Madagascar's reform program. In the period ahead, the authorities are determined to implement their agenda of economic transformation embodied by the President's platform "Initiative pour l'Emergence de Madagascar" (Initiative for the Emergence of Madagascar).

The staff report candidly depicts the achievements made under the program and the policy areas that warrant the authorities' efforts in 2019 onward. The authorities have posted a strong program performance over the period of the fourth review, despite challenges associated with the elections. Going forward, they intend to step up efforts to gradually address critical issues in areas such as fiscal policy and economic governance. The ECF-supported program will continue to serve as an important framework to enhance macroeconomic stability and advance key structural reforms.

**Recent Developments, Program Performance and Outlook**

The year 2018 confirmed the positive momentum of economic recovery of the past years. Real GDP growth is estimated to have accelerated at 5.2 percent against 4.3 percent in 2017, on the back of rising public and private investment and buoyant agriculture. Inflation is declining from rice price-related pressures of the recent years and stood at 6 percent at year-end. Budget execution has been broadly consistent with the program albeit challenges in the second half of the year, notably stemming from delays in adjusting fuel prices to international prices. This led to delayed tax payments

by affected private distributors, a government cash shortfall and, consequently, budget savings at the expense of domestically-financed investment. On the external front, high international vanilla prices and mining receipts have helped maintain a strong position, with a current account surplus of 0.3 percent of GDP. As a result, reserves have risen, covering more than 4 months of imports, which is a comfortable level.

Program performance has continued to be strong despite elections-related spending pressures. All end-June 2018 quantitative performance criteria (PCs) were met. As well, all but one indicative targets (IT) were met. The IT on tax revenue was observed with a comfortable margin, exceeding the target by more than 0.1 percent of GDP. Regarding the IT on priority social spending, which was slightly missed due to administrative delays, the authorities are confident that such situations will be fixed going forward as they make progress in enhancing investment processes. Furthermore, they have prepared contingency measures, should the minor shortfalls on tax revenue caused by elections-related disturbances continue through early 2019. The authorities remain committed to keeping the primary fiscal balance in the margins agreed under the program. As regards structural reforms, most of the structural benchmarks (SBs) were observed, some with delays. The SB on avoiding budget costs from fuel pricing was not observed for its sensitivity in a fragile social and political situation. The authorities' newly adopted plan will address the issue going forward. Preliminary data indicate that all end-December 2018 PCs have been observed except the one on the fiscal balance due to lower tax revenue in the run-up to the election.

The implementation of the two prior actions for this review adds to the strong program performance. An agreement with the fuel distributors has been signed on February 28. This is part of the authorities' plan to settle the liability related to fuel pricing and avoid its re-occurrence. Regarding the second prior action, the management of the state-owned public utility JIRAMA has adopted a revised budget consistent with the transfers envelope planned in 2019. Furthermore, the authorities who oversee the company confirmed the Government's commitment to the adoption and implementation of this revised 2019 budget.

The authorities share the view of the balance of risks to the outlook presented by staff. On the downside, terms of trade shocks, disappointing global growth and rising protectionism could negatively affect exports. As regard risks related to low investment project implementation and to corruption, the authorities are confident that their ongoing measures to overhaul the framework for public investment and improve the business

environment will bear fruits in the coming period. On the upside, the authorities are optimistic that the country will soon reap the dividends of the peaceful elections, including in terms of increasing FDI. As well, public investment should be scaled up as a result of an enhanced institutional framework. Such developments should boost growth and contribute further to the favorable outlook.

## Policies for 2019 and the Medium Term

### Bolstering Growth-Enhancing Fiscal Policy

The authorities continue to focus their fiscal policy on creating space for growth-enhancing public investment and social spending. To this end, they maintain a twofold strategy in the 2019 budget which targets a domestic primary surplus of 0.1 percent of GDP; mobilizing more revenue to increase the net tax to GDP ratio to 12.3 percent and restraining low priority spending while keeping the wage bill in check. On the revenue side, administrative measures introduced in 2018, notably the performance contracts with management-level staff in the customs administration, continue to bear fruits. New tax measures including adjustments in the VAT regime and streamlining exemptions and spending savings, form a package of contingency measures to be adopted in a supplementary budget in case of a revenue shortfall. Overall, the authorities will continue their efforts of domestic revenue mobilization by further improving the tax and customs administrations and broadening the tax base to new activities.

On the spending side, the authorities are strongly committed to stepping up efforts to reduce transfers to JIRAMA. Resolute cost-cutting measures are being implemented as well as efforts to increase revenue, with World Bank support. On fuel pricing, the authorities have adopted a plan to avoid any new budget impact. The plan includes a new fuel pricing mechanism and a settlement of arrears to distributors, which will gradually help phase out costs on public finances. Going forward, the authorities are dedicated to closely monitoring developments in world oil prices and stand ready to take measures for a smooth implementation of the pricing mechanism and for mitigating its potential adverse impact on the most vulnerable. Other efforts for spending restraint will proceed as well. They include reforms to contain the wage bill and transfers to the civil servants' pension fund.

It is the authorities' intention to use the fiscal space stemming from the combined efforts in revenue mobilization and non-priority spending restraint, to scale up growth-enhancing public investments. To this end, they are also

working on lifting the administrative bottlenecks. A central institutional body has been created in the Presidency and is solidifying linkages and coordination with technical ministries involved in the implementation of investment projects. Similar efforts are underway to improve the institutional framework for future PPP projects, including mitigating fiscal risks.

### Strengthening Monetary Policy and the Financial Sector

The authorities have continued their efforts to improve the central bank's capacities, including with the support of IMF technical assistance (TA), on many fronts. In the face of a persistent trend of high world vanilla prices, the central bank has used a well-inspired combination of exchange rate flexibility, foreign reserves accumulation and liquidity operations. A draft law on repurchases to be adopted in 2019 is meant to further improve the monetary policy transmission mechanisms and spur the interbank market.

Reforms to invigorate the financial sector have proceeded well. While the banking sector remains healthy, efforts are warranted to diversify it beyond the few large banks which make the bulk of the industry. The authorities therefore welcome the development of smaller commercial banks, microfinance institutions (MFI) and electronic money services. Such a trend should gain further impetus with the implementation of their strategy for financial inclusion. Important steps have been made in that regard, including revamping the legal and regulatory frameworks, licensing a provider of electronic money services and a provider of a private credit bureau. The transformation of the public savings fund (CEM) into an MFI would also be a welcome development for the authorities' financial inclusion strategy. These efforts to deepen the financial sector are being complemented with a draft law to be submitted to Parliament by mid-2019 and meant to enhance financial stability and address systemic risks.

### Improving Economic Governance and Fighting Corruption

The authorities have made significant progress in creating and strengthening institutions for better economic governance, furthering accountability and fighting corruption. Efforts started in 2016 have culminated recently with the adoption of several additional laws. The institutional architecture is now made up of an anti-corruption law; a law on anti-corruption courts; a law on international cooperation; and a law on anti-money laundering and combating the financing of terrorism (AML/CFT). The authorities will also take steps for the adoption of the draft law on asset

recovery in future parliamentary session with the view to completing the anti-corruption framework.

Noteworthy progress has also been made in the areas of public financial management, with the implementation of the 2018-2020 Strategic Plan of Modernization of Public Financial Management. Key aspects include priority areas on the management of fiscal risks, a better integration of SOEs and PPPs in the budget, the implementation of the new public procurement code and the strengthening of the debt management strategy.

### Conclusion

Amid a challenging domestic electoral environment, Madagascar has maintained its momentum of strong economic performance under the ECF-supported program. Growth has accelerated further, macroeconomic stability has been preserved, and the implementation of structural reforms has broadly proceeded well. Going forward, the authorities are committed to continuing their efforts to create fiscal space for scaling up growth-enhancing public investment and social spending. Furthermore, they are determined to step up effort to further improve economic governance for unleashing the economy's full potential.

In view of the strong economic performance and the authorities' renewed commitment to the objectives of the program, we would appreciate the Executive Directors' support for the completion of the fourth review under the ECF arrangement and the authorities' request for modification of performance criteria.

Ms. Pollard and Mr. Grohovsky submitted the following statement:

The economic recovery in Madagascar has continued, with accelerating growth, stable inflation, and a stronger external position. Meanwhile, program performance has generally been solid, with all end-June and most end-December PCs met despite elections taking place in between. We therefore support conclusion of the 4<sup>th</sup> review. Going forward, the authorities will need to prioritize reforms to strengthen fiscal policy, improve governance, and enhance financial stability. We offer the following points for emphasis.

### Fuel Price Adjustment

The failure to adjust fuel prices and establish an automatic price mechanism remains the weak link in the program. At the same time, with oil prices having just hit a high for 2019, the authorities will urgently need to develop well-targeted measures to limit the impact on the most vulnerable and maintain social support. Although the deadline for implementation of the automatic price mechanism has been pushed to end-September 2019, we look forward to an update on the status of both the implementation of the mechanism and the mitigation measures at the time of the next review.

### JIRAMA

We welcome the progress on installing smart meters and meeting the continuous structural benchmark on procurement. However, we note that a tariff increase anticipated in January was not implemented. While we are supportive of the general fiscal contingency plans, JIRAMA losses continue to pose fiscal sustainability risks and sustained efforts should be taken to rectify the problems. Could staff comment on whether the “substantial” cost-savings the authorities hope to realize could make up for a lack of tariff increases?

### Corruption and Governance

Strengthening the anti-corruption framework remains one of the key issues in Madagascar. We thank staff for the helpful annex on recent actions and welcome the progress made on governance issues. A remaining challenge is the adoption of a law on asset recovery. We appreciate the indication in Messrs. Raghani, Razafindramanana and Alle’s buff statement that the authorities will take steps for the adoption of this law in parliament and encourage the authorities to make this a priority.

### Financial Stability

We welcome the new draft banking law that addresses many of the key recommendations from the FSSA. We strongly encourage the authorities to push through this law as well as a separate law on financial stability to prevent systemic risks and manage financial crises. Additionally, could staff provide detail on how the authorities plan to supervise small commercial bank activities, MFI institutions, and e-money services for stability risks?

## Surrender Requirement

Finally, we welcome IMF technical assistance to improve the operation of the foreign exchange market. We strongly encourage the authorities to take staff's advice to make the surrender requirement, a capital flow management measure, temporary and to phase it out.

Mr. Saraiva, Ms. Benoit and Ms. Florestal submitted the following statement:

We thank staff for their comprehensive report and Mr. Raghani, Mr. Razafindramanana, and Mr. Alle for their insightful statement.

In 2018, GDP growth was the highest in a decade, pulled by agriculture recovery and robust public works, while inflation decelerated by more than anticipated in the ECF program. The external position strengthened with international reserves peaking in nominal terms and NIR increasing to more than 4 months of imports coverage backed by improved terms of trade. The current account also improved despite a sharp fall in export volumes. Fiscal revenues remained essentially flat whereas expenditures did not vary much in terms of GDP but switched away from non-essential subsidies (e.g. to Air Madagascar and JRAMA) towards capital investment. However, social priority spending remained flat in GDP terms, while transfers to SOEs such as JRAMA continue to be considered a high risk in the RAM. We welcome Mr. Raghani and colleagues' conclusion that the "peaceful elections (...)" helped preserve the momentum of strong economic recovery."

Notwithstanding the generally positive outlook, Madagascar remains vulnerable to exogenous shocks. Vulnerability is particularly linked to oil prices in particular and to the liquidity volatility in the banking sector, resulting from the swings of international price of vanilla, the country's main export crop. The adoption of an automatic fuel price formula remains a key policy for sustainable fiscal accounts. In the short term, the authorities' adoption of a plan to settle liabilities related to fuel pricing and avoid their re-incidence is a welcome step. However, social and political sustainability requires tangible measures to mitigate the impact of upward fuel prices adjustments on the most vulnerable and the authorities should benefit from international experience to avoid backlashes. We look forward to stronger emphasis on social safety nets, including through priority social spending, an IT that has been repeatedly missed.

