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September 12, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Madagascar - Staff Report for the 1984 Article IV Consultation and Second Review of Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Madagascar and the second review of its stand-by arrangement. Draft decisions appear on pages 27 and 28.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Bhatia (ext. 73253) or Mr. Schiavo-Campo (ext. 77189).

Att: (1)

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INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF MADAGASCAR

Staff Report for the 1984 Article IV Consultation and Second Review of the Stand-By Arrangement

Prepared by the African Department

(In consultation with the Exchange and Trade Relations, Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by J. B. Zulu and S. Kanesa-Thasan

September 12, 1984

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I. Introduction

The 1984 Article IV consultation discussions with Madagascar and the second review of the stand-by arrangement were held in Antananarivo during July 22-August 3, 1984; the review was to cover the exchange rate policy and the banking system. The representatives of Madagascar included Mr. P. Rakotomavo, Minister of Finance, Mr. R. Randriamaholy, Governor of the Central Bank, and Mr. J. Robiarivony, Director General of Planning. The mission also met with representatives of the Ministries of Agriculture, Industry, Transport, Labor, and Commerce. The staff representatives were Mr. R.J. Bhatia (head), Messrs. T.T. Gibson, S. Schiavo-Campo, M.G. Gilman, and J.C. Williams, and Ms. C. Elwell (secretary) (all AFR).

Since June 1980 Madagascar has made substantial use of Fund resources under four successive stand-by arrangements. The latest of these was approved in principle by the Executive Board on December 21, 1983, for an amount of SDR 33 million (49.7 percent of quota). It became effective on April 10, 1984, following findings by the Board that adequate agricultural producer price increases had been adopted and that satisfactory arrangements were in place for the financing of the projected balance of payments gap in 1984. This followed the successful conclusion on April 5-6 of a Fund-organized Aid Donors' meeting to seek the required balance of payments assistance. 1/ As of August 31, 1984, Fund holdings of Malagasy francs subject to repurchase were equivalent to 223 percent of quota, including holdings resulting from purchases under the compensatory financing facility equivalent to 82 percent of quota. Madagascar's relations with the Fund are summarized in Appendix I.

Madagascar's relations with the World Bank Group are summarized in Appendix II. As of March 31, 1984, Madagascar's total debt outstanding to the World Bank Group (including undisbursed) under IDA credits and IBRD loans amounted to US$406 million, in addition to IFC investments of US$15 million. Two major IDA credits were approved in 1983, for assistance to rice production and for road rehabilitation, in amounts of US$18 million and US$45 million, respectively. Sectoral loans for agriculture and for industry are under active consideration; negotiations on the latter are expected to be completed before the end of 1984. The Bank is organizing a consultative group meeting in Paris at the end of November 1984. Fund and Bank staff have cooperated closely and constructively on major issues of concern to Madagascar's adjustment and development effort.

II. Economic Developments in 1983-84

Madagascar's current financial difficulties are directly traceable to the 1979-80 surge in external borrowing to finance a massive increase

1/ See EBS/84/82 for details.

in public expenditure on investment projects that contributed little to expanding productive capacity. The consequences were a short-lived growth spurt and a lasting inheritance of external debt. The resulting financial problems were compounded by the maintenance of an overvalued exchange rate and by a rigid and unremunerative structure of incentives to domestic producers. Viewed in this perspective, developments in 1983 and in the first half of 1984 were encouraging. The last 18 months have witnessed both a continuation of the process begun in 1982 to reduce domestic financial imbalances, and the introduction of important measures to liberalize marketing and pricing and to improve the structure of incentives toward export-oriented and import-substituting production. As a result, while the external debt overhang continues to dominate the economy's prospects, 1983 brought a halt to the process of deterioration, and 1984 is expected to show the beginning of a turnaround in most economic and financial respects (Table 1 and Appendix IV).

1. Developments in real output and aggregate demand

Following the investment expansion in the public sector of 1979-80 (during which real GDP grew by nearly 11 percent), real GDP declined by 9.7 percent in 1981, and by 1.8 percent in 1982, thus returning to its 1979 level. In 1983 the erosion was halted, and very modest real growth of just under one percent was experienced. GDP is projected to rise by 1.6 percent in 1984.

Agricultural production, the mainstay of the Malagasy economy, grew by 2.4 percent in 1983, and would have shown almost an equal increase in 1984 were it not for the impact of cyclone "Kamisy" in April. 1/ Industrial output, which stagnated in 1983, is expected to grow by 4.6 percent in 1984, mainly due to increased foreign exchange allocations. Private services, stagnant in 1983, are projected to show a 2 percent real growth in 1984, with public services unchanged.

In 1982 private consumption had been insulated from the decline in income, mainly by the very large increase in imports of rice; by contrast, private consumption rose proportionately less than GDP in 1983 and a similar outturn is expected this year. Public consumption has remained about constant in both years. The slowdown in consumption growth has allowed an upturn in the rate of gross domestic savings: at current prices, the savings rate bottomed out at less than 5 percent of GDP in 1982, rose to 6.8 percent in 1983, and is projected to return to its 1979 level of about 8 percent in 1984.

1/ The impact of the cyclone is estimated at about FMG 5 billion, or less than one half of one percent of GDP. Its effect on the 1984 budget and balance of payments was not great and was largely cushioned by additional external assistance.

Table 1. Madagascar: Selected Economic and Financial Indicators, 1980-84

	1980	1981	1982	1983 Prog.	1983 Est.	1984 Prog.	1984 Proj.
	(Annual percent changes, unless otherwise specified)						
National income and prices							
GDP at constant prices	0.8	-9.7	-1.8	1.0	0.9	1.0	1.6
GDP deflator	15.1	26.6	28.5	24.7	21.5	18.0	16.0
Consumer prices 1/	18.0	30.5	31.5	25.1	19.6	20.0	16.0
External sector (on the basis of SDRs)							
Exports, f.o.b.	10.0	-16.0	7.6	6.3	-5.3	11.2	9.7
Imports, c.i.f.	10.6	-28.5	-3.0	-4.6	-15.3	-5.6	-4.6
Non-oil imports, c.i.f.	8.6	-29.1	-16.1	-9.8	-16.4	-4.3	-5.4
Export volume	-21.9	1.1	11.6	3.9	-21.0	...	10.8
Import volume	-5.3	-31.4	-14.0	-2.7	-12.2	...	-10.0
Terms of trade (deterioration -)	6.3	-8.7	-10.7	2.0	17.6	...	--
Nominal effective exchange rate (depreciation -)	-5.6	-8.8	-18.1	...	-21.5	...	...
Real effective exchange rate (depreciation -)	4.1	4.7	5.6	...	-12.8	...	...
Government finance							
Total revenue and grants	7.9	-3.1	26.8	22.5	22.3	15.2	27.5
Total expenditure	28.7	-6.1	1.8	12.0	13.3	7.5	15.9
Money and credit							
Domestic credit	48.2	21.5	17.6	16.3	13.3	18.6	18.6
Government	77.4	33.0	11.5	13.6	14.2	11.7	10.4
Private sector	21.7	8.4	25.0	20.1	12.1	26.2	29.0
Money and quasi-money (M_2)	19.0	21.4	10.2	23.3	-1.5	19.0	15.3
Velocity (GDP relative to M_2)	3.6	3.5	3.8	3.7	4.4	4.5	...
Interest rate (annual rate, one-year savings deposit)	5.65	6.75	10.50	12.50	12.50	...	14.00
	(In percent of GDP)						
Overall government savings	-1.8	-1.0	-0.6	-0.7	-0.4	-0.2	-0.2
Overall government financial deficit	-18.4	-14.6	-8.8	-6.7	-7.0	5.5	5.4
Domestic bank financing	11.3	7.3	3.4	3.1	3.1	2.4	2.2
Foreign financing (net)	6.9	7.0	5.1	3.7	3.9	3.2	3.3
Gross domestic investment	23.5	18.0	13.4	12.9	13.2	11.5	12.4
Gross domestic savings	6.9	7.0	4.8	6.0	6.8	6.5	7.8
Current account deficit 2/	-18.3	-14.6	-12.8	-9.0	-11.2 3/	-10.8 3/	-10.8 3/
External debt (including the Fund)	34.3	50.5 4/	64.4 5/	...	72.0 6/	...	87.7 6/
	(In percent of export of goods and services)						
Debt service ratio	18.1	25.1 4/	31.9 4/	...	34.8 7/	...	31.3 8/
Interest payments	7.9	16.7 4/	18.4 4/	...	22.2 7/	...	17.2 8/

1/ Low-income CPI index for Antananarivo.
2/ From 1981, severe constraint on foreign exchange availability.
3/ After debt rescheduling obtained from the Paris Club, from certain other official creditors, and from London Club groups of banks under rescheduling agreement in principle.
4/ After debt rescheduling, but excluding arrears.
5/ After debt rescheduling obtained from the Paris Club, through June 1982, but excluding arrears.
6/ Including arrears.
7/ On the basis of debt relief obtained in 1983 from Paris Club I and II, the London Club and other creditors.
8/ After debt rescheduling already obtained from the Paris Club through December 1984, the London Club, and other creditors.

Gross investment, which had borne the brunt of the economic downturn of 1981 and 1982, declined again in real terms in 1983 and 1984 but at a much slower pace. It is difficult to assess the impact on production of the decline in real investment expenditure because of the fact that a number of marginal projects of dubious economic worth have been abandoned, and investment has been reoriented toward rehabilitation of existing capital and infrastructure.

2. Prices, wages, employment

Substantial progress in reducing inflation was registered in 1983 and 1984. The inflation rate was brought down sharply, by a combination of sluggish private sector credit demand and tighter fiscal and monetary policy, from its 31 percent average level of 1981-82 to 20 percent in 1983 and is projected to moderate further in 1984. 1/ It is especially noteworthy that this progress has been taking place during a period when the Malagasy franc has been depreciating and a substantial liberalization of agricultural and industrial prices has begun.

A general posture of restraint has characterized the recent wage policy. Following no cost-of-living adjustment in 1983, minimum wages for unskilled laborers were increased by less than 11 percent in January 1984, and public sector wages were raised by less than 3 percent effective in July 1984. This decline in real wages in both the public and the private sector has been particularly pronounced for employees at the higher end of the salary range.