Based on the satisfactory performance and the authorities' renewed commitment, we support the completion of the fourth review under the ECF

arrangement as well as the request for modification of performance criteria. All June-2018 performance criteria (PCs) and all but the one indicative target on priority social spending were met. Fund staff has assessed all but one of the medium-term objectives under the ECF-supported program to have already been met while the evaluation on structural reform front is mixed. We welcome the new government's engagement to pursue a robust reform agenda.

The 2017 External Sector Assessment (ESA) concluded that the external position was stronger than implied by fundamentals. The current report confirms that reserves remain within the targeted range of the assessed reserve adequacy metric based on months of imports. We note the authorities' engagement to strengthen the foreign exchange market which remains shallow. We would appreciate it if staff could elaborate more and share their views on the current external position?

Efforts to strengthen banking supervision and address emerging risks are welcome. Several soundness indicators for the banking sector are not available. From the data included in the report, it appears that banks remain more or less as capitalized and profitable as during the last review. However, with the rapid expansion of electronic money service, we wonder if current legislative framework on electronic money institution adopted in 2016 remains appropriate.

We concur with staff that strengthening governance and combating corruption must continue to be part of the backbone of the program going forward. Weak governance and corruption will constrain competitiveness, hamper the business environment and undermine the growth of fiscal revenue, while weakening institutional capacity. We commend the authorities for progress thus far in strengthening the anti-corruption framework in particular for legislation adopted on anti-corruption courts, international cooperation and AML/CFT. We look forward to the adoption by the Parliament of the asset recovery law and its implementation.

Mr. Mouminah, Mr. Alkhareif and Mr. Rouai submitted the following statement:

We thank staff for a well-written report and Mr. Raghani, Mr. Razafindramanana, and Mr. Alle for their helpful buff statement. We broadly concur with staff assessment and policy recommendations and support the proposed decision to complete the fourth review under the ECF arrangement.

We welcome the indication that the ECF program remains broadly on track. Recent developments in Madagascar as well as the outlook are encouraging. Growth is accelerating and is projected to remain around 5 percent over the medium-term, inflation is declining, the external position is stronger, and the budget is being implemented as planned. It is also reassuring to note, as highlighted in the buff, that performance during the period of the fourth review remained strong despite the challenges associated with the election cycle. We therefore commend the authorities for these achievements, for the smooth political transition, and for the commitment, at the highest level, to a strong reform agenda and to the Fund-supported program.

We welcome the focus of the discussions on the importance of promoting pro-growth fiscal policy. Against the background of a 2019 budget consistent with the program objectives, including a small primary surplus, we also agree with staff on the importance of continuing progress on a pro-growth fiscal policy over the medium-term. Further revenue mobilization efforts are needed to sustain the implementation of the ambitious social and growth objectives. At the same time, improvement of the business climate and of the quality and composition of spending should also guide the authorities in their plans to increase public investment. Since Madagascar remains subject to exogenous shocks, we also encourage the authorities to remain vigilant and pursue their efforts to further strengthen debt management and sustainability. In this regard, we welcome the inclusion in the Budget Law of an annex on fiscal risks.

The banking sector remains well capitalized, liquid, and profitable. We welcome the new draft banking law, which will help in strengthening banking supervision and improving the recovery and resolution framework. In the same vein, we consider that the new law on financial stability will contribute to prevent systemic risks. Finally, we encourage the authorities to further promote financial inclusion.

With these remarks, we wish the authorities further success.

Mr. Beblawi and Ms. Fadhel submitted the following statement:

We thank staff for the informative report and Mr. Raghani, Mr. Razafindramanana, and Mr. Alle for the useful buff statement. The Malagasy economy continued its recovery in 2018, despite some economic pressures in the second half of the year, while economic conditions remained broadly favorable. Given the program has been broadly on track, and the

authorities are committed to achieving its objectives, we support the proposed decisions.

It is important to maintain momentum toward achieving the key program objective of promoting pro-growth fiscal policy. Program performance was strong except for some slippages on revenue and fuel pricing. We concur with staff on the need for corrective actions to settle government liabilities that resulted from the revenue shortfall and to avoid its reoccurrence while protecting the more vulnerable segment of the population. In this regard, we welcome the authorities' plan to establish a pricing mechanism that includes automatic price calculation with a smoothing formula while allowing limited discretionary adjustment to help manage difficult social impact. Staff note that the current measures to mitigate potential impact of the pricing mechanism are not well-targeted to the most vulnerable. We stress the importance of continuing to develop and up-scale the social safety net programs to help mitigate the impact of the planned measures on that segment of the population.

We welcome the contingency plans the authorities are preparing to counter potential revenue shortfalls including new tax measures—like adjustments in the VAT regime and streamlining exemptions—and spending savings. We also agree on the importance of creating more fiscal space to continue improving the quality and composition of spending. In this connection, we welcome the authorities' commitment to gradually reduce lower priority spending, including eliminating transfers for JIRAMA's operating losses, and to continue increasing public investment and priority social spending while keeping the wage bill in check. We are pleased by the creation of the central institutional body in the Presidency to solidify coordination with technical ministries involved in the implementation of investment projects and the planned efforts to improve the institutional framework for future PPP projects.

We note staff and authorities' agreement that the current flexible exchange rate policy with limited intervention to counter excessive volatility, guided by an algorithm developed with Fund technical assistance, is appropriate. Building an interbank market should improve liquidity management, deepen the financial sector, and strengthen the authorities' monetary policy framework. To this end, we welcome the draft legislation on repo transactions and look forward to its enactment. We are also encouraged by the authorities' efforts to further the development of a sound and inclusive financial sector including the development of smaller commercial banks, microfinance institutions, and electronic money services. The new banking

law, which is due for submission to the parliament in the first half of 2019, will be an important step to improve financial stability and address systemic risks.

Despite the favorable medium-term outlook, potential risks remain including weak investment implementation capacity, larger than anticipated transfers to SOEs, failure to tackle corruption, and retreat from multilateralism. These sources of risks should be monitored vigilantly and contingency plans to counter them should be put in place. Moreover, continuing the reforms of major SOEs, especially JIRAMA, improving fiscal governance and fighting corruption as well as enhancing the business climate should remain policy priorities going forward. In this regard, we welcome the implementation of the 2018-2020 Strategic Plan of Modernization of Public Financial Management, and the latest efforts to enhance governance, further accountability, and strengthen the anti-corruption framework. Since Madagascar is broadly dependent on mining and vanilla exports, how does staff assess the economy's vulnerabilities to fluctuations in the global prices both in the short and medium terms?

Mr. Psalidopoulos, Mr. Rashkovan, Mr. Tolici and Mr. Persico submitted the following joint statement:

We thank staff for the informative report and Mr. Raghani, Mr. Razafindramanana, and Mr. Alle for their helpful buff statement. We commend the authorities for the continued economic recovery and the good program performance despite domestic and external challenges. We praise the authorities for having successfully concluded the transfer of power without undermining Malagasy growth. Moreover, we welcome the commitment of the new president to continue the ongoing reform implementation and to address the current slippages. We broadly agree with the thrust of the staff appraisal and fully support the completion of the Fourth Review Under the Extended Credit Facility and the related request for modification of Performance Criteria (PC). The following comments are for emphasis.

As the growth rate reached its highest level in a decade and budget execution was linear, greater fiscal efforts – both on revenue and spending side - are needed. The falling revenue performance is adding pressure on public finances which are still facing long-standing issues related to transfers to the public utility company (JIRAMA) and fuel subsidies. In this regard, as the authorities' will to limit the impact of the needed tariff' adjustments on social stability is reasonable, we look forward for the ongoing analysis (with the World Bank support) to identify mitigating measures while addressing

these issues. We share the staff rationale for the modification of the PC on primary balance, nonetheless we wonder if the expectation of a positive fiscal anchor remains adequate as the earlier positive end-2018 PC is now pointing to a deficit. In this regard, could staff provide some projections on fiscal indicators and the related targets for the end of the current year?

Despite the contained inflation rate, liquidity management remains challenging. While the central bank is continuing its transition towards interest rate targeting, it should remain vigilant in managing excess bank liquidity. The ongoing removal of existing surrender requirement on export proceeds is a most welcome step on the way to a greater flexibility on foreign exchange market. Also, we welcome the new draft law which addresses many of the FSSA recommendations. While recognizing the opportunities provided by the new technologies and the micro-finance institutions to improve financial inclusion, the authorities should remain vigilant to address the related rising potential risks for financial stability.

Despite progress in some areas, poverty in Madagascar remains pervasive. The country loses recently three positions in the global UN Human Development ranking and has one of the highest rates of out-of-school children and one of the lowest rates of access to electricity. In this context, missing the IT target on priority social spending was unfortunate and we invite authorities to promptly fix the situation going forward as envisaged in the buff statement. Considering also the poverty reduction focus of the PRGT, we would have appreciated a greater attention on dedicated pro-poor policies both in the report analyses and in the overall program conditionality. In this regard, we wonder that domestically-financed priority spending will continue to steadily increase as a percentage of GDP, but the related indicative target (end-June 2019) is going to be reduced by 10 percent on a nominal base. Staff comments are welcome.

We welcome the overall good program performance accomplished under very challenging conditions. Nonetheless, structural benchmarks were only partially met. For this reason, we invite the authorities to step up their efforts to guarantee a timely implementation of the envisaged structural reforms. We welcome the recent progress on anti-corruption and AML/CFT frameworks; nonetheless, we invite the authorities to strengthen their efforts to guarantee a rapid adoption and proper enforcement of the envisaged regulations. We wonder whether the timing of the review could have been better managed and if current delays could affect the execution of the next reviews. Staff comments are welcome.

Mr. Ray, Mr. Shin and Mr. Kikiolo submitted the following statement:

We thank staff for the informative set of reports and Mr. Raghani, Mr. Razafindramanana and Mr. Alle for their useful buff statement. We noted the strong economic rebound in 2018 which stemmed from the recovery in agriculture supported by public and private sector investments, the strong external position and the decline in overall inflation. We concur with the staff appraisal and recommendations and offer the following points for emphasis.

The authorities met all end-June 2018 performance criteria, all but one indicative target and five out of nine structural benchmarks through end-2018 even in a challenging socio-political environment. The renewed assurance from the newly elected president and the positive medium-term outlook provides an opportunity for the authorities to rectify the missed targets and consolidate the gains. We welcome the implementation of two prior actions relating to the agreement with fuel distributors and adoption by JIRAMA of a revised budget in line with the transfer envelope for 2019. In this regard, we support the successful completion of the fourth review of the ECF and request for modification of performance criteria.

We are encouraged by the authorities focus on creating fiscal space to support pro-growth investment. Administrative measures alone might not be sufficient and need to be complemented with additional tax measures. In this regard, we support the authorities' revenue mobilization plan and take a positive note of the formulation of a revenue contingency plan given recent shortfalls. While understanding the authorities' concerns over the push for higher fuel tariffs in view of the social sensitivities, we agree with staff that the corrective actions need to be taken with carefully-designed compensation measures for vulnerable groups. We noted that staff have urged the authorities to continue efforts to develop and scale up social safety net programs, building on World Bank supported programs such as PSNP and HDCT. We invite staff to elaborate on this initiative and its distribution effects.

We consider the monetary policy and exchange rate policies to be appropriate. We welcome the collaborative efforts by the authorities and the IMF TA, not only to improve the foreign exchange market operations but also to build a sound financial sector that supports growth. We note the emerging vulnerabilities in the banking sector and see merit in the new draft banking law that enhances the independence and functions of the financial supervisor and improves bank resolution.