The employment picture is mixed. While the number of salaried employees in manufacturing and mining rebounded by 8 percent in 1983 from the depressed 1982 level, the authorities believe that underemployment may have also increased substantially. The unemployment problem has also reportedly been exacerbated by migration from the countryside to the towns and by the increased proportion of educated persons in the total of job seekers.

3. Domestic financial developments

The overall budget deficit has been reduced continuously over the last three years from 14.6 percent of GDP in 1981 to 8.8 percent of GDP in 1982 and 7.0 percent of GDP in 1983 (Table 2). 2/ Based upon

1/ The seasonally adjusted annual rate of price increase (as measured by the low-income consumer price index for Antananarivo) was only 8 per cent in the first five months of 1984.

2/ In evaluating this trend, it must be borne in mind that the above ratios refer to cash payments and do not include changes in arrears. In the text, the budget deficit is defined as the deficit on Treasury operations and the net operating results of the FNUP and of central bank rice import operations as well as the receipt of external grants less expenditure of counterpart funds.

Table 2. Madagascar: Overall Government Operations, 1980-84

	1980	1981	1982	1983 Prog.	1983 Actual	1984 Prog.	1984 Proj.
	(In billions of Malagasy francs)						
Total revenue	123.4	119.6	151.7	185.8	185.5	213.8	236.6
Budgetary receipts	100.4	104.4	121.7	138.4	141.0	155.5	164.3
Direct taxes	(19.9)	(23.5)	(22.1)	(25.8)	(24.3)	(33.1)	(32.1)
Indirect taxes	(77.3)	(76.9)	(96.5)	(109.1)	(111.3)	(118.9)	(128.1)
Nontax revenue	(3.2)	(4.0)	(3.1)	(3.5)	(5.4)	(3.5)	(4.1)
Other	23.0	15.2	30.0	47.4	44.5	58.3	72.3
FNUP receipts	(15.6)	(15.2)	(26.4)	(36.0)	(36.3)	(53.0)	(61.4)
Grants	(...)	(...)	(3.6)	(11.4)	(8.2)	(2.3)	(9.0)
Treasury operations (net)	(7.4)	(...)	(...)	(...)	(...)	(...)	(...)
Central bank rice import operations (net)	(...)	(...)	(...)	(...)	(...)	(3.0)	(1.9)
Total expenditure	-250.1	-234.8	-239.1	-267.7	-271.0	-291.4	-314.2
Current budgetary expenditure	-112.7	-112.2	-127.5	-147.0	-145.5	-158.2	-167.0
Wages and salaries	(-60.9)	(-68.6)	(-80.7)	(-82.0)	(-81.9)	(-90.2)	(-91.8)
Interest on external debt	(-2.8)	(-4.5)	(-9.2)	(-11.9)	(-11.6)	(-14.9)	(-19.6)
Interest on domestic debt	(-1.2)	(-2.2)	(-1.8)	(-3.1)	(-3.3)	(-2.9)	(-2.9)
Other current expenditure	(-48.0)	(-36.9)	(-35.8)	(-50.0)	(-48.7)	(-50.2)	(-52.7)
Capital expenditure	-89.6	-84.1	-72.1	-70.6	-80.4	-75.6	-84.4
Development budget 1/	(-74.4)	(-62.1)	(-44.1)	(-45.8)	(-51.3)	(-47.7)	(-52.3)
On-lending	(-15.2)	(-22.0)	(-28.0)	(-24.8)	(-29.1)	(-27.9)	(-32.1)
Other	-47.6	-38.5	-39.5	-50.1	-45.1	-57.6	-62.8
Deferred payments 2/	(-12.9)	(-14.6)	(-13.6)	(-22.1)	(-21.8)	(-15.3)	(-15.3)
Grant-financed expenditure	(-0.3)	(-0.3)	(-0.4)	(-6.0)	(-6.7)	(-20.0)	(-25.2)
FNUP expenditure	(-30.3)	(-18.0)	(-6.1)	(-13.4)	(-13.0)	(-16.7)	(-16.7)
Treasury operations (net)	(...)	(-0.6)	(-7.2)	(-5.4)	(-0.4)	(-5.6)	(-5.6)
Central bank rice import operations (net)	(-4.1)	(-5.0)	(-12.2)	(-3.2)	(-3.2)	(...)	(...)
Overall deficit	-126.7	-115.2	-87.4	-81.9	-85.5	77.6	-77.6
Foreign (net)	47.9	55.6	50.4	45.0	46.3	45.1	47.1
Domestic (net)	78.9	59.7	36.9	36.9	35.3	32.5	30.5
Banking system	(78.2)	(57.8)	(34.2)	(37.6)	(37.6)	(34.0)	(32.0)
Nonbank	(0.7)	(1.9)	(2.7)	(-0.7)	(-2.3)	(-1.5)	(-1.5)
Other 3/	...	...	...	...	3.9	...	...
Memorandum items:	(As a percent of GDP)						
Budgetary receipts	14.6	13.2	12.2	11.4	11.5	11.1	11.4
FNUP receipts	2.3	1.9	2.7	3.0	3.0	4.2	4.3
Total receipts	17.9	15.2	15.2	15.3	15.2	15.3	16.4
Current budgetary expenditure	-16.3	-14.2	-12.8	-12.1	-11.9	-11.3	-11.6
Capital expenditure	-13.2	-10.7	-7.2	-5.8	-6.6	-5.4	-5.9
Total expenditure	-36.2	-29.8	-24.0	-22.0	-22.2	-20.8	-21.8
Overall deficit	-18.4	-14.6	-8.8	-6.7	-7.0	-5.5	-5.4
Banking system	11.3	7.3	3.4	3.1	3.1	2.4	2.2
GDP (billions of FMG)	690.0	789.0	996.0	1,217.0	1,221.0	1,400.0	1,439.0
Change in stock of domestic arrears	...	...	19.2	-6.0	-10.2	-9.0	-9.0

Sources: Ministry of Finance and Economy; Central Bank of Madagascar; and staff estimates.

1/ Including capital expenditure financed from reserved funds.
2/ Including arrears payments, with respect to the stock of arrears outstanding at end-1982; such payments amounted to FMG 10.2 billion in 1983 and are estimated at a maximum of FMG 9.0 billion in 1984. All domestic arrears are to be eliminated by the end of 1984.
3/ Includes unpaid expenditure commitments at year-end, of FMG 3.9 billion in 1983, which constitute float.

developments in the first half of 1984, all indications point to a further reduction in the deficit to 5.5 percent of GDP, in line with the program target.

In 1982, total revenue rose relatively less than nominal GDP, so that the sharp reduction in the deficit was achieved entirely by containing expenditure to approximately the previous year's level. Consequently, total nominal expenditure fell by 6 percentage points of GDP--the bulk of the reduction coming from public investment. Expenditure restraint continued in 1983 and 1984 and was accompanied by substantial improvement in administrative procedures. Total expenditure rose by 13 percent in 1983 (with current expenditure up by 12 percent) compared to a 22 percent increase in the GDP deflator. For 1984, the 15.9 percent increase of projected total expenditure should be just under the increase in the GDP deflator. 1/ As a result, total government expenditure has declined slightly from 24 percent of GDP in 1982 to just over 22 percent in 1983 and is projected at under 22 percent in 1984.

In contrast to 1982, the reduction in the overall deficit in 1983 and 1984 was largely attributable to the increase in government revenue relative to GDP. This has been almost entirely due to a substantial increase in the receipts of the Fonds National Unique de Pérēquation (FNUP--the major export crops stabilization fund), which act as a form of tax on traditional exports; the increase reflects primarily the effects of the depreciation, combined with increases in world prices, which more than covered the increase in producer prices. FNUP receipts rose from an average of 2.5 percent of GDP in 1979-82 to 3.0 percent in 1983 and are projected to increase to 4.3 percent in 1984. In 1983, 44 percent of the overall deficit was financed by the banking system, which is expected to finance 41 percent of the deficit in 1984. 2/

A marked increase in the velocity of broad money characterized monetary developments in 1983. Broad money actually declined slightly, as against the 23 percent increase envisaged in the program (Table 3). Credit to both the Government and the private sector increased (by 14 and 12 percent, respectively), while net external liabilities of the banking system rose by the equivalent of FMG 150.2 billion (over 50 percent of broad money at the beginning of the year), reflecting the difficult balance of payments situation. For 1984, the first quarter decline in credit to both the Government and the private sector was reversed in the second quarter, and for the year as a whole these are projected to increase by 10 percent and 29 percent, respectively.

1/ The expenditure increase in both years included some payment of domestic arrears in the context of the program with the Fund. This is discussed later in the report.

2/ During the three-year period 1979-81, bank financing averaged 55 percent of the overall deficit.

Table 3. Madagascar: Monetary Survey, 1980-84

(In FMG billions; end of period)

	1980	1981	1982	1983 June	1983 December	1984 June
Total credit	340.1	413.2	483.9	494.1	548.1	561.5
Net credit to Government	181.1	240.8	268.5	275.2	306.6	310.8
Central Bank	176.7	223.8	257.0	262.3	305.7	315.5
National Banks	-11.5	-0.5	-3.3	-4.1	-15.9	-21.4
Treasury	15.9	17.5	14.8	17.0	16.8	17.1
Credit to the private sector	159.0	172.4	215.4	218.9	241.5	250.7
Central Bank	8.6	8.6	18.3	21.8	26.9	32.8
National Banks	144.9	159.9	192.6	194.8	211.9	215.4
Treasury	5.5	3.9	4.5	2.3	2.7	2.5
Assets = liabilities, net	340.1	413.2	483.9	494.1	548.1	561.5
Broad money	206.0	249.8	275.4	254.3	271.4	277.0
Money supply	164.7	207.1	221.2	195.5	210.8	213.3
Currency	70.2	83.1	90.4	81.3	75.7	77.7
Demand deposits	94.5	124.0	130.8	114.2	135.1	135.6
National banks	(81.1)	(110.4)	(117.1)	(100.5)	(121.2)	(121.5)
Post Office & Treasury	(13.4)	(13.6)	(13.7)	(13.7)	(13.9)	(14.1)
Quasi-money	41.3	42.7	54.2	58.8	60.6	63.7
National banks	31.5	32.5	44.2	48.9	50.3	53.1
National Savings Fund	5.4	5.3	5.5	5.6	5.5	5.5
Other	4.4	4.9	4.5	4.3	4.8	5.1
External position	125.2	158.6	255.4	327.6	405.6	511.7
Net foreign liabilities	93.4	49.8	110.9	107.2	121.4	165.5
Central Bank, net	85.7	47.9	118.2	109.2	130.8	179.8
Assets	(4.5)	(6.6)	(9.4)	(9.3)	(17.3)	(30.4)
Liabilities	(90.2)	(54.5)	(127.6)	(118.5)	(148.1)	(210.2)
National Banks, net	7.7	1.9	-7.3	-2.0	-9.4	-14.3
Assets	(6.3)	(13.2)	(16.6)	(12.9)	(17.7)	(19.4)
Liabilities	(14.0)	(15.1)	(9.3)	(10.9)	(8.3)	(5.1)
Long-term foreign liabilities	31.8	108.8	144.5	220.4	284.2	346.2
Central Bank	20.7	94.1	128.5	204.6	269.2	332.3
Rescheduling agreements	(0.0)	(49.9)	(87.5)	(145.3)	(193.1)	(262.1)
National bank						
Long-term foreign borrowing	11.1	14.7	16.0	15.8	15.0	13.9
Other liabilities, net	8.9	4.8	-46.9	-87.8	-128.9	-227.2
Valuation adjustment	(--)	(--)	(-55.1)	(-68.6)	(-108.6)	(-180.1)

Source: Central Bank of Madagascar.