We noted from the buff statement that considerable steps have been taken to improve economic governance and fight corruption, but more could

be done. The enactment of various laws forming the institutional architecture is commendable. And we note that the authorities are urged to accelerate the law on asset recovery to complete the anti-corruption framework. We welcome the 2018-2020 Strategic Plan of Modernization of Public Financial Management as it provides a useful roadmap for public sector reforms. Like staff, we believe that strong enforcement and implementation of these laws and strategies are critical to achieving the desired outcomes.

Mr. Di Tata and Mr. Corvalan Mendoza submitted the following statement:

We thank staff for the well-written report and Mr. Raghani, Mr. Razafindramanana, and Mr. Alle for their informative buff statement.

Based on performance under the program and the new authorities' renewed commitment to economic reform, we support the request for completion of the fourth review under the ECF arrangement, as well as the proposed modification of performance criteria for end-June 2019. Madagascar met all end-June 2018 performance criteria and all but one indicative targets. It also fully met five of the nine structural benchmarks throughout end-2018, showing good progress on the others except fuel price adjustment. Most of the objectives for 2019 remain achievable.

Madagascar continued to perform well in 2018, despite the challenges associated with the presidential election that took place towards the end of the year. We welcome the new authorities' commitment to a strong economic reform agenda and to the IMF-supported program. Real GDP growth rose to 5.2 percent in 2018 (the highest growth rate of the decade), inflation declined by year's end, budget execution was broadly as envisaged, and the international reserves position remains adequate. The medium-term outlook continues to be generally favorable, with growth projected at above 5 percent a year in 2019-2021, moderate inflation, and debt sustainability. The country remains vulnerable to exogenous shocks, in particular changes in the terms of trade.

We agree with the program objective of promoting a pro-growth fiscal policy. The 2019 budget anticipates a domestic primary surplus of 0.3 percent of GDP, in line with the program's objectives and fiscal sustainability. The fiscal program envisages a further increase in revenue, restraint in lower-priority spending and the wage bill, and higher priority spending (public investment and social spending). Could staff elaborate on the incidence of poverty in Madagascar and the characteristics of the main social programs? The main fiscal challenges are fuel pricing and transfers to the

public utility, JIRAMA. On fuel pricing, the report indicates that the authorities have adopted an automatic price mechanism with a smoothing formula and limited discretion, to be fully implemented no later than end-September. Could staff elaborate further on the characteristics of this mechanism, including the implications of discretionary adjustments by prior agreement with distributors, the surcharge element to be included in the price structure, and possible measures to mitigate the impact on the most vulnerable? Regarding the transfers to JIRAMA, could staff comment on the feasibility of adhering to the amount envisaged in the budget without resorting to tariff increases, by relying only on cost-saving measures?

We concur with staff that further enhancing revenue mobilization over the medium term is crucial to generate fiscal space to protect the most vulnerable. In this regard, the report emphasizes improvements in tax administration, in particular for domestic taxes. Could staff also comment on possible tax policy reforms, in addition to tax administration measures, to strengthen revenue mobilization? Does staff have an estimate of the potential revenue cost of the new tax incentives?

On the spending side, increasing public investment requires not only finding additional fiscal space but also strengthening implementation capacity. Ambitious projects financed by foreign loans have fallen short of expectations because of constrained implementation capacity and insufficient progress in improving the business climate for catalyzing higher private investment. On other fiscal reforms, the authorities need to develop a medium-term strategy to modernize the civil service, reform the civil pension fund, and improve the management of fiscal risks, including those associated with PPPs.

The central bank plans to move gradually from monetary toward interest rate targeting. We encourage the authorities to seek early approval of the draft law on repurchase agreements, which will help improve the transmission of monetary policy. We also welcome the efforts under way to improve the operation of the foreign exchange market with Fund technical assistance, as well as to gradually phase out the surrender requirement on export proceeds.

The financial sector appears to be sufficiently capitalized, liquid, and highly profitable, but there are significant differences among banks. We welcome the new draft banking law to be submitted to parliament, which constitutes a positive step towards addressing FSSA recommendations by enhancing the powers and independence of the financial supervisor (CSBF) and improving the bank recovery and resolution framework. We encourage

the authorities to seek prompt approval of this law, as well as the law on financial stability that is expected to be submitted by end-June 2019. We take positive note of the ongoing implementation of a detailed strategy for financial inclusion.

Significant progress has been made on strengthening the anti-corruption framework, including through the adoption of the AML/CFT law in December 2018. Going forward, we encourage the authorities to press ahead with proper implementation and to seek prompt approval of a law on asset recovery. We welcome the adoption of the updated version of the 2018-2020 Strategic Plan of Modernization of Public Financial Management (PFM), which sets priorities in this area.

With these comments, we wish the people of the Republic of Madagascar every success in their future endeavors.

Mr. Jin and Mr. Huang submitted the following statement:

We thank staff for the well-written report and Messrs. Raghani, Razafindramanana and Alle for their informative buff statement. Madagascar enjoyed a robust economic recovery in 2018, with the highest growth rate over the past 10 years. Given the sound program performance and the authorities' commitment to the policy plans in the program, we support the completion of the fourth review under the Extended Credit Facility (ECF) as well as the authorities' request for modification of performance criteria. We broadly agree with staff's appraisal and would like to limit ourselves to the following comments.

We welcome the authorities' efforts to enhance revenue mobilization. Despite a small shortfall in tax revenue last year, due to one-time election-related disturbance, improvement in tax administration and tax policy design are beginning to bear fruits. The continuous cut in transfers to public electricity and water company JIRAMA is welcome. Meanwhile, increasing the transparency and profitability of JIRAMA is equally important. We welcome the recent agreement signed between the authorities and fuel distributors on the plan for the fuel pricing mechanism and settlement of the existing liability. The authorities are encouraged to mitigate the potential impact on the most vulnerable when narrowing the domestic and global fuel price gap.

The current monetary stance is appropriate, with inflation on a downward trend, foreign reserves at its highest level, and a healthy credit

growth to the private sector. We commend the authorities' efforts to develop the inter-bank market and enhance the monetary policy transmission mechanism. A flexible exchange rate is important for a small, open and commodity-exporting country like Madagascar to absorb external price shocks. In this regard, we see merit in staff's suggestion to phase out the surrender requirements on export proceeds and develop the exchange rate market. We noticed the proposed modification in the performance criteria of the central bank's floor on net foreign asset and ceiling on net domestic assets. Could staff elaborate more on the reasons behind these modifications?

The banking sector is broadly resilient, but pockets of vulnerability remain. A new banking law to ensure the independence of the financial supervisory institution and improve bank recovery and resolution framework is a step in the right direction. The rapid growth of electronic money service and micro-finance institutions could help promote financial inclusion but could also pose new challenges for supervision. We encourage the authorities to keep vigilant to the development of these emerging institutions, enhance the supervisory framework when necessary and improve financial literacy.

Notable progress has been made in anti-corruption legislation. We welcome all the laws adopted in recent years. Going forward, concrete implementation and enforcement is the key to combat corruption. The independence of relevant institutions, including the anti-corruption court and agency, should also be ensured. Meanwhile, the recently updated Strategic Plan of Modernization of Public Financial Management would help improve the public procurement framework, strengthen debt management strategy and further enhance governance.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Ostros and Mr. Vaikla submitted the following statement:

We thank staff for comprehensive reports and Mr. Raghani, Mr. Razafindramanana, and Mr. Alle for the useful buff statement. Madagascar has a stable macroeconomic situation, it has witnessed strong economic growth and implemented prudent policies, while the successful transfer of power has strengthened investor confidence. We urge the authorities to use these supportive backwinds to continue to successfully implement the program and structural reforms to improve governance, support inclusive growth, and reduce poverty. To mitigate fiscal risks and increase fiscal space, we encourage the authorities to prioritize reducing the share of

lower priority spending, including settling the liability related to fuel pricing and implementation of an automatic price mechanism. We support the authorities' requests for the completion of the fourth review under the ECF arrangement and modification of a performance criteria given the program performance and the authorities' determination. We broadly share staff's appraisal and would like to offer a few remarks for emphasis.

Further strengthening the tax revenue mobilization and containing spending are important to create fiscal space to increase public investments. We commend the authorities for their fiscal performance and progress in mobilizing tax revenue, while we note some weakness in revenue collection in 2018. Strengthening the revenue collection is vital to create space for much needed priority public spending given the very high poverty rate. In this regard, we welcome efforts to further increase the tax revenue-to-GDP ratio, which has in recent years already significantly improved. However, if revenue mobilization continues to underperform, we urge the authorities to implement revenue contingency plans. We note with concern, that the public wage bill will increase this year by 11 percent compared to 2018 and transfers to civil servants and military pension fund will increase to 0.7 percent of GDP. Going forward, we urge the authorities to align salary increases with productivity growth and implement reforms to civil servant pension fund to reduce relatively large transfers. Furthermore, restructuring of JIRAMA is needed to limit fiscal costs and to eventually introduce automatic tariff adjustments. For the medium-term, we underline the need to strengthen the fiscal framework, focus on mitigating fiscal risks and increase higher priority public investments to enable more resources for enhancing education, health, and infrastructure areas.

We welcome the authorities' plan to settle the liability related to fuel pricing and urge the authorities to carry it out to avoid any future liabilities. We welcome recent progress related to fuel pricing, which has resulted in a substantial drop in the gap between pump and market-based prices. We fully support staff's recommendation to implement plans to pay off current liabilities and contain spending in the future to make room for increased priority spending.

We positively note recent efforts in improving the anti-corruption framework and underline the importance of its effective implementation. Combating corruption is vital to support private sector investments, build confidence in public institutions, and enhance business environment. The recent implementation of several important laws, including the law on AML/CFT adopted in the end of last year, are important milestones in

strengthening governance framework. We join staff in their call for adoption of draft law on asset recovery, which is important to complete the anti-corruption framework and to successfully combat corruption. After completing the legal framework, the authorities should strengthen their efforts toward its effective implementation.

The Fund's capacity development is essential to support the authorities' reform agenda. We appreciate that the report gives a comprehensive overview of the Fund's technical assistance and its priorities going forwards. Over recent years, the Fund's provided technical assistance has been crucially important in strengthening Madagascar's fiscal and monetary framework, financial sector, and governance. We emphasize the importance of the Fund's capacity development also going forward in a close continuous cooperation with the World Bank.

Mr. Benk and Mr. Zaborovskiy submitted the following statement:

We thank staff for the informative paper, and Messrs. Raghani, Razafindramanana, and Alle for their helpful buff statement. The Extended Credit Facility (ECF)-supported program is broadly on track, bearing fruit in terms of accelerating economic growth, reducing imbalances, and strengthening financial stability. We note that the all end-June performance criteria and all but one indicative target have been met, and preliminary information points to good progress throughout end-2018, except for the fuel price adjustment and targeted primary fiscal balance. In view of the newly elected president's commitment to pursuing the country's reform program targets, including plans to address some slippages, we support the completion of the fourth review under the ECF and request for modification of performance criteria. We broadly share staff's assessment and policy recommendations, and encourage the authorities to use the favorable political momentum and generally positive economic outlook to accelerate reforms, as well as address existing vulnerabilities to boost economic potential and living standards.

Structural fiscal reforms, underpinned by domestic revenue mobilization and reductions in inefficient transfers and subsidies, should be accelerated. As revenue mobilization has met program targets, transfers to state-owned enterprises and the fiscal costs of the existing fuel pricing mechanism remain higher than initially envisaged. This underlines the need for accelerating growth-friendly consolidation on the expenditure side to substitute inefficient spending by investments in infrastructure and human capital. We take note that the fragile social and political context of the

electoral period somewhat slowed progress on the fiscal front, and encourage the authorities to press ahead with growth-friendly consolidation to reduce fiscal risks from the public utility company and increase fiscal space for priority spending over the medium term. Could staff comment on the overall size of fiscal risks identified in the Malagasy economy?