Correspondingly, the 1983 decline in broad money is expected to give way to a 15 percent increase in 1984--still somewhat lower than the projected increase in nominal GDP, thus entailing a further slight increase in velocity. Net foreign assets, although still negative, are expected to show a small increase, reflecting the modest reconstitution of central bank reserves envisaged under the program.

In October 1983, both the interest rate on 6-12 month deposits and the central bank discount rate were raised by 1 and by 0.5 percentage points to 12 percent and 13 percent, respectively. As of July 1984, minimum deposit rates ranged from 9 to 24 percent, and minimum lending rates from 14.5 percent (the prime rate) to 23.5 percent. 1/ In light of the deceleration of inflation, most actual lending rates and several deposit rates have become positive in real terms.

4. The external sector

The balance of payments in 1983 and 1984 continued to be characterized by falling imports and increasing external debt service (Table 4). In addition, in 1983 there was a substantial fall in exports of cloves, which, when combined with higher debt service of SDR 80 million led to a doubling of the overall balance payments deficit to SDR 248 million. The overall deficit, however, is projected to decline significantly to SDR 198 million in 1984. As noted below, significant improvement has been realized in the nondebt service items of the balance of payments in both these years.

Before debt reschedulings obtained from commercial banks, the Paris Club, and other official creditors, debt service payments (excluding repurchases from the Fund) rose from SDR 188 million in 1982 to SDR 268 million in 1983 and to an estimated SDR 289 million in 1984. The debt service ratio, before rescheduling, and including the Fund, increased from 55 percent in 1982 to 80 percent in 1983 and is projected to rise further to 86 percent in 1984.

In both 1983 and 1984 the bulk of the financing was provided by debt rescheduling and other exceptional balance of payments assistance. In addition, the 1983 deficit was financed in part by a substantial net cash increase in external arrears. The total financing being made available in 1984 is expected to permit both a net cash reduction in external arrears and a small increase in gross reserves of the Central Bank.

a. The current account excluding interest payments

In 1983 exports fell by 5 percent to SDR 287 million, entirely as a result of a severe shortfall of export earnings from cloves, which fell to just one third of their 1982 value of SDR 73 million. However,

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1/ All interest rates that are fixed in Madagascar are fixed as minimum rates. Actual rates are reportedly higher than the minima.

Table 4. Madagascar: Balance of Payments, 1980-84

(In millions of SDRs)

	1980	1981	1982	1983	1984 Rev. prog.	1984 Proj.
Exports, f.o.b.	335.3	281.5	302.8	286.9	312.6	314.7
Imports, f.o.b.	-587.3	-433.2	-409.0	-364.7	-344.1	-340.1
Trade balance	-252.0	-151.7	-106.2	-77.8	-31.5	-25.4
Service receipts	62.9	55.6	49.7	45.0	45.0	47.0
Service payments	-274.2	-267.5	-272.0	-262.4	-273.0	-282.2
Freight	-113.5	-66.2	-68.1	-49.6	-47.6	-47.8
Transport and travel	-58.2	-59.3	-55.7	-54.6	-54.6	-54.6
Investment income	-35.6	-78.3	-90.7	-101.0	-120.1	-122.2
Other	-66.9	-63.7	-57.5	-57.2	-50.7	-57.6
Services (net)	-211.3	-211.9	-222.3	-217.4	-228.0	-235.2
Private unrequited transfers	2.9	3.4	-1.3	-1.1	-1.1	-1.1
Current account	-460.4	-360.2	-329.8	-296.3	-260.6	-261.7
(Excluding interest)	(-428.4)	(-292.9)	(-241.6)	(-197.5)	(-142.4)	(-141.4)
Public transfers	32.7	53.1	65.5	56.9	56.7	68.8
Nonmonetary capital (net)	288.0	210.4	90.0	11.8	6.3	10.6
Drawings	320.7	277.2	190.1	181.1	155.5	179.5
Amortization	-32.7	-66.8	-100.1	-169.3	-149.2	-168.9
Banks (net)	5.1	-18.1	-23.8	20.4	--	-4.7
Other 1/	-41.6	5.9	75.2	-40.3	-2.9	-10.5
Overall balance	-176.2	-108.9	-122.9	-247.5	-200.5	-197.5
Financing	176.2	108.9	122.9	247.5	...	197.5
Debt rescheduled (net)	0.0	64.4	81.1	156.0	...	199.4
Principal, incl. arrears	--)	64.4	58.4	146.5	...	151.4
Interest	--)		24.0	25.4	...	74.7
Amortization on rescheduled maturities	--	...	-0.6	-3.1	...	-7.4
Interest charges on rescheduling and consolidation	--	...	-0.7	-2.4	...	-16.6
Repayment of consolidated arrears	--	...	--	-10.4	...	-2.7
IMF (net)	37.7	31.6	47.0	6.5	-22.7	17.9
Purchases	41.4	35.3	52.4	10.2	3.5	41.4
Repurchases	-3.7	-3.7	-5.4	-3.7	27.0	-23.5
Net cash change in arrears (decrease -)	219.2	21.3	2.6	69.6	...	-7.3
Net central bank reserves (increase -)	-80.7	-8.4	-7.8	15.4	...	-12.5
Memorandum items:						
Current account deficit as percent of GDP	-18.3	-14.6	-12.8	-11.2	-9.5	-10.8
(Excluding interest)	-17.0	-11.9	-9.4	-7.4	-5.2	-5.8
Arrears (end of period)	...	...	213.5	95.5 2/	...	88.2

Sources: Central Bank of Madagascar; staff estimates.

1/ Includes valuation adjustment, short-term capital, errors and omissions, and, in 1980 and 1981, SDR 3.5 million in SDR allocations.
2/ After London Club rescheduling and Paris Club III consolidation.

exports of the other two traditional crops, coffee and vanilla, were favorable compared to 1982: the increase in coffee earnings by 32 percent (entirely from an increase in average unit price received) and in vanilla earnings by 9 percent served to offset partially the shortfall in cloves. Prospects for 1984 include a partial recovery of clove exports and some additional increase in coffee and vanilla earnings as well. On the other hand, mainly due to an industrial accident in August 1983 that put the oil refinery out of commission until at least early 1985, exports of petroleum products are expected to be nil. Total exports are projected to rise by about 10 percent to SDR 315 million in 1984. Imports, c.i.f., declined in 1983 by 15 percent and are projected to decrease in 1984 for the fourth consecutive year by a further 4 percent to SDR 406 million, a decrease of SDR 94 million from the 1982 level. Given these developments, and the approximately constant noninterest service receipts and payments, the current account deficit excluding interest has declined from SDR 242 million in 1982 (9.4 percent of GDP) to SDR 198 million in 1983 (7.4 percent of GDP) and a projected SDR 141 million in 1984 (5.8 percent of GDP).

b. Interest payments and the capital account

Interest payments increased from SDR 89 million in 1982 to SDR 99 million in 1983 and an estimated SDR 120 million in 1984. As a consequence, although the overall current account deficit decreased from SDR 330 million in 1982 to SDR 296 million in 1983 and a projected SDR 262 million in 1984 (12.8, 11.2, and 10.8 percent of GDP, respectively), this decrease was much less pronounced than that of the current deficit excluding interest.

In 1983 capital account developments were less favorable. Compared to 1982, a 5 percent lower inflow of new long-term capital and a 13 percent reduction in public transfers combined with a 20 percent increase in scheduled amortization payments to produce an SDR 87 million decline in the surplus of the capital account (including public transfers). For 1984 a significant amount of additional grants and loans was provided as a result of the Aid Donors' meeting organized by the Fund in Paris on April 5-6, and from emergency assistance in connection with cyclone "Kamisy"; the capital account surplus is projected at SDR 79 million, or 16 percent higher than in 1983.

c. Debt rescheduling

As noted earlier, debt rescheduling financed the bulk of the overall balance of payments deficit in 1983 and 1984. With reference to debt owed to commercial banks, the negotiations with the London Club that had begun in June 1982 resulted in an agreement in principle, in September 1983, to reschedule all commercial bank debt outstanding at the end of 1982. A difference of view emerged, however, among the banks concerning the appropriate treatment to be accorded to secured loans in the context of the rescheduling agreement. After further negotiations, a compromise was reached in June 1984 on the appropriate preferential terms for rescheduling of the secured debt (without changes in the September 1983 terms of rescheduling of the unsecured debt).

With reference to debt owed to official creditors, the third meeting of the Paris Club on Madagascar took place on March 22-23, 1984. 1/ In recognition, inter alia, of the policy adjustments and of the balance of payments financing needs for 1984, the Paris Club agreed to offer rescheduling terms more favorable than those it had previously granted to Madagascar (including rescheduling of previously rescheduled debt), entailing net debt relief of about SDR 85 million in 1984 SM/84/74).

Total debt rescheduling in 1984 (provided by the London and Paris Clubs and other official creditors) amounted to SDR 199 million, on a net basis. Thus, the debt service ratio (including repurchases from the Fund) for the year was reduced from 86 percent to 31 percent.

III. Economic Policies and Performance Under the Stand-by Arrangement

During the past two years Madagascar has initiated a fundamental change in economic policy. The discussions revealed that a substantial degree of convergence exists between the authorities and the staff concerning appropriate policies in various areas, and that all undertakings under the program have so far been implemented fully. In this light, the consultation discussions could be somewhat forward looking and centered upon the authorities' policies to continue to restructure relative prices, to promote the production of tradable goods, to reduce financial imbalances, and to improve infrastructure and administrative efficiency.

1. Production and pricing policies

a. Agriculture

(1) Rice

The policy reforms of mid-1983, which saw the liberalization of the pricing and marketing of paddy throughout most of the country, were followed by implementation in early 1984 of a system to enhance competition in the two areas reserved to the paddy purchasing monopoly of the state agencies SOMALAC and FIFABE. 2/ This system entailed the

1/ The previous Paris Club reschedulings had taken place in 1981 and 1982.

2/ This system was described in EBS/84/45, and its initial results reported in EBS/84/133.

introduction of sealed-bid auctions, at the beginning of the harvest season, for a part of the paddy to be collected by SOMALAC; the producer prices for both the SOMALAC and FIFABE areas were set as a function of the results of these auctions. The experiment with auctions was successful insofar as the average offer price was higher than the "reserve" price; as a consequence, producer prices in the two reserved areas were raised by about 20 percent compared to those paid for the 1983 harvest. The authorities, however, expressed some concern about the low private sector participation in the auction process. Four possible explanations emerged from the discussion: the newness of the experiment, uncertainty about the amount of rice imports for the year, the ability of Antananarivo's private millers to obtain paddy from nearby areas thus avoiding the difficulties of transport from the SOMALAC area, and certain administrative features of the auction, including the fact that the paddy to be bought was to be milled by SOMALAC itself. The Malagasy authorities have been reviewing this experiment to evolve a more permanent mechanism that will, in any case, ensure more private participation and competition.

The second major element of policy was the pricing of imported rice at a level sufficient to avoid consumer subsidization. The authorities stated that imported rice has been selling at more than the import parity price and, considering the quality differential, at a price higher than domestic rice. 1/

The third, and consequential, element was a reduction in imports of rice, 2/ in keeping both with the foreign exchange situation and with the authorities' objective of self-sufficiency by 1987. It is in this area that some uncertainty remains for 1984. According to the current forecasts, stocks of imported rice will be nil by the fourth quarter of 1984, precisely the period when domestic supplies dwindle. However, the authorities hope that domestic production during the summer months may well be higher than forecast and that a greater proportion of it may be commercially marketed. They stated that, in keeping with their commitment, they had not used any additional foreign exchange of their own for rice imports beyond the initial purchase of 42,000 tons, which, combined with foreign-assisted rice imports, bring the total to 92 thousand tons. The authorities do not intend to purchase additional rice during the year until after the results of the present buying season are known (in September) and then not before further discussions with the staff.

1/ The average price of rice in the first half of 1984 was about one third higher than the official market price in 1983.

2/ From the 1982 peak of 350 thousand tons to 183 thousand tons in 1983 and a programmed 90 thousand tons in 1984.

(2) Other agricultural products

In addition to rice policy, adequate measures concerning the pricing and marketing of cotton, sugar, groundnuts and edible oil, and coffee were announced in February 1984 and were fully implemented shortly thereafter (EBS/84/133).

Concerning cloves (the main source of the 1983 export shortfall that gave rise to the June 1984 CFF purchase of SDR 14.4 million), the authorities confirmed that clove exports were recovering in 1984. However, longer term market prospects are considered unfavorable and, therefore, additional price stimuli to production are undesirable. For vanilla, an agreement was negotiated in March 1984 between the producing countries and representatives of the buyers, on quantities and price of vanilla exports over the next three years. The Malagasy representatives considered that long-term agreements of this nature are important to preserve the market share of natural vanilla vis-à-vis its synthetic substitutes. They stated that producer prices would be adjusted as needed to maintain adequate producer incentives consistent with external market possibilities. Prices and marketing of other agricultural products are not subject to state intervention.

Two important, and related, agricultural issues deserve closer attention in the near future. First, regarding coffee, although competition is strong at the local collection level, it needs to be fostered among the four state enterprises with the monopoly on exports. The authorities feel that competition does take place within the established margin between the minimum producer price and the guaranteed export price, but agreed with the mission's observation that a thorough examination of the role, operations, and remuneration of the state enterprises would be highly desirable. This issue is linked to that of export taxation through the FNUP and to the need for export diversification. Products such as fruit and vegetables, cashews, spices, maize, and meat have good export potential.

b. Industry

The program envisaged a partial decontrol of some industrial prices. After extensive discussion with the staff of the World Bank, prices of industrial products accounting for 30 percent of industrial value added were decontrolled by the Malagasy authorities on July 11, 1984. Further liberalization is envisaged as early as possible. In the meantime, a more flexible system of price setting has been put in place for products still subject to control, by automatic approval of a price increase request if no action is taken within 30 days of its receipt.

The Malagasy representatives highlighted the dilemma posed by their wish to attract private investment in state enterprises, on the one hand,

and the financial difficulties of these companies, which make them unattractive to private investors, on the other. The authorities do not wish to foster the desired private investment by granting special concessions, which would create economic distortions. Quite aside from the question of ownership, the main issues to be considered include the clear definition of the role of state enterprises, the manner of funding those among their functions that are considered to be socially necessary, a sound solution to their debt problems vis-à-vis the banking system, and measures to foster their economic profitability. Both the general policy toward the state enterprises and the situation of major enterprises will be examined, and it is expected that a comprehensive policy for their rehabilitation would be in place next year.

2. Public finance

The Malagasy authorities are pursuing their efforts to improve public finance administration. In particular, significant improvements in the monitoring of revenue and expenditure have occurrred. Reflecting this, the final figures for 1983 were essentially the same as those provided during the staff visit in February 1984, only six weeks after the close of the fiscal year. Preliminary data through end-June 1984 show a first semester overall government deficit of FMG 16.2 billion, against the targeted annual deficit of FMG 77.6 billion, or 5.5 percent of GDP. Taking into account the seasonal pattern of the budget, the authorities expressed confidence in remaining within the program target. Since the first program review in June 1984, the only revisions to the 1984 projections have been an increase in expenditure on external interest (by FMG 3.6 billion), with a compensating increase in export taxes; 1/ these revisions reflect the latest exchange rate adjustment of late June 1984.

Concerning revenue prospects, the Malagasy representatives noted the already high levels of taxation. They expressed the view that future revenue increases will be largely a result of changes in the value of imports (and exports) and domestic profits as well as the administrative capacity to expand tax assessment and collection more evenly across the country.

On the expenditure side, controls on current budgetary outlays have been reinforced. The 1984 ceiling on net government recruitment (no more than 1,000 persons over the end-1983 figure of 127,500) will be respected, according to the authorities, as well as the limit on personnel expenditure of FMG 91.8 billion (including a 3 percent wage increase implemented from July 1, 1984).

1/ The authorities are considering raising budgetary export taxes within the existing margin for the FNUP so that the entire increase in export-related receipts is shown under taxes (see below).

The consultation discussions also focused on three specific issues in public finance: the public investment program, the elimination of domestic arrears, and the desirability of reviewing export taxation, including the role of the FNUP.

a. Public investment

The 1984 program envisages a 6.7 percent growth in nominal capital expenditure, with continued emphasis on a more efficient use of existing capacity rather than capacity expansion. Public investment expenditures for 1984 are consistent with the 1984-87 investment program, which the authorities have discussed with the World Bank. This investment program, to be presented to the Consultative Group meeting in November 1984, shows continued emphasis on rehabilitation of existing capacity. As regards the few about-to-be-completed industrial projects of questionable economic validity, the Malagasy representatives stated that studies were under way that should enable them to decide whether and how these projects should go into operation. The conclusions of those studies would be discussed with the World Bank.

b. Domestic arrears

The authorities have revised and tightened their procedures for monitoring commitments and disbursements of government expenditures. The new guidelines establish a clear procedure that the spending ministries must follow after they have received their budgetary allocations for the year, and provide for centralized monitoring through a computerized data processing system in the Ministry of Finance. The new procedures are felt to be working well. There were some spending commitments, equivalent to about 1.5 percent of total 1983 expenditures, at the end of 1983, that were carried over to 1984. The Malagasy representatives stated that they regarded this as a normal administrative carry-over and that it should not be construed as arrears. The authorities have already put in place procedures by which such carry-overs would be automatically paid out of the budgetary credits of the following year. In conformity with these procedures, the Minister of Finance states in the attached letter (Appendix V) his intention to pay the 1983 carry-over bills out of the 1984 budgetary appropriations.

c. FNUP

FNUP receipts have been increasing substantially and are projected to account for 26 percent of 1984 revenue. The mission emphasized the desirability of a review by the authorities of the FNUP in respect to its double function of stabilization of export prices and implicit export taxation; in particular to examine whether explicit export taxes could be raised within the existing margin, and FNUP receipts reduced correspondingly, so as to put a greater emphasis on the stabilization role of the FNUP.

3. Monetary policies

There was a marked increase in the velocity of broad money in 1983 as the result of the sharp decline in money supply. Actual inflation may have been somewhat overstated by the increase in official prices, which actually represented a narrowing of the divergence from parallel market prices. As to the decline in money supply, this was essentially related to the deficits in the balance of payments, though a tight liquidity position of the banking system and the financial difficulties of the state enterprises could also have contributed to the moderation in the expansion of credit to the private sector. Also, the Malagasy representatives noted that the liquidity of the private sector was enhanced by government settlement in 1983 and 1984 of a substantial amount of domestic arrears and, in 1984, by the higher exports of cloves.