Monetary and financial policies should be geared towards keeping inflation in the single digits and maintaining healthy credit growth, while ensuring fiscal inclusion and stability. We positively note the growing credit to the private sector and the broadly healthy banking system. We commend the authorities for their sound monetary policy stance and recent achievements in reinforcing financial stability, and welcome their plans to continue with a reform agenda to increase the central bank's transparency and independence. Exchange rate flexibility should also preserve external competitiveness and shield foreign reserves. Further strengthening the financial stability architecture to cover the developing segments of financial intermediation is warranted. We welcome that the new draft banking law addresses many of the Financial System Stability Assessment's key recommendations on financial stability and systematic risks, and encourage the authorities to press ahead with its enactment.

Strengthening economic governance, enforcing anti-corruption legislation, and facilitating the private sector-led growth remain critical to sustain economic growth down the road. We welcome the authorities' focus on strengthening governance and tackling corruption, and commend the measures taken so far in this direction. We note staff's concern that an important anti-corruption law submitted to parliament has yet to be adopted. Could staff elaborate more on the issues behind the delay and how the authorities intend to move forward in this regard? We also encourage the authorities to continue their work on improving public institutions and strengthening public financial management.

We wish the authorities continued success in their reform efforts.

Mr. Merk and Mr. Fragin submitted the following statement:

We thank staff for a concise and insightful report and Messrs. Raghani, Razafindramanana, and Alle for their helpful buff statement.

We welcome the continuing economic recovery in Madagascar and the new government's expressed commitment to the country's reform program

allowing for continuity in the process towards sustainable growth and macroeconomic resilience building.

We agree to the completion of the review based on end-June 2018 targets and the requested modification of performance criteria. We welcome that all end-June 2018 performance criteria have been met, although implementation of structural benchmarks remains mixed. On the latter, we agree with staff on the particular importance of containing transfers to JIRAMA as well as establishing an automatic fuel price mechanism in order to limit risks to the budget. In this context, we also acknowledge that the costs of higher fuel prices borne by vulnerable portions of the population deserve attention and encourage the authorities to make full use of priority social spending under the indicative target (floor), which was missed due to administrative delays.

We welcome that the 2019 budget is in line with the objectives of the program, according to staff, albeit improving revenue mobilization and spending composition remain key challenges. We further welcome staff's assessment that fiscal sustainability remains solid and commend the authorities' intention to strengthen debt management to support the long-term fiscal position. At the same time, in light of the somewhat lower domestic primary balance relative to earlier projections, further strengthening the fiscal position remains of the essence, going forward. Prompt activation of contingency measures will be crucial in case of further revenue shortfalls. Moreover, we take note of the planned recapitalization of the central bank by the government and would welcome if staff could further elaborate on this issue.

We take positive note of the recent progress on strengthening the anti-corruption framework and encourage the authorities to remain steadfast in the implementation and enforcement of the new framework. We also agree with staff that adaptation of the draft law on asset recovery is important to complete the anti-corruption framework.

Finally, on a specific point, we note the significant impact of the positive vanilla price shock since 2016, which has helped to strengthen the current account position and macroeconomic stability more broadly. Against this backdrop, we wonder whether more abrupt changes to the price of vanilla than the gradual decline foreseen by staff could constitute an important risk (also to be mentioned in the Risk Assessment Matrix). Staff comments would be welcome.

Mr. Tan and Mr. Pham submitted the following statement:

We thank staff for an insightful report and Messrs. Raghani, Razafindramanana, and Alle for their helpful buff statement.

We commend the authorities for their solid program performance in 2018, considering the challenges related to elections. All end-June 2018 quantitative performance criteria and most indicative targets were met. The economic recovery has persisted, despite multiple shocks, with solid growth of around 5 percent, positive fiscal performance, contained inflation, and a robust external position. With that, we support the completion of the fourth review under the ECF. The key reform priorities ahead are to boost the quality of public spending while enhancing revenue mobilization, support financial inclusion, and improve economic governance, especially the fight against corruption. We agree with the broad thrust of the staff appraisal and offer the following points for emphasis.

We urge the authorities to create more fiscal space by improving the quality of public spending. Continuing to reduce inefficient public spending, particularly by adjusting subsidies in the fuel and electricity sectors, is key. In this regard, we note positively staff's recommendation on the adoption of the fuel pricing mechanism to avoid budgetary impact and the plan to eliminate the large existing liabilities to fuel distributors. We urge the authorities to develop targeted social measures to protect the poor and most vulnerable groups from the future impact of pricing adjustments. We also share the need to continue improving the financial soundness of the JIRAMA by improving revenue, cutting costs, and improving governance.

Efforts to build a sound financial sector to support growth should continue. We welcome the authorities' draft banking law, which addresses many of the FSSA's main recommendations. We look forward to the authorities' plans and strategies to increase financial access as stated in the buff statement. Appropriate measures are also needed to strengthen the state-owned banks.

We welcome the authorities' commitment to continue strengthening governance and stepping up the fight against corruption as key objectives of the new government. In this respect, the adoption of the draft law on asset recovery is important to complete the legal framework to fight corruption. The authorities' adoption of the AML/CFT law and the efforts to strengthen enforcement through appropriate mechanisms and agencies are welcome

steps. We look forward to the effective implementation of this law in the time to come.

Ms. Levonian and Mr. Sylvester submitted the following statement:

We thank staff for the useful report and Messrs. Raghani, Razafindramanana, and Alle for their helpful buff statement.

The Malagasy authorities have continued to demonstrate strong ownership and commitment to their Extended Credit Facility (ECF) arrangement. Program performance has remained strong, notwithstanding some setbacks, and risks appear manageable going forward. In light of this, we support the completion of the fourth review of the ECF arrangement and other proposed decisions. We offer the following additional comments for emphasis.

We welcome the continued focus of fiscal policy in line with program objectives. In this regard, the passing of the 2019 Budget, which supports the creation of fiscal space for growth-enhancing public investments and social spending is noteworthy. The budget seeks to boost taxes and restrain lower-priority spending, including through limiting transfers to the state-owned electricity company. Additionally, we welcome the authorities' plan to address arrears related to fuel pricing and to prevent its recurrence. Looking ahead, we share staff's assessment for continued efforts to further boost domestic revenue mobilization, to increase the efficiency of spending, and to manage fiscal risks, including from public-private partnerships (PPPs).

Given high poverty rates in Madagascar, spending to reduce poverty is critical. In light of the missed indicative target (IT) on social spending, we urge the authorities to urgently address administrative bottlenecks to improve priority social spending and strengthen social protection efforts to ensure that resources to reduce poverty are well targeted and the impact of program policies that may adversely affect the poor are mitigated. This is particularly important in the context of higher energy prices that will result from the full implementation of the automatic fuel pricing mechanism.

Like staff, we welcome the authorities' ongoing efforts to strengthen the financial sector in line with the FSSA recommendations. The new banking law should strengthen financial stability and contain systemic risks. We also welcome the authorities' plan to address low levels of financial inclusion. We would be interested in hearing from staff what has been the impact of the strengthened financial sector on correspondent banking relationships (CBRs).

The political context for advancing structural reforms appears favorable. The peaceful transition of power in 2018 and the commitment by the new government to key ongoing reforms bode well for the continued successful performance of the ECF program. We encourage the Malagasy authorities to remain steadfast in their commitment to implement much-needed structural reforms, including to improve the business climate to bolster private sector investments.

Finally, the recent progress made on strengthening governance and combating corruption is commendable. Like staff, we welcome the authorities' recent progress on strengthening the anti-corruption framework and urge them to accelerate implementation of remaining aspects to complete this framework, including to enact the law on asset recovery. Also, we welcome the authorities' commitment to further improve the quality of statistics, including by broadening the coverage of government finance statistics from central government to general government. Finally, as alluded by staff, implementation is where it matters for results. We urge the authorities to follow through with the implementation of the improved governance framework.

Mr. Trabinski, Mr. Makhammadiev and Ms. Wehrle submitted the following statement:

We support the completion of the fourth review under the ECF arrangement and the modifications in the performance criteria. We welcome the commitment of the new President to continue to pursue the economic reform agenda and to address the election-related fiscal slippages, as also mentioned by Mssrs. Raghani, Razafindramanana and Alle in their helpful buff statement. We encourage the authorities to use the favorable economic environment to continue progress on their structural reform agenda. We also support initiatives on building a stable and inclusive financial sector. We have the following points for emphasis:

Further progress is needed towards cost-recovery fuel pricing and to contain lower priority spending. We welcome the implementation of the two prior actions related to winding down transfers to JIRAMA and to the agreement with fuel distributors. We encourage the authorities to pay off the existing fuel-related liabilities and to proceed with the full implementation of an automatic pricing mechanism with a smoothing formula speedily to prevent the future build-up of liabilities to fuel distributors. The mechanism should be accompanied with well-targeted measures to mitigate its impact on the poor.

We concur with staff that the authorities should also boost revenue mobilization, reprioritize spending, and reform JIRAMA to make it more cost-efficient. Swift progress on reforms to contain the wage bill and transfers to the civil servants' pension fund would also be needed. Moreover, improving the climate for private investment and strengthening public investment management will be necessary to address the country's medium-term objectives.

We call the authorities to make progress on enhancing the anti-corruption framework. While the adoption of a new AML/CFT law lays a good groundwork for anti-corruption institutions, its full implementation and enforcement will play a crucial role in buttressing governance and donor sentiment. In this regard, we encourage the authorities to step up with the implementation of the law on asset recovery to complete the anti-corruption framework.

Lastly, we welcome the authorities' work on the new banking law and the law on financial stability, based on the FSSA's findings. We encourage the authorities to promptly implement these laws upon approval by the Parliament.

Mr. Kaizuka and Ms. Mori submitted the following statement:

We thank staff for a comprehensive report and Mr. Raghani, Mr. Razafindramanana, and Mr. Alle for their informative statement. We welcome that the presidential election was held peacefully in 2018 and newly elected President has committed to pursuing the country's reform programs. It is also encouraging that economic recovery continued in 2018 with moderate inflation, fairly good fiscal performance and a solid external position. Given the relatively strong program performance despite the election period, we support the completion of the fourth review under the ECF arrangement and modification of performance criteria for end-June 2019. Having said so, challenges including fuel pricing and transfer to the public utility JIRAMA remain and sustained progress is required to reduce poverty. Therefore, we encourage the authorities to continue their reform effort. As we broadly agree with the thrust of the staff's appraisal, we will limit our comments to the following points:

#### Fiscal Policy

Although tax revenue shortfall affected by election and impact from delay of a fuel price adjustment were observed in 2018, we welcome that

the 2019 budget is consistent with program objectives of boosting pro-growth fiscal policy and overall fiscal sustainability remains solid. Also, we positively note that the authorities are preparing contingency plans in case revenue shortfall occurs. While we positively note that the JIRAMA management adopted a revised 2019 budget consistent with the government budget, further effort to reduce costs and losses are needed as operational losses pose fiscal pressures. On the fuel price, while recognizing difficulties in a fragile social and political situation, implementing an automatic fuel pricing formula with a smoothing mechanism and limited discretion is warranted as the delay of reform has fiscal impact. At the same time, as staff point out, measures to mitigate the impact on the most vulnerable should be developed. Related to this point, we note that indicative target of floor on social priority spending were missed in three consecutive times, due to administrative delays in some investment spending. We would appreciate staff's comments on the background of administrative delays, and whether there are any plans to provide TA in case the cause is the authorities' capacity constraint? To improve living standard and reduce poverty, we encourage the authorities to execute planned spending while continuing on-going efforts to develop and scale up social safety net programs by expanding the beneficiary base. Going forward, we encourage the authorities to find additional fiscal space for growth friendly investment by enhancing revenue mobilization, strengthening implementation capacity for public investment, and reducing the share of lower priority spending including transfers to JIRAMA.

### Monetary Policy

It is encouraging that the current approach of a combination of a flexible exchange rate, foreign reserve accumulation and liquidity operations to limit excess bank reserves volatility has been well adopted and inflation remains under control. We appreciate the Fund's TA toward gradual move to interest rate targeting and development of the operation of the foreign exchange market. On the surrender requirement on export proceeds, we would like to hear staff's view on whether there should be prerequisite conditions for phasing it out.