According to the available data, about 38 percent of total loans of commercial banks are classified as "high risk" (the bulk of these are owed by state enterprises). This remains a factor of major concern to the authorities. Following a Fund Central Banking Department mission report earlier in 1984, a comprehensive bank-by-bank audit process, to be completed by end-October, has been launched, with participation by international auditors. In the authorities' view, any major changes in the banking structure must await the results of these audits; their plans in this regard would be discussed with a Fund staff mission toward the end of the year with a view to implementing them in 1985. It was noted that a central bank takeover of the commercial banks' nonperforming assets is prohibited by the statute of the Central Bank. However, two other possible solutions were mentioned: selective government takeover of nonperforming assets when the enterprise's financial difficulties are clearly due to government policies rather than inefficiency or mismanagement; and a special facility to assist individual enterprises with their financial problems while they undertake a recovery program.

The mission urged that the bank audit process include an element of audit of the borrowing enterprises. Looking ahead, the mission also suggested a re-examination of the present "specialized" structure of the banking system with a view to determining its compatibility with the recent reorientation toward liberalized pricing and marketing. In this regard, a greater degree of competition among banks for both deposits and loans, independent and autonomous boards of directors, and a more active interbank money market (with or without the intermediation of the Central Bank), are some of the issues to be considered.

The Malagasy representatives confirmed that those interest rates that are fixed in Madagascar are fixed only as minimum rates, and stated that actual rates are higher. Also, the effective minimum rate on certificates of deposit is higher than the nominal rate, since the interest is prepaid, and taxes on it are paid by the bank. In light of the deceleration of inflation, it was considered that interest rates on some type of deposits have become positive in real terms. In furtherance of this trend, on August 8, 1984, the authorities raised by 2 percentage points to 14 percent the minimum interest rate on 6-12 month deposits by individuals, but not on deposits by public enterprises and state agencies, which would continue to receive 12 percent. Concerning lending rates, the authorities strongly believe that, given the high minimum lending rates currently in effect and the substantial proportion of nonperforming loans, any increase in lending rates at this time and outside the context of an eventual restructuring would simply raise the amount of nonperforming loans, with an adverse impact on the already fragile banking system.

4. Balance of payments and exchange rate policies

Export policies were examined in the discussion on production and pricing, and external financing problems are considered in the context of the medium-term scenario. The other topics discussed and reviewed of major relevance to the external sector were the import program, reserves and external arrears, exchange rate policy, and exchange and trade restrictions.

a. Import program

The reduction in the external current account deficit (excluding interest) has been almost entirely due to a contraction in imports. The adverse effects on economic activity in 1983-84 of this contraction have been so far cushioned to a great extent by three important developments. First, the aggregate decline in imports has been accompanied by a marked change in their internal composition. It should be recalled that the high level of imports of 1979 and 1980 was associated with the externally financed and unproductive overexpansion of public investment. The share of equipment and consumer goods in total imports has declined markedly from an average of SDR 320 million in 1980-82 to SDR 212 million in 1983 and SDR 180 million in 1984, e.g., from about 57 percent of total imports in 1980-82 to 46 percent in 1984. However, imports of raw materials and intermediate goods, essential inputs for a recovery of production, have remained relatively constant in SDR terms, thereby increasing their share in total imports from about 20 percent in 1980-82 to about 30 percent in 1984. Second, the share of domestic resources in investment has increased in recent years, in keeping with the reorientation of public investment toward rehabilitation and the increase in utilization of existing productive capacity: at current prices, equipment imports were equivalent to 38 percent of gross investment in 1980-82, compared to 29 percent in 1983 and a projected 28 percent in 1984. Third, over three fourths of the SDR 94 million difference between projected 1984 imports and 1982 imports is accounted for by a contraction in expenditure on imported rice. Such a contraction is in line with the authorities' goal of self-sufficiency in rice by 1987 and is an expected consequence of the pricing and marketing measures enacted to stimulate domestic production of rice.

It is, however, true that any further compression of aggregate imports will be more and more likely to affect imports of essential inputs and of incentive goods needed to stimulate agricultural production. Accordingly, the staff expressed its concern with what appeared to be a first semester, 1984, shortfall in imports of raw materials and spare parts from the target of a 17 percent increase over the year. The authorities noted that the shortfall was largely accounted for by cement, with other imports broadly on schedule, and was due to the extreme scarcity of foreign exchange in the first semester. To assure the realization of the 1984 import program of raw materials and spare parts, the authorities will issue all remaining licenses for these imports before end-August, will allocate foreign exchange on a priority basis, and will take account of this priority in their credit policy.

With a view to improving domestic availability of imported inputs for export-oriented industries an export earnings retention account (EPI), was introduced in April 1983. Under this account, export-oriented firms retain foreign exchange earnings in specified proportions (varying from 10 to 35 percent for different industries) of the value added, measured at world prices, of their average exports over the previous three years. The authorities considered that the EPI mechanism has been working well.

b. Exchange rate policy

Recently the Government has followed a flexible exchange rate policy to restore the competitiveness of the Malagasy economy and to underpin the other major elements of its adjustment program. This policy, initiated in the first quarter of 1984, entails quarterly adjustments of the exchange rate in keeping with the change in the domestic cost of living. In addition, the Malagasy franc was depreciated, in foreign currency terms and in relation to the currency basket to which it is pegged, by 9.5 percent in October 1983, and by 13 percent in March 1984. As a result, between May 1982 and June 1984, the Malagasy franc has depreciated by 29.7 percent in nominal terms and by 14.7 percent in real terms. (Movements in nominal and real effective exchange rates since January 1979 are shown in Chart 1).

c. Exchange restrictions

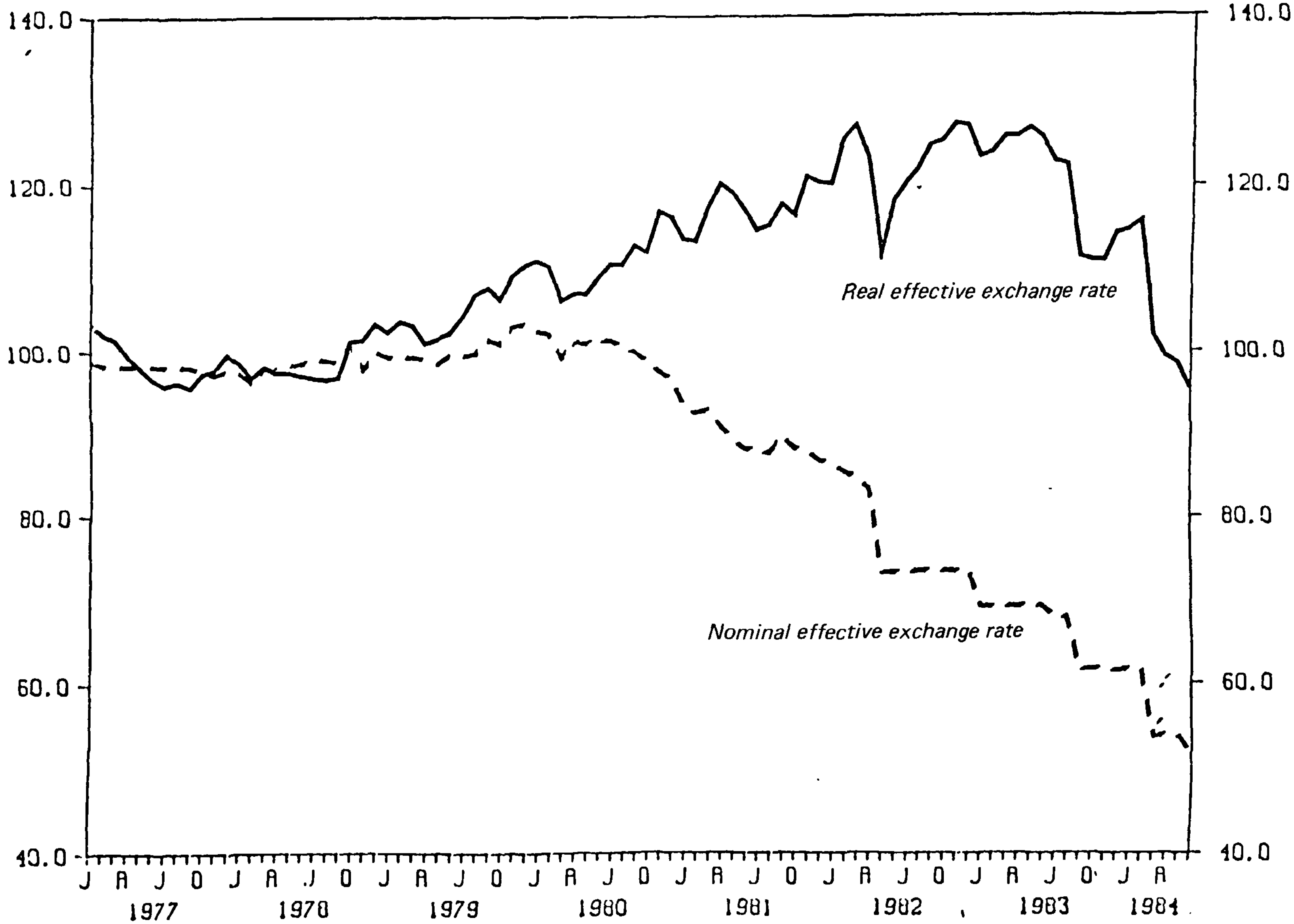
Madagascar avails itself of the transitional arrangements of Article XIV, and maintains exchange restrictions subject to Fund approval under Article VIII, Sections 2 and 3 of the Articles of Agreement. Since the 1983 Article IV consultation, no additional restrictions have been introduced and no significant changes have been made in the structure and operation of the exchange and trade system.

Chart 1

MADAGASCAR

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, 1977-84

(1978=100)



5. Performance under the present stand-by arrangement and performance criteria

The stand-by arrangement, approved in principle on December 21, 1983, initially set quantitative performance criteria only for the end of December 1983. Performance criteria on new external borrowing commitments or guarantees, and on the transfer abroad of bona fide dividend payments were set for the entire program period. The other quantitative performance criteria for 1984 were to be determined at the time of the first review of the program.

Prior to the first review, which had been delayed due to a need to assess program implementation and to obtain adequate external financial support, a report was sent to the Executive Board (EBS/84/45, 3/8/84) indicating that one of the two conditions to the activation of the arrangement, pertaining to adequate producer prices, had been met and that performance criteria on credit had been set for end-April and end-June 1984, respectively. The arrangement became effective on April 10, 1984, following the conclusion of debt rescheduling in the context of the Paris Club and the results of the Aid Donors' meeting organized by the Fund on April 5-6; the latter met the second condition for the activation of the stand-by arrangement.

The first review, on July 16, 1984 (EBS/84/133, 6/19/84), set additional quantitative performance criteria for end-June 1984 with respect to reductions on a cash basis of domestic and external arrears. It was not considered feasible at that time to set performance criteria for the second semester as originally intended, given the uncertainties concerning the April cyclone and the phasing of disbursements of the exceptional assistance from the April aid donors' meeting.

Performance criteria through end-1984, as proposed in the attached letter from the Malagasy Minister of Finance (Appendix V), are shown in Table 5. All performance criteria for end-June have been satisfied. Three purchases, totalling SDR 15 million, have been effected: the first (SDR 3 million) on April 16, upon activation of the arrangement and satisfaction of end-December 1983 performance; the second (SDR 6 million) upon the completion of the first review; and the third (SDR 6 million) upon satisfaction of the end-April performance criteria. The next purchase (SDR 6 million) would be contingent upon completion of the present review, and satisfaction of the end-June performance criteria, which have already been met.

After an assessment that the impact of the cyclone could be accommodated within the existing program and further clarification of the scheduled disbursement of 1984 aid commitments, performance criteria were established for end-September and end-December 1984, respectively, concerning total credit to the economy, net credit to Government and net cash payments of domestic and external arrears as set out in Table 5.

Table 5. Madagascar: Quantitative Performance Criteria for the Period December 1983 - December 1984

	1983		1984					
	End-Dec.		End-April		End-June		End-Sept.	End-Dec.
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Prog.
Cumulative, annual increase in total domestic credit of banking system (FMG billion) 1/	96.0	74.2	24.0	7.4	38.0	13.4	32.0	102.0
Cumulative, annual increase in net credit to Government by banking system (FMG billion)	37.6	36.1	9.0	-11.7	14.0	3.9	21.0	32.0
Cumulative reduction by net cash payments of external arrears other than dividends (SDR million) (reduction -)	...	...	...	...	-4.0	-5.4	-6.0	-7.3
Cumulative reduction on a cash basis of domestic arrears (FMG billion) (reduction -)	...	...	...	...	-1.0	-5.1	-6.0	-9.0 2/
			(Through end-1984)					
Cumulative reduction of external arrears with respect to dividends (FMG billion) (reduction -)	-0.25	-4.8	...	-5.2	...	-5.5	...	-1.25
Increase in commitments or guarantees of external debt (SDR million)								
Up to and including 1 year 4/	--	--	--	--	--	--	--	--
Above 1 year and including 10 years	--	--	--	--	--	--	--	--
Above 10 years and including 15 years 5/	22.0	10.5	22.0	10.6	22.0	10.5	22.0	22.0

1/ Ceilings are defined on a flow basis and include on-lending of foreign loans by the Central Bank but exclude deposits at the Treasury by the National Savings Bank and the postal checking system.

2/ The specific undertaking is to eliminate the stock of all verified domestic arrears outstanding at the end of 1982 by the end of 1984, estimated at a maximum of FMG 9.0 billion.

3/ Cumulative reduction in external arrears with respect to bona fide dividends must be at least FMG 1.25 billion during the program period.

4/ Ceiling includes only nontrade external borrowing, i.e. it excludes bankers' acceptances, suppliers credits, and letters of credit.

5/ Increase in commitments or guarantees under the ceiling are limited to specific credits for certain export industries.

It may be recalled that in the course of the first review, the Minister of Finance had already communicated indicative targets in respect of total credit and net credit to the Government. The proposed performance criterion relating to total credit is identical with the indicative target. However, in recognition of the reduced requirement of the Government for bank credit, net credit to the Government is proposed to be somewhat lower than under the indicative target, with a corresponding implied increase in credit to the private sector. The authorities recognized that, in view of the developments in credit to the private sector in the first half of 1984, the permitted increase may appear to be on the high side and that actual credit expansion may, therefore, be lower than programmed. However, they pointed out that it was difficult to predict the private sector's demand for credit in the light of the recent liberalization measures, and they did not wish the resulting, hoped for, increase in economic activity to be atrophied by an undue restriction of credit. As regards arrears, the proposed criteria imply elimination of domestic arrears of the Government, while reducing the stock of external arrears by SDR 7.3 million to SDR 88 million. The two final purchases (SDR 6 million each) of the arrangement will be made upon completion of the third review and satisfaction of the end-September performance criteria, and upon satisfaction of the end-December performance criteria, respectively. Completion of the third review, as stated in the Minister's letter of November 21, 1983, will require reaching understandings with the Fund on budgetary policies and the import program for 1985. It is intended that indicative targets for 1985 in these areas will be agreed during that review.

IV. The Medium-Term Outlook

Madagascar's balance of payments prospects will continue to be dominated over the medium term by its very substantial debt service as shown in the projections of Table 6. In this scenario, as in the earlier one presented in EBS/83/235, it is clear that the scope for significant progress in reducing the present very large imbalances in the external account is relatively limited. The assumptions governing these estimates are that the structure of incentives to produce tradable goods will be further strengthened. The projected annual average rise in exports is about 7.5 percent over the period (and a 17 percent annual rate for nontraditional exports), which is viewed as consistent with the policy assumptions and a return, in many cases, to previous volume levels. Total imports are projected to rise at an average rate of 7.3 percent a year which includes the WEO assumption of annual average price increases of 4.5 percent. Most of the increase is to be attributable to raw materials and energy, with some increase in the volume of capital goods imports. Such a level of imports is regarded as consistent with, and indeed required by, the further implied assumption of about 2.8 percent growth in real GDP. Public transfers, drawings on foreign assistance, and foreign investment are estimated to remain unchanged in real terms and thus, in line with WEO assumptions, to increase by 4.5 percent in nominal terms.

Table 6. Madagascar: Projected External Debt Servicing Capacity and Debt Service, 1984-89

(In millions of SDRs)

	1984	1985	1986	1987	1988	1989
Exports, f.o.b.	315	336	346	394	421	452
Of which:						
coffee, cloves, and vanilla	(226)	(225)	(217)	(237)	(248)	(255)
Imports, f.o.b.	-340	-360	-378	-400	-427	-459
Of which: raw materials, energy	(-118)	(-210)	(-225)	(-242)	(-260)	(-280)
Trade balance	-25	-24	-32	-6	-6	-7
Services, Net (excl. interest)	-115	-111	-111	-113	-119	-127
Private transfers	-1	-1	1	3	5	6
Current account (excl. interest)	-141	-136	-142	-116	-120	-128
Public transfers, drawings, and foreign investment	248	248	259	271	283	296
Balance available for debt service 1/	107	112	117	155	163	168
Total debt service	-312	-310	-303	-325	-312	-294
Amortization	-192	-170	-166	-196	-183	-175
Of which: IMF repurchases	(-24)	(-32)	(-35)	(-35)	(-25)	(-16)
Interest	-120	-140	-137	-129	-129	-119
Initial financing gap 2/	-205	-198	-186	-170	-149	-126
Memorandum items:						
Debt service ratio, before rescheduling 3/	86	81	77	72	65	57
Debt service capacity, as percent of exports of goods and services 4/	29	29	30	34	34	32

1/ Defined as current account (excluding interest) plus public transfers, drawings, and other items.
2/ Excluding Fund purchases; SDR 6 million would be available in 1985 under the present stand-by arrangement. These estimates also do not include servicing of financing needed to cover the gap.
3/ As a percent of exports f.o.b. and service receipts.
4/ Defined as the balance available for debt service as a percent of exports f.o.b. and service receipts.

The projections show that the current account, excluding interest payments on existing loans as well as on the assumed capital inflow, will show only a small improvement. However, taking into account the projected capital inflow, the debt servicing capacity should increase from approximately SDR 112 million in 1985 to SDR 168 million in 1989. This improvement, which will continue the tendency apparent in the last two years, will occur notwithstanding the projected increase in real imports, in marked contrast to the actual decline registered over the last two years.

It will be noted that at least until about 1987 the debt servicing capacity would barely match interest payments on the presently scheduled debt as well as on the additional normal capital inflow assumed in Table 6. Indeed, if account is taken of the interest payments on the additional financing required to meet the calculated "initial financing gap," total interest payments would absorb almost the entire debt servicing capacity throughout the period.

Thus, a sizable financing gap is apparent in every year of the period considered in this scenario, gap which would be even higher once the costs of financing it are taken into account. In the circumstances, it is essential that the terms on which such financing (whether debt rescheduling or exceptional balance of payments assistance) is accorded be consistent with the constraints implicit in the above scenario. Rescheduling of debt would already burden the balance of payments in the subsequent years, and if the financing is accorded at other than concessional rates, it would further erode the capacity of the country to amortize its debts.

On the other hand, to augment Madagascar's debt servicing capacity in the immediate future by scaling back the projected increase in imports would almost certainly reduce the rate of growth of GDP and of exports and, thereby, the country's eventual ability to service the debt. In addition, it may make it more difficult, both politically and socially, to accept such a regime for so long a period with no promising resolution of the debt overhang.

V. Staff Appraisal

The economy of Madagascar showed a number of welcome developments in 1983-84 that give rise to the hope that the corner has been turned on the road to economic recovery. The ability of the Malagasy authorities to monitor their financial program and their commitment to its success have both been in evidence. This assessment stands in contrast to the difficulties encountered in the previous three Fund-supported programs.