### Financial Sector

While recognizing generally healthy financial soundness indicators, we encourage the authorities to further strengthen financial regulatory and supervisory frameworks. The submission of a new draft banking law and implementation of risk-based supervision are welcome steps. The development of non-bank financial institutions contributes to financial

inclusion. At the same time, risks stemming from the growth of micro-financial institutions and rapid expansion of electronic money services should be carefully monitored.

### Governance and Fighting Corruption

Strengthening economic governance including enhancing public financing management is an essential element in economic success given the widespread weakness in numerous state functions. We welcome the progress including adoption of several laws since 2016 to strengthen governance, supported by Fund's program engagement and TA. Effective implementation and enforcement of these laws are important going forward and we welcome the opening of the first anti-corruption court in June 2018 and increased budget allocation to the anti-corruption agency BIANCO. In this point, we would like to know whether there are any tangible outcome of the opening of the court and budget increase to BIANCO such as rulings of the court at this stage.

Mr. Palei and Mr. Snisorenko submitted the following statement:

We thank staff for the informative report and Messrs. Raghani, Razafindramanana, and Alle for their helpful buff statement. Madagascar's economic recovery continued in 2018, with real GDP growth estimated at 5.2 percent, while inflation remained moderate at 6.1 percent in December. The program remained broadly on track despite the challenges of the electoral year. The constitutional transfer of power following the election provides good prospects for program implementation going forward. We agree with the thrust of the staff appraisal and support the completion of the fourth review under the Extended Credit Facility as well as the authorities' request for modification of performance criteria.

Fiscal position remains robust despite the shortfall in net tax revenue. We welcome the authorities' efforts to settle the liability related to fuel pricing and their commitment avoid its re-occurrence, as indicated in the buff statement. At the same time, the full implementation of an automatic price adjustment mechanism with due consideration of social impacts should remain a priority. We welcome the reduction in transfers and subsidies, including transfers to JIRAMA. At the same time, further shift in spending composition towards public investment and priority social spending is critical to boost pro-growth fiscal policy.

On the monetary policy, we agree that current combination of a flexible exchange rate, foreign exchange reserve accumulation, and liquidity operations remains appropriate. We welcome the continuing move by the central bank toward interest rate targeting. We look forward to additional measures aimed at strengthening the monetary policy framework, including improving the functioning of the interbank market. We call for a rapid adoption and operationalization of the law on repos which will contribute to the development of the interbank market.

The authorities should continue strengthening financial sector. We welcome the banking law and the law on financial stability that address many of the key recommendations from the FSSA. Improving financial inclusion remains among key priorities in financial sector reforms. We welcome the recent steps to improve regulation of the public savings fund and the postal savings fund. Could staff provide an update on how these two institutions with systemic importance for financial inclusion are adapting to new regulation?

According to staff, the authorities achieved significant progress in enhancing economic governance and strengthening the anti-corruption framework. Enactment of the law on AML/CFT in December 2018 was an important milestone. We strongly encourage adopting the law on asset recovery, as it will further enhance the anti-corruption framework. Staff's update on enforcement of anti-corruption regulation would be welcome.

We wish the Malagasy authorities continued success in their reform efforts.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We thank Staff for their comprehensive reports and Messrs. Raghani, Razafindramanana, and Alle for their helpful buff statement. Economic conditions in Madagascar remain generally positive, amidst stronger macroeconomic stability and highest growth in ten years, but external shocks to terms of trade could put the recovery at risk. We welcome that confidence has been strengthened as elections passed and would encourage the incoming administration to take advantage of the positive medium term to continue the reform agenda.

We welcome the continued solid performance under the ECF arrangement. All end-June 2018 PCs and all but one ITs were met and the structural agenda is on track. We are encouraged by the implementation of the two prior actions We support the completion of the fourth review under the

Extended Credit Facility arrangement and the request for the modification of performance criteria.

On fiscal policy, we welcome that fiscal sustainability remains solid, but we encourage authorities to remain committed to revenue mobilization measures and improve the quality and composition of spending. Corrective actions to address slippages from the electoral period and a renewed commitment to managing fiscal risks will be required to continue progress on reforms in the medium term.

Fuel price adjustment and the commitment to reducing the share of lower priority spending are key aspects going forward. We welcome the completion of two prior actions regarding the agreement on plans for the fuel price mechanism and JIRAMA's adoption of a revised budget for 2019. We look forward to the new price structure, the implementation of the fuel price mechanism in September 2019 and the settlement of the existing liabilities. Moreover, we agree with staff that efforts should continue to reform JIRAMA so it achieves full operational cost recovery in the medium term.

We welcome efforts to strengthen the anticorruption framework. We are encouraged by the adoption of the AML/CFT law in December 2018. Now that the institutional framework is in place, implementation and enforcement will be of the essence.

The new drafting laws on FSSA key recommendations and on financial stability are good steps in the right direction. We encourage authorities for the steadfast implementation of these laws as soon as approved by parliament in order to build a sound financial sector.

Finally, we underscore the importance of the extensive technical assistance provided by the IMF in the past years and welcome the update of the Capacity Development Strategy Note to refine the sequencing of upcoming TA in line with the priorities of the new government.

Mr. de Villeroché, Mr. Castets and Mr. Bellocq submitted the following statement:

We thank staff for the comprehensive and well written report and Mr. Raghani, Mr. Razafindramanana and Mr. Alle for their insightful buff statement.

Program performance has been satisfactory at end-June 2018, with all Performance Criteria (PCs) and all but one Indicative Target (ITs) met. The

program's structural reform agenda was also implemented, although partially, with five out of nine Structural Benchmarks (SBs) met at end-December 2018 and good progress, according to staff, for all the others except the SB on fuel price adjustment. Regarding the two Prior Actions associated with the review, we take good note of the supplementary information issued by Staff on March 19<sup>th</sup>. Against this background, we support the completion of the fourth review of the program supported by the Extended Credit Facility (ECF). We welcome the recent peaceful and constitutional transfer of presidential power, as well as the renewed authorities' commitment to implement the IMF-supported program. Indeed, we are of the view that the program has helped in addressing economic imbalances and stabilizing the economy. As staff, we consider that the outlook will continue to be positive if the authorities remain committed to the program's objectives.

The 2018 budget execution was in line with the projections of the program. However, we regret that the domestic tax performance was lower than expected in the second part of the year (associated with the electoral context, as underlined by staff), as well as the fact that the floor on social priority spending was not achieved. We would like to reiterate the need for Low Income Countries (LICs) to design and implement fiscal consolidation through a realistic but ambitious Domestic Resources Mobilization agenda, while preserving development and social priority spending. This remains instrumental to protect social and capital spending in a country like Madagascar where poverty rate remains elevated. In that regard, we strongly encourage the new authorities to keep on strengthening the positive trend observed with tax-to-GDP ratio in recent past (this ratio increased from 9.9 to 11.7 between 2014 and 2018).

Looking forward, the fiscal policy remains prudent for 2019, with a projected fiscal primary balance which is expected to remain positive. Staff also underscores that past domestic payment arrears should be cleared as scheduled by government. The state budget exposure to oil price volatility has to be addressed as the fuel price adjustment was postponed during the presidential election run-up. We note that the implementation of an automatic fuel price adjustment is expected by end-September 2019. As staff, we encourage the authorities to set up targeted measures to mitigate the impacts of fuel price increase on the poorest. In that regard, we would appreciate if staff could further detail the costing of the measures described in paragraph 17, as well as the way those measures will be targeted to the most vulnerable and how the World Bank is involved in this regard.

Regarding the DRM agenda, we value the measures presented in the Memorandum of Economic and Financial Policies (MEFP) but we encourage staff to further investigate the way to enlarge the tax base in a context in which there is a very high concentration of tax collection on a few taxpayers (the MEFP mentioned that 0.2 percent of total tax payers account for 80 percent of tax collection). Staff comments would be welcomed. Still on DRM, we take note of the new law on Special Economic Zone approved by the Parliament in April 2018 and we reiterate that it will be critical over the medium term to manage the risk of allocating new tax incentives for private investment. We think the effectiveness of such measures has to be assessed very carefully through a cost-benefit analysis.

We note positively that the IMF program paves the way for a deeper and strengthened financial sector. The new draft banking law that will be submitted to the parliament in the coming months will be an opportunity to implement the Financial Sector Assessment Program's recommendations. We also value the authorities' strategy to develop mobile banking and financial inclusion and we would appreciate if staff is able to report back to the board about the main outcomes of this strategy going forward. Another step in the right direction is the adoption of the law on anti-money laundering/combating the financing of terrorism (AML/CFT) in December last year. We look forward to seeing its full implementation during the program implementation period. Finally, we agree with staff that the anti-corruption law submitted to the Parliament in December 2017, which has not been considered until now, should be discussed swiftly.

Ms. Mannathoko and Mr. Essuvi submitted the following statement:

We thank staff for their informative report and Messrs. Raghani, Razafindramanana and Alle for their helpful buff statement.

We congratulate the people of Madagascar on peaceful elections. We also commend the authorities on having sustained reforms through the 2018 election year and welcome the new President Rajoelina's stated commitment to sustaining reform progress going forward. Given the solid reform implementation reported for 2018, we support both modification of the end-June performance criterion and the completion of the fourth review under the Extended Credit Facility (ECF). Madagascar's economic recovery was sustained in 2018, in part due to the economic reforms adopted under the ECF which support macroeconomic stability and provide an environment that enables the investment needed for growth. With this in mind, we encourage the authorities to continue to persevere especially with reforms to further

enhance fiscal performance and expenditure management, make SOEs more financially independent of government, strengthen project implementation and investment efficiency, improve financial sector performance, entrench structural measures needed to improve governance, and generally promote inclusive growth.

Regarding public investment, the desire, of course is for a well-executed high-yielding public investment program that will raise GDP and be self-financing in the long run. However, this requires fully funded programs that can be effectively implemented without delays or disruptions. This can be difficult in a low capacity environment. New financing gaps may arise due to rising debt costs, or implementation delays or inadequate concessional financing once debt limits are reached. The expectation may then be for authorities to apply new tax increases or spending cuts that will require further macroeconomic adjustments, crowding out private investment and consumption, with the growth benefits of investments then being delayed. This in turn could then fuel instability. It would be helpful, therefore, if there was scenario analysis looking at some of these longer-run possibilities to enable advance planning. Could staff clarify whether such scenarios are available from their Madagascar DIG model (Fund's micro-founded dynamic equilibrium debt-investment-growth model) and if so what the results show?

It would also be helpful to have a sense of the likely timeframe before the current account recovers, so authorities can plan beyond the ECF. With the continued implementation of planned policies and programmed investments, GDP is projected to grow at around 5 percent over the next three years. However, as investment inputs lead to higher imports, projections show deterioration of the current account through 2024. Do staff have a sense of the amount of time that will likely be needed for the current account to recover, and whether the debt management strategy associated with these investments matches the recovery path?

While the medium-term outlook is favorable, the economy remains vulnerable to a variety of risks, thus on fiscal policy, we encourage the authorities to focus on improving the quality of spending and to manage fiscal risks, guarding against domestic slippages that could undermine the reform agenda. In this regard, we support the key features of the 2019 budget including mitigating fiscal risks that could emerge from SOEs and PPP guarantees. We commend the settlement of arrears to distributors and note the planned introduction of a new fuel mechanism. On the latter, we encourage the authorities to pay close attention to mitigating adverse impacts on the

poor. We also encourage continued restraint with the wage bill, while we commend the authorities' decision to reduce transfers to JIRAMA.

We commend the authorities on the monetary policy success reflected in effective liquidity operations and reserve accumulation; and look forward to further improvements in monetary policy transmission once measures to improve the interbank market have been implemented. Shifting from monetary to interest rate targeting should further improve the effectiveness of monetary policy in the current context. We also welcome steps underway to improve the operation of the foreign exchange market and would advise taking a gradual approach to capital account reforms, as rapid liberalization in low capacity environments can sometimes lead to unforeseen effects.

As the financial sector expands, reinforcing financial sector stability through risk-based supervision and appropriate prudential guidelines is essential to guard against systemic risk. In this regard, while we welcome the financial sector competition brought by new smaller banks, and the inclusive finance and financial deepening that will be brought by microlenders and the implementation of the new law on electronic money, we caution that the corresponding regulatory framework also needs to be put in place. We therefore appreciate the authorities' decision to submit a law to Parliament in a few months that incorporates pertinent recommendations from the FSSA and also welcome the adoption of a new law to regulate the establishment, licensing, operation, and supervision of private credit bureaus.

Finally, we urge authorities to sustain progress in strengthening governance, curbing corruption and improving the business environment. We welcome the progress made on AML/CFT measures and look forward to the timely adoption of the law on asset recovery.

With these points we wish the authorities success in implementing the reform agenda.

The Acting Chair (Mr. Furusawa) noted that Madagascar's economic recovery continued in 2018 amid the presidential election. The authorities' program implementation had been sound overall. Directors had highlighted the importance of using the broadly positive economic outlook to maintain progress on the key program objectives, especially boosting fiscal space for priority investment and social spending. Directors had noted transfers to the public utility and fuel pricing as the main challenges while also encouraging continued reforms to promote inclusive growth and enhance governance.

Mr. Vaikla made the following statement:

We support the authorities' request for the completion of the fourth review given the program's good performance and the authorities' commitment. Due to strong economic growth and the peaceful transfer of power, Madagascar is currently well positioned. We encourage the authorities to use this positive momentum to carry out necessary fiscal and structural reforms.

We appreciate that the report gives a good overview of the Fund's recent technical assistance (TA), which has been well aligned with program objectives. The Fund's capacity development is important also going forward in close cooperation with the World Bank.

Mr. Castets made the following statement:

We issued a gray statement, so I would like to emphasize a few points. First, we support the completion of the fourth review. Program performance has been satisfactory, and the program has helped the authorities in stabilizing the economy despite several exogenous shocks. The authorities should be commended for that. We welcome the recent peaceful and constitutional transfer of executive power in Madagascar, and we also commend the authorities for that, and we note positively that the new authorities are committed to implementing the Fund-supported programs. There is a strong continuity. We believe that Madagascar has a very positive economic outlook in front of it if macro and political stability are maintained.

On the fiscal side, we slightly regret the underperformance observed on the revenue side last year, as well as the fact that the floor on social spending has not been met. We encourage the authorities to correct those deviations. It also illustrates the need to discuss those two aspects in the conditionality review that is ongoing. More specifically, on the domestic resource mobilization agenda, we encourage the new administration to keep strengthening the positive trend in the tax-to-GDP ratio in recent years, and we encourage the authorities to enlarge the tax base and to use the tax exemption tools cautiously and after an in-depth economic analysis.

On the expenditure side, I would like to echo many Directors and stress the need for implementing an automatic fuel price adjustment mechanism, that has targeted compensation for the poorest and the most vulnerable. I ask the staff to elaborate on the preparation for that, because we

had past examples where the rollover of the compensation mechanisms was difficult. It is a very important point.

Finally, we would like to welcome the positive developments in the public governance agenda, and I would like to conclude by stressing the need to move forward with the anti-corruption law that was submitted to the parliament in December 2017, but which has not yet been considered.

Mr. Kaizuka made the following statement:

I commend the authorities and Mr. Mills and his team for the good track record of the program so far and the new government's strong commitment to the reform process following the election. At the same time, there are a number of challenges which include mobilizing domestic resources and improving the composition of spending.

I will touch on three issues. First, on the JIRAMA reform, we welcome the ongoing cost saving effort, but eventually there might be a need for a tariff increase to make JIRAMA more sustainable. In this regard, we look forward to the productive outcome of the study supported by the World Bank, as a tariff increase may have wide-range social implications.

Second, on the social spending floor, which is the only unachieved indicative target, there seems to have a delay in some capital investment projects, and the staff's answers to technical questions indicate that there is ongoing TA on investment capacity from the World Bank and the Fund, including updating the Public Investment Management Assessment (PIMA), which is a welcome step. Could the staff share some of the main findings of the recent PIMA?

Third, on the surrender requirement on export receipts, we understand the necessity of such measures as a temporary solution to support liquidity in the foreign exchange markets. We learned that the authorities will develop and adopt a plan to phase out such a requirement. Could the staff share their view on the desirable timeframe, pace, and sequencing of the phasing-out process.

Mr. Alkhareif made the following statement:

We have issued a gray statement where we supported completion of the fourth review under the program. I would like to limit my remarks to a few issues for emphasis.

First, we commend the authorities for their efforts to improve the fiscal side and reform agenda under the program. The authorities deserve to be commended for the efforts under the program. Like Mr. Kaizuka and Mr. Castets, we encourage the authorities to improve social spending and take it into account in future work.

Finally, we encourage the authorities to remain vigilant and step up their efforts to further strengthen the debt management sustainability. In this context, we welcome the inclusion in the Budget Law of the annex of managing fiscal risks. With these remarks, we wish the authorities continued success.

Mr. Sylvester made the following statement:

We issued a comprehensive gray statement supporting the completion of the fourth review, and so I will touch on a few areas for emphasis.

First, we commend the authorities for the continued strong performance under the program despite difficult circumstances. We also welcome the commitment to program objectives by the new government. This bodes well for continued successful performance.

Second, we urge the authorities to urgently address bottlenecks related to improving priority social spending and to ensure that resources to reduce poverty are well targeted, as well as ensure that the impacts of program policies on the poor are adequately mitigated by appropriate safety nets.

Third, this chair welcomes the authorities' focus on addressing governance and corruption issues. We encourage them to continue to make progress in this area, including to enact the law on asset recovery and to improve the quality of statistics.

Fourth, like most members of our constituency, Madagascar is exposed to the risk of natural disasters. We take this opportunity to reiterate our call for the Fund, in collaboration with World Bank and others, to support the country's efforts to build ex ante resilience to natural disasters.

Finally, we support Mr. Ostros and others on the need for ongoing capacity development to support the country's reform agenda.

The staff representative from the African Department (Mr. Mills), in response to questions and comments from Executive Directors, made the following statement:<sup>1</sup>

I will address five issue areas that were raised in gray statements and interventions. First, regarding the timing of the review, it is important to consider two aspects in the review: the evaluation of performance, and the forward-looking policy stance to ensure stability and sustainability, including the supporting structural agenda.

Past performance has been generally satisfactory, including on structural reforms. While four out of the nine structural benchmarks for the last year were not fully met, all but one were implemented either to a large extent or with a short delay. These slippages are understandable given capacity constraints in a fragile country. The notable exception was a cumulative liability to fuel distributors due to the incomplete fuel prices adjustment reform, which had an impact on the budget. In this case, agreeing on a plan to settle the liability and especially avoid its reoccurrence was crucial for protecting the objectives of the program. For this reason, the staff believed it was necessary to have a revised plan in order to propose the completion of the review. Furthermore, it was important to have the support of the new authorities for this plan. The continuous benchmark on fuel pricing has been modified accordingly. The revised plan has an extended timetable to enhance feasibility, particularly adopting the pricing mechanism in September.

Second, numerous gray statements highlighted the importance of targeted measures to mitigate the impact of fuel price increases on the poorest. The authorities, as well as Fund and World Bank staff, share this concern and have been working on it for some time. Fortunately, significant fuel price hikes are not needed in the near future under current conditions. In addition, the direct impact of price hikes when needed would be primarily on less poor households. Nevertheless, they could have an important indirect impact on the many highly vulnerable households, for example, through the cost of transportation or food. The staff is focused on developing social mitigation measures to address possible future price increases.

Unfortunately implementing well targeted social programs is currently problematic in Madagascar as the administrative machinery to identify households in need and transfer resources has only a nascent and very partial coverage. Even the subsidy for urban transport has faced some

---

<sup>1</sup> Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

implementation difficulties. The authorities are working with the World Bank to develop and extend these mechanisms, and the new authorities have made this effort an even higher priority, and Fund staff will continue to support those efforts.

Third, the staff strongly shares the concern over the delays in adopting the draft law on asset recovery. The previous parliament declined to examine the draft law in committee. The staff has urged the new president to pursue its adoption, and he committed to push for it in the first session of the new parliament planned for midyear. He has also made the fight against corruption a top priority.

Let me also address a few other points raised in the oral interventions. Concerning the PIMA, there are a number of procedural weaknesses currently in terms of meeting requirements for external donors and monitoring the implementation of investment projects that are ongoing. The PIMA recommended strengthening the institutional framework with the central coordinating body—that has been achieved—and streamlining procedures, which is underway. The most recent update mission, which took place earlier this month, found some significant improvements on those fronts, and we are hoping there will be continuing progress. There is an action plan to address these weaknesses in place.

Lastly, on the surrender requirement, both the country team and the TA team from the Monetary and Capital Markets Department (MCM) have worked with the authorities on steps to gradually phase out the surrender requirement, and while maintaining stability in the foreign exchange market and in particular adequate liquidity. This effort is being coordinated in terms of timing with the new law governing foreign exchange transactions. The deepening of the market would be part of this effort and part of the plan which would be in accordance with the integrated approach under the Institutional View on capital flows.

Mr. Castets made the following statement:

I wanted to come back on the mitigation measures for the fuel subsidies, and sorry for insisting so much on that aspect, but once again the some past experiences have been difficult, and we heard the staff's remarks on the division of labor with the World Bank, but the devil is very much in the details when it comes to sequencing. This chair's concern is that when the prices increase, even if they do not affect the poorest share of the population, people who are not among the poorest are not always affluent in Madagascar.

Our point is that when the price increase intervenes, there should be social safety nets in place that are ready to be enhanced or increased. I ask the staff to indicate whether it is the case, and if the staff is anticipating such a sequence with the authorities.

The staff representative from the African Department (Mr. Mills), in response to further questions and comments from Executive Directors, made the following additional statement:

The current coverage of the social safety net programs is limited. It is less than 1 million in a country of 25 million, so that is something to work on. Progress is rapid, and the goal is to extend that to the vast majority of the population in the next few years. The government has made this a priority. The World Bank has recently increased resources in that effort.

In terms of the impact on the less poor, which are concentrated on the urban areas, they are impacted more directly, for example, through urban public transportation. There is one measure already in place which would enable the authorities to subsidize that and mitigate the increase in public transportation. I should also highlight that the smoothing formula that the authorities are working on would allow the shock to be spread over time, so that is important.

In terms of social and political stability, the agreed discretionary adjustment enables the authorities to avoid poorly timed adjustments in the fuel prices, something that they learned from last year when this was a difficult problem. We feel that this goes a fair bit of the way toward mitigating these impacts, but it remains a concern, and we will continue working on it with the World Bank. In fact, we have recommended some increased TA if possible from the Fund in this area already and are working with the Fiscal Affairs Department to find that.

Mr. Razafindramanana made the following concluding statement:

I thank Directors, management, and the staff for their continued support to Madagascar. I welcome Directors' insightful comments and recommendations, which I will convey to my authorities. The authorities are committed to the objectives of the program, and they will continue to make every effort to maintain and even advance the current strong growth momentum. To this end, they are determined to pursue pro-growth policies and implement the critical reforms agreed on with the staff aimed at

enhancing financial stability, deepening the financial sector, while ensuring financial stability and improving governance and business climate.

I thank staff and share the responses to Directors' questions. I would just emphasize a few points. First, many Directors have stressed the critical importance of addressing JIRAMA losses and adjusting fuel prices as conditions to maintain fiscal sustainability. My authorities share these concerns and are dedicated to the actions in these areas.