The erosion of real GDP was halted in 1983 when a very modest growth was achieved, and gross domestic savings rose slightly. In 1984 real GDP is projected to rise by 1.6 percent, notwithstanding the damage to production from a cyclone in April. The rate of inflation came down sharply from its 32 percent level in 1982 to 20 percent in 1983 and is projected to moderate further in 1984. On the domestic financial side, the budget deficit in 1983 was lower in absolute terms, though somewhat higher as a percent of GDP, than the program target. For 1984 it is projected at slightly less than the program limit of 5.5 percent of GDP. Broad money, after declining in the previous year, is projected to increase by about 15 percent in 1984, largely reflecting the programmed expansion in private sector credit needed to support the emerging economic recovery; the proportion of expansion of credit to government to total credit increase is expected to be reduced from 59 percent in 1983 to 31 percent in 1984. The external current account deficit, excluding interest, declined in 1983 to 7.4 percent of GDP, compared to 9.4 percent of GDP in 1982, and is projected to show a further decline to 5.8 percent of GDP in 1984. The overall balance of payments deficit is projected to decline from 9.3 percent of GDP in 1983 to 8.1 percent of GDP, or SDR 198 million, in 1984. The financing of the 1984 balance of payments provided by debt rescheduling, exceptional assistance from aid donors, and by the Fund, should suffice to provide for both a modest cash reduction of external arrears and a small increase in the depleted gross reserves of the Central Bank.

In the light of the results obtained so far, the authorities are persuaded about the appropriateness of their policy reorientation and are making every effort to execute the program. Also, impressive progress has been made by the authorities in their capacity to monitor closely current financial developments. 1/ As a result, all performance criteria so far have been met. In the course of the review of the present stand-by arrangement, the authorities have proposed performance criteria for the balance of the program period in respect of total domestic credit, net credit to Government, and domestic and external arrears. The discussions also covered policies relating to agricultural pricing and marketing, a possible restructuring of the banking system, and the exchange rate. The staff regards these policies and performance criteria as appropriate and consistent with the original targets of the program and recommends their approval.

Thus, by the end of 1984, the financial imbalances that emerged subsequent to 1979-80 have been substantially reduced, with the exception of the severe debt problem. This result is largely attributable to the implementation of policies under the adjustment programs supported by stand-by arrangements with the Fund. Major elements of the policy package under the program have been: improved incentives to producers in the form of higher producer prices for agricultural products and of removal of controls over many industrial prices; liberalization of marketing in agriculture, particularly in rice, accompanied by measures

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1/ The staff hopes that this progress will be accompanied in the near future by improved reporting of data to the Fund's Bureau of Statistics, reporting which has thus far been inadequate (Appendix III).

to prevent consumer subsidization; continuation of the progress made in controlling and containing public expenditure, leading to a further reduction in the budget deficit; an import program that gives priority to essential inputs; and a flexible exchange rate policy to reverse the earlier loss of international competitiveness of the Malagasy economy and to underpin the above major policy elements.

The staff is encouraged by the results of these policies so far and believes that the authorities should now place increasing importance on the resolution of underlying structural problems, to encourage the resumption of an acceptable rate of growth, while reinforcing the thrust of present policies. The emphasis must be placed on policies to stimulate production, especially of exportable output and for import substitution. This should be accompanied by a restructuring and reorientation of the banking system in the light of the liberalization of the pricing and marketing systems, the rehabilitation or closure of unprofitable and highly indebted state enterprises, the liberalization of the import and export regime, improvement in the assessment and implementation of the public investment program, and further steps to liberalize prices and distribution of agricultural and industrial products. In these areas, while the Fund could continue to play a role in assisting the Government in its stabilization efforts, an increasing role should be played by the World Bank and other development institutions. The World Bank is organizing a second Consultative Group meeting for Madagascar in late November 1984 where these issues will be addressed.

The staff regards the authorities' policies as providing a reasonable balance between what could be considered as socially and politically acceptable within the country and the implicit needs of the adjustment effort that could be supported by the international community and be regarded as appropriate in the light of the difficulties faced by Madagascar. The constraints facing the authorities in their major effort at adjustment must be recognized. In particular, the massive overhang of external debt (equivalent to 88 percent of GDP) and a consequent high debt service ratio (86 percent in 1984 compared to only 4 percent in 1978) will have a decisive influence on the pace of adjustment and growth.

The overall conclusion of the last year's Article IV consultation was that, while a significant policy improvement had begun in 1983 with some positive initial results, the outlook for the future was dominated by the external debt service burden, which implied that the medium-term viability of the balance of payments was far from assured. Developments since then have validated that conclusion. Staff projections of the medium-term balance of payments show that, under the assumption of appropriate policies and modest growth in real GDP, Madagascar's debt servicing capacity would rise slowly but will not come close to matching the country's debt service obligations, and will barely be sufficient to cover interest payments for the next few years. Resolution of the debt problem is, therefore, an indispensable precondition underlying the medium-term scenario projected for the balance of payments. Such a scenario should, of course, be viewed as providing an indication of the needed strong adjustment program on the part of Madagascar as well as the response that will need to be found by the international community for a satisfactory resolution of the country's problems.

The 1984 consultation discussions have thus confirmed, in the view of the staff, the validity of the two-pronged approach recommended in last year's consultation report, namely: (1) consolidation and continuation of the recent reorientation of economic policy, and (2) extraordinary assistance by donors and creditors in resolving the debt problem and supporting Madagascar's adjustment efforts.

Madagascar continues to maintain comprehensive exchange restrictions in the form of foreign exchange budgeting for current international transactions, specific limits for certain invisible payments, and external payments arrears, though there has been some liberalization in the context of the adjustment programs supported by Fund stand-by arrangements. The authorities are keeping the restrictive system under constant review and intend to continue to reduce progressively dependence on these restrictions. The staff believes that, notwithstanding the critical situation in the balance of payments, the authorities should make a beginning in the direction of reducing restrictions on imports and of liberalizing exports, while continuing with their flexible exchange rate policy. In the meantime, the staff recommends that the Executive Board approve the retention of the exchange restrictions until March 31, 1985. The staff recommends approval of the restrictions maintained by Madagascar on payments and transfers for current international transactions.

The Article IV consultation discussions with Madagascar should be maintained on the existing 12-month cycle.

VI. Proposed Decisions

The following decisions are proposed for adoption by the Executive Board:

Article IV Consultation

1. The Fund takes this decision relating to Madagascar's exchange measures subject to Article VIII, Section 2, and in concluding the 1984 Article XIV consultation with Madagascar, in the light of the 1984 Article IV consultation with Madagascar conducted under Decision No. 5392-(77/63), adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. Madagascar maintains restrictions on payments and transfers for current international transactions as described in EBS/84/195 and in SM/84/___ . The Fund welcomes the intention of the authorities to progressively remove exchange restrictions in the context of the adjustment program supported by the current stand-by arrangement. In the meantime, the Fund grants approval for their retention until March 31, 1985.

Review Under Stand-By Arrangement

1. Pursuant to paragraph 4(c) of the stand-by arrangement for Madagascar (EBS/83/255, Supplement 1), as amended by paragraph 3(b) of Executive Board Decision No. 7650-(84/42), adopted March 19, 1984, and by paragraph 3 of Executive Board Decision No. 7753-(84/107) adopted July 16, 1984, Madagascar has consulted with the Fund in order to reach understandings with the Fund regarding the policies and measures that Madagascar will pursue with respect to exchange rate policy and the banking system, and to establish performance criteria regarding (i) total credit to the

economy, (ii) net credit to the Government, (iii) domestic payments arrears, and (iv) external payments arrears for the remaining period of the arrangement.

2. The letter dated July 31, 1984, from the Minister at the Presidency of the Republic of Madagascar in Charge of Finance and Economy shall be attached to the stand-by arrangement for Madagascar (EBS/83/255, Supplement 1) and the letter dated November 21, 1983, attached thereto as modified and supplemented by the letter and memorandum of February 23, 1984, and the letter of June 8, 1984, shall be read as further modified and supplemented by the letter of July 31, 1984.

3. Accordingly, the limits referred to in paragraph 11 of the letter of November 21, 1983, and paragraph 5 of the letter dated June 8, 1984, on total credit to the economy, net credit to the Government, the targets for the reduction of external payments arrears through net cash payment and the elimination of domestic payments arrears, shall be those referred to in paragraph 3(a), (b), (d), and (c), respectively, of the letter of July 31, 1984.

4. The Fund finds that no additional understandings are necessary concerning exchange rate policies and the banking system, and that Madagascar may proceed to make purchases under the stand-by arrangement.

MADAGASCAR - Fund Relations

(As of August 31, 1984, unless otherwise indicated)

I. Membership status

a. Date of membership: September 23, 1963

b. Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

a. Quota: SDR 66.4 million

b. Total Fund holdings of

Malagasy francs: SDR 213.92 million, or 322.2 percent of quota.

	Amount (SDR millions)	Percent of quota
c. Fund credit	147.5	222.2
Compensatory financing	(50.8)	(76.5)
Stand-by	(47.8)	(72.0)
Supplementary financing	(20.9)	(31.5)
Enlarged access resources	(28.0)	(42.1)

d. Reserve tranche position: 0

III. Stand-by arrangement and special facilities

a. Present stand-by arrangement:

i. Duration: April 10, 1984 through March 31, 1985.

ii. Amount: SDR 33 million, or 49.7 percent of quota.

iii. Utilization: SDR 15 million.

iv. Undrawn balance: SDR 18 million.

b. Previous stand-by arrangements during the last 10 years:

i. 1982-83 stand-by arrangement:

Duration: July 9, 1982 through July 8, 1983.

Amount: SDR 51 million.

Utilization: SDR 40.8 million.

Undrawn balance: SDR 10.2 million.

ii. 1981-82 stand-by arrangement:

Duration: April 13, 1981 through June 26, 1982.

Amount: SDR 109 million.

Utilization: SDR 39 million.

Undrawn balance: SDR 70 million.

iii. 1980-82 stand-by arrangement:

Duration: Initially requested to cover the period from June 27, 1980 to June 26, 1982; was canceled in April 1981 by request of the Malagasy authorities.

Amount: SDR 64.45 million.

Utilization: SDR 10 million.

Undrawn balance: SDR 54.45 million.

c. Special facilities: Compensatory financing of SDR 14.4 million was approved June 27, 1984 in respect of 1983 export shortfall. Outstanding purchases under compensatory financing facility amount to SDR 54.5 million, or 82.0 percent of quota.

IV. SDR Department

a. Net cumulative allocation: SDR 19.27 million.

b. Holdings: SDR 0.0 million, or 0.0 percent of net cumulative allocations.

c. Current designation plan: None.

V. Administered Accounts

a. Trust Fund loans

i. Disbursed - SDR 25.4 million

ii. Outstanding - SDR 22.8 million

b. SFF Subsidy Account payments: SDR 2.2 million

VI. Overdue Obligations to the Fund

None

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

FMG 597.65 per U.S. dollar (on July 2, 1984). The Malagasy franc is pegged to a basket of currencies with weights based on the pattern of trade. There is no single intervention currency.