Regarding JIRAMA, the authorities will step up efforts that started over the first period aimed at restoring the financial stability of the company and phasing out government transfers. Changes in the management of the company have already started, and its main operations are under review. With the support of the World Bank, many initiatives are underway to reduce operational costs and raise revenue, including through the recent installation of smart meters. The authorities will closely monitor the impact of these measures and stand ready to take additional steps in the coming period as needed.

On the fuel price, as mentioned in our buff statement, the authorities have already signed an agreement with distributors to settle liabilities to the sector as the first step of their plan to address the budget costs of fuel price differentials. Going forward, the authorities will prepare for the implementation of the automatic pricing mechanism in due course. In doing so, they concur with the view expressed by Directors that care should be taken with mitigating measures to protect the most vulnerable. They also look forward to hearing from the staff about any helpful peer country experience with such reforms.

Besides addressing those issues that cause a drain on public finances, the authorities are also engaged in efforts to mobilize more domestic revenue. Recent reforms, notably of the customs administration, have yielded more than programmed resources. Such experience will be enhanced, including by making good use of the Fund's TA and the analysis of the tax policy unit.

On the financial sector, I thank Directors for acknowledging the progress made so far in strengthening the sector, including with the adoption of bank laws. The authorities intend to keep pace with these steps, including by adopting in the period ahead the new law to enhance financial stability and address systemic risks.

Directors have called for strengthening the overall economic governance and combating corruption. I would like to reassure Directors that these issues are a top priority of my authorities' economic transformation agenda.

Improving governance and fighting corruption stand high among the steps to improve the business climate for attracting badly needed foreign investment. The new government has taken on corruption head-on. There are many ongoing investigations, and several persons involved in cases of mismanagement of public resources have been arrested. Efforts will continue in enhancing public financial management procedures, implementing the anti-corruption framework, and completing it with the adoption of the law on asset recovery.

To conclude, I would like to once again reassure Directors on my Madagascar authorities' commitment to speed up reforms and move toward a successful completion of the program. As we conclude this fourth review, they have asked me to warmly thank the mission chief, Mr. Mills, for his dedication, hard work, open mind, qualities, and skills which have served Madagascar well over the past few years. We congratulate Marshall. He is known as Marshall in Madagascar. We congratulate Marshall as he leaves Madagascar for his new appointment in the African Department. We wish him well in his career. I also acknowledge his team for their hard work. The authorities look forward to future engagement.

The following summing up was issued:

Executive Directors commended the authorities' sound implementation of their Fund-supported program, as well as the solid economic growth, single-digit inflation, and generally good fiscal performance. They welcomed the renewed commitment to the economic program by the new authorities, and urged them to leverage the favorable political momentum and broadly positive economic outlook to accelerate reforms and address vulnerabilities.

Directors underscored the importance of pursuing sustained and inclusive economic growth through continued fiscal reforms. They emphasized in this context the need for further progress on revenue mobilization. Directors, therefore, encouraged additional efforts to increase tax collection and avoid tax base erosion when implementing new tax incentives for investment. Directors also stressed the need to continue to improve the quality and composition of spending by increasing capital

expenditure and social spending and decreasing the share of lower-priority outlays, including transfers. Efforts to improve the business environment and enhance investment capacity are essential for successfully scaling up investment. Nonetheless, Directors called for ongoing vigilance on fiscal risks, including continued commitment to debt sustainability.

Directors highlighted the need to reduce the fiscal costs stemming from losses by the public utility JIRAMA and liabilities related to fuel pricing. In this regard, they welcomed the agreement with fuel distributors on a plan to avoid budget costs from fuel pricing, including implementation of an automatic price mechanism. Directors underlined the importance of measures to limit its potential impact on the poorest.

Directors supported the authorities' efforts to build a sound and inclusive financial sector, drawing on the FSSA recommendations. They urged them to push through with the new banking law and the law on financial stability to address systemic and emerging risks. Directors encouraged the authorities to phase out the surrender requirement on export proceeds.

Directors welcomed the adoption of the new law on AML/CFT and stressed the importance of enacting the law on asset recovery, which is necessary to bring the anti-corruption legal framework into closer alignment with international standards. They also underlined the need to provide adequate resources to recently established institutions for fighting corruption to ensure effective enforcement of the new laws.

The Executive Board took the following decision:

**Republic of Madagascar—Fourth Review Under the Extended Credit Facility and Request for Modification of Performance Criteria**

1. The Republic of Madagascar has consulted with the Fund in accordance with paragraph 4.B(b) of the arrangement for the Republic of Madagascar under the Extended Credit Facility (EBS/16/68, Supplement 3, 07/25/2016) (the “ECF Arrangement”) to review program implementation and to reach understandings regarding the conditions for future disbursements.
2. The letter dated March 8, 2019 from the Minister of Economy and Finance of the Republic of Madagascar and the Governor of the Central Bank of Madagascar (the “March 2019 Letter”) together with its Memorandum of Economic and Financial Policies (the

“March 2019 MEFP”) and the Technical Memorandum of Understanding (the “March 2019 TMU”) shall be attached to the ECF Arrangement, and the letter dated July 12, 2016 from the Minister of Finance and Budget of the Republic of Madagascar and the Governor of the Central Bank of Madagascar, together with all its attachments, as supplemented and modified, shall be read as further supplemented and modified by the March 2019 Letter and its attachments.

3. Accordingly, the ECF Arrangement for the Republic of Madagascar shall be amended as follows:

The performance criteria specified in paragraph 4.D of the ECF Arrangement with regard to the seventh disbursement shall be as specified in Table 1 of the March 2019 MEFP, and further specified in the March 2019 TMU.

4. The Fund decides that the fourth program review specified in paragraph 4.B(b) of the ECF Arrangement is completed, and that the Republic of Madagascar may request the fifth disbursement referred to in paragraph 2(e) of the ECF Arrangement, on the condition that the information provided by the Republic of Madagascar on the implementation of the measures specified as prior actions for the fourth review in Table 2 of the March 2019 MEFP is accurate. (EBS/19/13, 03/11/19)

Decision No. 16493-(19/21), adopted  
March 22, 2019

APPROVAL: February 12, 2020

JIANHAI LIN  
Secretary

## Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

1. ***We wonder whether the timing of the review could have been better managed and if current delays could affect the execution of the next reviews. Staff comments are welcome.***
  - Will be addressed in oral intervention.
2. ***We noticed the proposed modification in the performance criteria of the central bank's floor on net foreign asset and ceiling on net domestic assets. Could staff elaborate more on the reasons behind these modifications?***
  - End-2018 reserves are currently higher than estimated at the time of the third review, due largely to higher vanilla prices. It was agreed that the related PC for June 2019 would be revised upward, consistent with the authorities' long-term aim to increase foreign reserves gradually towards 6 months' import cover, the regional convergence criteria. Reserves are currently below the top of the assessed reserve adequacy range based on months of imports. Regarding net domestic assets, the proposed modification in the related PC is very limited and without macro-economic implications.

### **Fiscal Policy**

3. ***We share the staff rationale for the modification of the PC on primary balance, nonetheless we wonder if the expectation of a positive fiscal anchor remains adequate as the earlier positive end-2018 PC is now pointing to a deficit. In this regard, could staff provide some projections on fiscal indicators and the related targets for the end of the current year?***
  - The end-2018 domestic primary balance is an estimated 0.3 percent of GDP deficit, as noted. This outcome is due to a revenue shortfall, which is expected to be temporary and does not affect 2019 projections. For 2019, the domestic primary balance is projected to reach a slight surplus of 0.1 percent of GDP, lower than the 0.4 percent to GDP expected at the time of the 3<sup>rd</sup> review. This change is largely explained by the recapitalization of the central bank (for the equivalent of 0.2 percent of GDP), which was not accounted at the time of the 3<sup>rd</sup> review.
4. ***Could staff also comment on possible tax policy reforms, in addition to tax administration measures, to strengthen revenue mobilization? Does staff have an estimate of the potential revenue cost of the new tax incentives?***
  - In addition to the ongoing efforts, FAD's TA on tax administration in 2018 highlighted several priorities to further strengthen revenue administration, including

- improving control and recovery procedures and better coordinating the central administration with the regions. Tax policy reforms being considered by the authorities (based on FAD TA) include adjustments in the VAT regime and revisiting exemptions based on a recent study by the tax policy unit (which has been annexed to the 2019 Budget Law).
- Although the new investment promotion laws (Special Economic Zones and Industrial Development) provide for the possibility of tax incentives, the nature and potential revenue cost of these incentives have not been decided. Once decided, they will be applied to a limited number of pilot projects to test their effects. Staff insisted on the need to assess the costs and benefits of planned incentives before taking any further actions.
5. ***Could staff comment on the overall size of fiscal risks identified in the Malagasy economy?***
- The main fiscal risks identified by the authorities (with help from Fund TA and attached as an annex to the Budget Law since 2018) include: the exposure to public sector liabilities (JIRAMA, up to 3 percent of GDP; exposure to public savings fund and postal savings fund, up to 1.5 percent of GDP); the imbalances of the public service pension system (0.7 percent of GDP in 2019); natural disasters (for example, the cost to the economy of natural disasters was estimated at 1.4 percent of GDP in 2018); international oil prices volatility (see Text Box 1 in Staff Report); and institutional and political stability.
6. ***Regarding the DRM agenda, we value the measures presented in the Memorandum of Economic and Financial Policies (MEFP) but we encourage staff to further investigate the way to enlarge the tax base in a context in which there is a very high concentration of tax collection on a few taxpayers (the MEFP mentioned that 0.2 percent of total tax payers account for 80 percent of tax collection). Staff comments would be welcomed.***
- The high concentration of company revenue tax collection on a few taxpayers increases the risk of revenue volatility. Beyond the need to increase the overall share of the formal sector in the economy, ongoing efforts to broaden the tax base focus on a better segmentation of taxpayers, improving information sharing protocols between customs and domestic tax administrations, and the strengthening of recovery plan for tax arrears and effective monitoring of tax controls. On the latter, important changes are underway to incorporate strong risk analysis for tax control decisions, with support of technical assistance.
7. ***The expectation may then be for authorities to apply new tax increases or spending cuts that will require further macroeconomic adjustments, crowding out private investment and consumption, with the growth benefits of investments then being delayed. This in turn could then fuel instability. It would be helpful, therefore, if there was scenario analysis looking at some of these longer run possibilities to enable advance planning. Could staff clarify whether such scenarios are available***

*from their Madagascar DIG model (Fund's micro-founded dynamic equilibrium debt-investment-growth model) and if so what the results show?*

- As part of the 2017 Article IV consultation, staff tested the realism of the assumptions underlying the impact of Madagascar's scaling up by applying the Debt-Investment-Growth (DIG) model. Three alternative scenarios were tested – a lower efficiency of public infrastructure investment, lower initial return on infrastructure investment, and a combination of both. In summary, while the DIG model confirmed a medium risk to debt sustainability with a potentially large growth dividend; a vulnerability of private sector growth to low public investment efficiency and quality; and the need for a careful monitoring of the impact of scaling up investment on exchange rate developments. The model assumed the same gradual increase in domestic revenue mobilization as in the program, with the scaling up financed initially through a reliance on concessional external financing. Medium and long-term impacts of the public investment scaling up will continue to be part of the discussions with the authorities, including with the upcoming 2019 Article IV discussion.

#### **Social, poverty, priority spending**

8. *In this regard, we wonder that domestically-financed priority spending will continue to steadily increase as a percentage of GDP, but the related indicative target (end-June 2019) is going to be reduced by 10 percent on a nominal base. Staff comments are welcome.*
  9. *We note that indicative target of floor on social priority spending were missed in three consecutive times, due to administrative delays in some investment spending. We would appreciate staff's comments on the background of administrative delays, and whether there are any plans to provide TA in case the cause is the authorities' capacity constraint?*
- In the 2019 budget, domestically financed investments increase significantly to 2.8 to percent of GDP from 2.3 percent of GDP in 2018, although the rate of increase is less than previously targeted. There was an effort to concentrate the smaller-than-planned increases in investment programs in non-social sectors, but it was unavoidable that some planned social sector investments have also been impacted, affecting the overall social spending. Social priority spending is still projected to increase by 0.2 percent of GDP in 2019 despite the smaller-than-planned increase, and social priority spending is planned to return to originally targeted levels in 2020.
  - In 2018, the PC on social priority spending is estimated to have been missed by MGA 20 billion (less than 0.05 percent of GDP), almost entirely due to lower-than-planned domestic contributions to foreign-financed investment projects, which were not executed as rapidly as expected. There is ongoing TA on investment

capacity from the World Bank and the Fund, including a recent FAD mission (in March 2019) updating the PIMA assessment and the guidelines for public investment management.

10. ***As staff, we encourage the authorities to set up targeted measures to mitigate the impacts of fuel price increase on the poorest. In that regard, we would appreciate if staff could further detail the costing of the measures described in paragraph 17, as well as the way those measures will be targeted to the most vulnerable and how the World Bank is involved in this regard.***
  - Research conducted by the World Bank has shown that in Madagascar the benefits from the subsidies for consumption of gasoline and diesel are concentrated in the top income quintile of the population (kerosene is an exception, as it is consumed by the poorest). Accordingly, the subsidies for gasoline and diesel are highly regressive. Our discussions with the authorities explored a number of options for scaling up targeted interventions to protect the poorest (see below). As an interim measure, the authorities occasionally provide a subsidy on public transport, mainly in the capital; while the cost is very small (and has varied according to fuel price levels), it faces difficulties in implementation and reaches a small portion of the population, which may not be the poorest.
  
11. ***We noted that staff have urged the authorities to continue efforts to develop and scale up social safety net programs, building on World Bank supported programs such as PSNP and HDCT. We invite staff to elaborate on this initiative and its distribution effects.***
  
12. ***Could staff elaborate on the incidence of poverty in Madagascar and the characteristics of the main social programs.***
  - Madagascar is one of the poorest countries in the world, with more than 70 percent of the population living on less than \$1.90 a day.
  - The HDCT and the PSNP are two of the components of the Social Safety Net (SSN) project, which is supported by the World Bank. The Human Development Cash Transfer (HDCT) is a conditional cash transfer program providing regular cash benefits for families with children 0-12 years. It is linked to primary schooling, and good practices for health, nutrition and early childhood development. Madagascar's Productive Safety Net program (PSNP) provides cash for work opportunities over three years households. It moves beyond the short-term interventions by incentivizing beneficiaries to make productive and long-term investments. In total, about 150,000 households (approx. 750,000 people) have benefitted so far from these safety net programs, with more than 70 percent of cash transfers being paid to the female head of the household. The scaling-up of these programs depend on a better capacity to reach the most vulnerable, with important difficulty of identification and monitoring.

13. *On fuel pricing, the report indicates that the authorities have adopted an automatic price mechanism with a smoothing formula and limited discretion, to be fully implemented no later than end September. Could staff elaborate further on the characteristics of this mechanism, including the implications of discretionary adjustments by prior agreement with distributors, the surcharge element to be included in the price structure, and possible measures to mitigate the impact on the most vulnerable?*
- The details of the automatic fuel pricing mechanism with a smoothing formula are still being developed in consultations with stakeholders, which are linked to the negotiations on the price structure. The authorities are examining mechanisms successfully implemented in other countries (using templates provided by FAD), which will be based on the fuel price structure to be agreed by June 2019. In agreement with the fuel distributors, this automatic pricing mechanism will be combined with limited discretionary adjustments for social stability reasons (see TMU ¶25 for details). The details of a potential surcharge to be included in the price structure are also to be decided; for example, a 4 percent surcharge during one year would roughly cover the total liability at end-2018 (MGA 140 billion).

#### **External sector**

14. *We would appreciate it if staff could elaborate more and share their views on the current external position?*
15. *As investment inputs lead to higher imports, projections show deterioration of the current account through 2024. Do staff have a sense of the amount of time that will likely be needed for the current account to recover, and whether the debt management strategy associated with these investments matches the recovery path?*
- The 2017 External Sector Assessment (ESA) attributed a strong external position partly to a positive terms of trade windfall related to vanilla prices, which was expected to unwind. For example, vanilla export prices in 2017 were triple their long-run average. Vanilla prices continue to be well above historical highs, so the terms of trade windfall has not yet unwound. Together with slower-than-anticipated increases in investment-related imports, this has contributed to a smaller current account deficit than forecast at the time of the ESA.
  - Assumed lower export prices, combined with rises in investment-related imports reflecting the country's long-term development needs, would make the external position less strong. The higher current account deficit over the medium term also reflects staff's conservative assumption of not including any budget grants (worth more than ½ percent of GDP in 2018) until they are identified. Investment-related imports are largely financed by concessional borrowing for identified projects, so the deficit is sustainable. Nonetheless, the current account deficit is expected to moderate over the longer-term as investment-related imports stabilize. The real effective exchange rate has appreciated since the ESA. Staff will further assess how these

developments, any policy gaps, and reserve adequacy combine in a new external sector assessment with the Article IV consultation.

16. *Since Madagascar is broadly dependent on mining and vanilla exports, how does staff assess the economy's vulnerabilities to fluctuations in the global prices both in the short and medium terms?*
17. *Finally, on a specific point, we note the significant impact of the positive vanilla price shock since 2016, which has helped to strengthen the current account position and macroeconomic stability more broadly. Against this backdrop, we wonder whether more abrupt changes to the price of vanilla than the gradual decline foreseen by staff could constitute an important risk (also to be mentioned in the Risk Assessment Matrix). Staff comments would be welcome.*
- Staff has highlighted terms of trade shocks as a key vulnerability in the staff report. Mining and vanilla comprise about half of Madagascar's goods exports. In the Risk Assessment Matrix, which covers a horizon of up to three years, weaker-than-expected global growth is a trigger for weaker commodity prices. For example, nickel is the biggest mining export for Madagascar, and China accounts for half of global demand. Our baseline has a decline in vanilla prices of about one third between 2018 and 2024 and back towards its historical long-run average, but the pace should depend in part on the speed of the supply response from alternative sources.

## **Financial sector**

18. *Could staff provide detail on how the authorities plan to supervise small commercial bank activities, MFI institutions, and e-money services for stability risks?*
19. *However, with the rapid expansion of electronic money service, we wonder if current legislative framework on electronic money institution adopted in 2016 remains appropriate.*
- The strengthening of financial stability is notably based on the ongoing implementation of risk-based supervision (RBS), which has specific components on small commercial bank activities, MFI institutions, and e-money services. The RBS methodological framework for microfinance has benefited from specific technical assistance of the World Bank, and the legislative framework on electronic money institution adopted in 2016 seems appropriate. The new banking law expected to be adopted by Parliament by mid-2019 also contributes to aligning prudential regulation for MFI with current standards. Staff will continue to monitor developments in these rapidly changing sectors.
20. *We take note of the planned recapitalization of the central bank by the government and would welcome if staff could further elaborate on this issue.*
- The recapitalization of the Central Bank is consistent with the 2016 central bank law (its adoption was part of structural conditionality under the SMP preceding the current ECF-arrangement), which strengthened its independence and provided a

mechanism for the automatic transfer of central bank losses and profits to the government. The needs for recapitalization in 2019 are limited (about 0.2 percent of GDP) and will be done by June through the transfers of government securities to the balance sheet of the central bank.

21. ***We would be interested in hearing from staff what has been the impact of the strengthened financial sector on correspondent banking relationships (CBRs).***
- The banking sector in Madagascar is largely dominated by subsidiaries of global and regional banks, which have not been facing serious problems concerning their correspondent banking relationships. Recent progress on the AML/CFT framework should further strengthen this situation. Staff will continue monitoring the situation.
22. ***We appreciate the Fund's TA toward gradual move to interest rate targeting and development of the operation of the foreign exchange market. On the surrender requirement on export proceeds, we would like to hear staff's view on whether there should be prerequisite conditions for phasing it out.***
- The surrender requirement supports liquidity in the FX market by obliging exporters to sell a portion of their proceeds directly into the interbank market (and not directly to the central bank). While the surrender requirement can be successful in supporting liquidity in the FX market, it is important to acknowledge its drawbacks, as it may increase transaction costs for the exporters and create incentives for exporters not to repatriate their export proceeds.
  - The foreign exchange market remains shallow and prone to volatility. Staff believes that the surrender requirement should be considered a temporary solution and efforts should be made to eliminate it as soon as practicable. The authorities' plan to develop and adopt a plan to phase out the surrender requirement without jeopardizing stability in the foreign exchange market is in line with the integrated approach set out in the IMF's Institutional View. Staff will study the authorities' forthcoming plans carefully.
23. ***We welcome the recent steps to improve regulation of the public savings fund and the postal savings fund. Could staff provide an update on how these two institutions with systemic importance for financial inclusion are adapting to new regulation?***
- The dynamism of nontraditional banking services like electronic money services (which nearly doubled every year since 2011) poses challenges for traditional state-owned savings institutions, such as the public savings fund (Caisse d'Épargne de Madagascar, CEM) and the postal savings fund (PAOMA). The CEM is following its action plan, for which the first step is the conversion into a microfinance institution (the request is currently under examination by the regulator). PAOMA is still working on a medium-term strategy, while limiting the development of new products, to avoid new risks, and undertaking a full audit of the customer accounts. These two institutions are of systemic importance for financial inclusion, but the associated risks to the financial system and government budget are limited.

## JIRAMA

24. *Could staff comment on whether the “substantial” cost savings the authorities hope to realize could make up for a lack of tariff increases?*
25. *Regarding the transfers to JIRAMA, could staff comment on the feasibility of adhering to the amount envisaged in the budget without resorting to tariff increases, by relying only on cost-saving measures?*
- The shortfall in revenue for JIRAMA due to the absence of tariff increase in 2019 is estimated at about 0.3 percent of GDP. The revised budget of the company offsets this shortfall through cost saving measures, which are benefiting from World bank expertise and financing. The measures include changes in the procurement of fuel (including the possibility of direct purchase on the international market) and renegotiation of the terms of some contracts with its independent power producers. Given JIRAMA’s high cost structure, the potential for savings is substantial.

## Governance

26. *We would like to know whether there are any tangible outcome of the opening of the court and budget increase to BIANCO such as rulings of the court at this stage.*
27. *Staff’s update on enforcement of anti-corruption regulation would be welcome.*
- The opening of the first anti-corruption court in Antananarivo happened as recently as June 2018. There are several ongoing investigations that are published and easily accessible on dedicated website, but no final court decisions have been taken yet. The authorities have committed to publish the final decisions of the anti-corruption court (a structural benchmark). Moreover, since April 2018, the authorities have published detailed statistics of enforcement actions, in accordance Tables 2-6 of the TMU.
  - The legal framework has been significantly strengthened and is still being finalized. A notable achievement is the adoption since 2016 of several laws: the anti-corruption law (2016), essential for the prevention and detection of the laundering of the proceeds of corruption; the law on anti-corruption centers (2016) to establish specialized and independent tribunals; the law on international cooperation (2017), which ensures that anti-corruption agencies can effectively participate in international cooperation; and a new law on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), adopted in December 2018. The authorities intend to issue the implementation decrees associated with the anti-corruption and AML/CFT laws by end-September 2019.
28. *We note staff’s concern that an important anti-corruption law submitted to parliament has yet to be adopted. Could staff elaborate more on the issues behind the delay and how the authorities intend to move forward in this regard?*

- The draft law on asset recovery, which ensures that judicial authorities can freeze, seize and confiscate illegally acquired assets, was initially submitted to parliament in late 2017 and is still awaiting parliamentary action.