VIII. Last Article IV Consultation

The 1983 Article IV consultation discussions were completed on December 21, 1983 (EBS/83/235 and SM/83/245). The decision adopted was:

"1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Madagascar in light of the 1983 Article IV consultation with Madagascar conducted under Decision No. 5392-(77/63), adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. Madagascar maintains restrictions on payments and transfers for current international transactions as described in EBS/83/235 and in SM/83/245. The Fund notes the intention of the authorities to remove these restrictions as soon as possible. In the meantime, the Fund grants approval for their retention until October 31, 1984 or the completion of the 1984 Article IV consultation with Madagascar, whichever is earlier."

The consultation is held under the normal 12-month cycle.

IX. Technical Assistance

The Central Banking Department provided consultants to the Central Bank of Madagascar for various periods in 1983 on accounting of external assets and liabilities, monetary statistics, data processing requirements, and the implementation of a new bank data reporting system. The consultant on the latter issue returned to Antananarivo for two weeks in February 1984.

MADAGASCAR - Relations with the World Bank Group

(In millions of U.S. dollars)

Amounts outstanding as of March 31, 1984	Disbursed	Undis-bursed	Total commitments
Completed projects	123.52	--	123.52
IBRD	32.57	--	32.57
IDA	90.95	--	90.95
Projects in execution (IDA)	148.99	145.41	294.40
Forestry	7.86	12.14	20.00
Agriculture and rural development	17.57	54.83	72.4
Education	17.20	8.30	25.50
Energy, power, and utilities	55.02	32.48	87.50
Transportation	48.73	35.27	84.0
Industry and tourism	2.61	2.39	5.00
Total	272.51	145.41	417.92
IBRD	32.57	--	32.57
IDA	239.94	145.41	385.35
Repayments			11.65
IBRD			3.07
IDA			8.58
Debt outstanding (including undisbursed)			406.27
IBRD			29.50
IDA			376.77
IFC investments			15.24

Source: World Bank.

Madagascar - Statistical Issues

1. Coverage, Currentness, and Reporting of Data in IFS

		Latest Data in August 1984 IFS
Real Sector	- National Accounts	1980
	- Prices	Q3 1983
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Central Bank	Q4 1983
	- Deposit Money Banks	Q4 1983
	- Other Financial Institutions	n.a.
External Sector	- Merchandise Trade: Values	December 1981
	- Merchandise Trade: Prices	December 1981
	- Balance of Payments	1979
	- International Reserves	May 1984
	- Exchange Rates	May 1984

During the past year, the reporting of data for inclusion in the IFS has been infrequent.

2. Outstanding Statistical Issues

Government Finance

No data are published in IFS, and data in the GFS Yearbook relate to 1972 through 1974, with those for the later year being incomplete.

Monetary Accounts

Although no money and banking statistics had been reported by the authorities for some time, recently quarterly data through end-1983 were provided based on the recommendations of a technical assistance mission undertaken in September 1981. While these data have been published in IFS there are several questions relating to developments in the data subsequent to the 1981 mission, which are currently being discussed with the IFS correspondent. It is hoped that monthly data can eventually be reported on a current basis.

Balance of Payments

Balance of payments data have not been reported to the Bureau of Statistics for the past four years and there is an urgent need to improve the currentness of the statistics.

3. Technical Assistance

The possibility of a Fund technical assistance mission in mid-October 1984, in the field of general economic data was discussed during the consultation mission. The objectives of the mission would be to review methodologies underlying the compilation of data on prices, production, and external trade, and provide suggestions for their improvement.

MADAGASCAR - Basic Data

Area, population, and GDP per capita

Area	587,000 square kilometers
Population: Total (1982)	9.3 million
Growth rate	2.8 percent
GDP per capita (1982)	SDR 277

	1979	1980	1981	1982	1983	1984 Proj.
GDP (at 1982 prices)						
Total (in billions of Malagasy francs)	1,115	1,123	1,014	996	1,005	1,021
Agriculture (percent of total)	37	37	39	41	42	41
Secondary sector (percent of total)	21	20	17	15	15	16
Annual real rate of growth (percent)	9.6	0.7	-9.7	-1.8	0.9	1.6
Investment as percent of GDP (at current market prices)	25	23	18	13	13	12
Prices (percent change)						
GDP deflator	11	15	27	29	22	16
Cost-of-living index	14	18	31	32	20	16
Central government finance	(In billions of Malagasy francs)					
Current budgetary revenue	90.7	100.4	104.4	121.7	141.0	164.3
Current budgetary expenditure	-97.4	-112.7	-112.2	-127.5	-145.5	-167.0
Current surplus/deficit (-)	-6.7	-12.3	-7.8	-5.8	-4.5	-2.7
Capital expenditure	-65.9	-89.8	-84.1	-72.1	-80.4	-84.4
Extrabudgetary revenue	23.7	22.9	15.2	30.0	44.6	72.3
Other expenditure	-30.9	-47.6	-38.5	-39.4	-45.1	-62.8
Overall deficit (-)	-79.9	-126.8	-115.3	-87.2	-85.4	-77.6
External borrowing (net)	35	48	55	50	50	48
Domestic bank borrowing (net)	42	78	58	34	36	32
Domestic nonbank borrowing	3	1	2	3	-1	-2
Overall deficit as percent of GDP	-13.4	-18.4	-14.6	-8.8	-7.0	-5.4
Money and credit	(Percent change)					
Domestic credit	47	48	23	17	13	19
Government	104	77	34	14	14	10
Nongovernment	20	22	8	25	12	29
Money and quasi-money	26	19	21	10	-1.5	15

MADAGASCAR - Basic Data (continued)

	1979	1980	1981	1982	1983	1984 Proj.
Balance of payments			(In millions of SDRs)			
Exports, f.o.b.	305	335	282	303	287	315
Imports, c.i.f.	-627	-722	-516	-500	-424	-406
Trade balance	-322	-387	-234	-197	-137	-91
Services and private transfers (net)	-41	-74	-126	-132	-159	-171
Current account balance	-363	-461	-360	-329	-296	-262
Official transfers (net)	27	33	53	66	57	69
Capital account (net)	234	288	210	90	12	11
Drawings	249	321	277	190	181	180
Amortization	-15	-33	-67	-100	-169	-169
Allocation of SDRs	4	4	4	--	--	--
Other 1/	-6	-40	-16	51	-20	-15
Overall surplus or deficit (-)	-104	-176	-109	-123	-248	-198
Current account deficit as percent of GDP	-16.8	-18.4	-14.6	-12.8	-11.3	-10.8
Gross official foreign reserves (end of period)	1	16	21	24	21	33
In weeks of imports	--	1	2	3	3	4
External public debt						
Disbursed and outstanding (end of period)	474	1,027	1,333	1,662	1,912	2,133
Debt service as percent of exports of goods and services						
Before rescheduling						
Excluding the Fund	9.3	17.1	43.0	53.4	78.3	80.0
Including the Fund	9.9	18.1	44.1	54.9	79.4	86.4
After rescheduling	9.9	18.1	25.1	31.9	32.4	31.3

IMF data

Date of membership	September 23, 1963
Quota	SDR 66.4 million
Intervention currency and the rate	Malagasy franc is pegged to a basket of currencies; no single intervention currency.
SDR/Local currency equivalent	SDR 1 = FMG 616 (on July 2, 1984)

1/ Includes banks, short-term capital, valuation adjustments, and errors and omissions.

MADAGASCAR - Basic Data (concluded)

IMF data (concluded)	(June 30, 1984)
	(In millions of SDRs)
Total outstanding purchases	142.6
Under tranche policies	88.1
Ordinary	(44.5)
Supplementary	(21.6)
Enlarged access	(22.0)
Compensatory financing	54.5
Oil facility	--
Total Fund currency holdings (in percent of quota)	293.0
Excluding CFF and oil facility (in percent of quota)	210.9
Net cumulative SDR allocation	19.3
Holdings of SDRs	1.6
Trust Fund loans outstanding	23.9

Democratic Republic of Madagascar
Ministry at the Presidency of the Republic
in Charge of Finance and Economy

Antananarivo, July 31, 1984

No. 13-MPFE/SG/SP/CF

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. de Larosière:

1. The present stand-by arrangement with Madagascar provides for a second review before end-August. When the first review took place on July 16, the Fund decided that the performance criteria regarding (i) total credit, (ii) net credit to the Government, (iii) domestic payments arrears, and (iv) external payments arrears for the rest of the period (after July 1984) of the arrangement should be established during the second review. At that time, policies relating to exchange rates, the prices and marketing of commodities, and a possible reorganization of the banking system will be reviewed.

2. The second review was conducted with Fund staff at the same time as the Article IV consultation discussions. The major conclusions of these discussions are: the real growth rate of GDP in 1984 would be about 1.6 percent; inflation would decline to an annual rate of 16 percent; and the budgetary and balance of payments targets for 1984, in particular a small increase in external assets, would be achieved. As a result, no change is needed in either the exchange rate policies or the pricing and marketing policies described in my letters of February 23 and June 8, 1984. The Government will continue to pursue a flexible exchange rate policy, to review agricultural prices at the beginning of the crop year in order to maintain production incentives, and to decontrol gradually the prices and marketing of industrial products.

3. With respect to performance criteria, the Government intends:

(a) to limit the increase in total credit to the economy, already limited to FMG 38 billion from end-December 1983 through end-June 1984, to FMG 82.0 billion from end-December 1983 through end-September 1984, and to FMG 102 billion from end-December 1983 through end-December 1984.

(b) to limit the increase in net credit to Government from the banking system, already limited to FMG 14 billion from end-December 1983 through end-June 1984, to FMG 21 billion from end-December 1983 through September 1984 and to FMG 32 billion from end-December 1983 through end-December 1984.

(c) to reduce by FMG 6 billion by end-September 1984 the stock of domestic payments arrears pertaining to budgetary expenditures as of the end of 1982, which had been reduced to FMG 9 billion as of the end of 1983, and to eliminate such arrears by the end of 1984. It must be noted, however, that when fiscal year 1983 was closed out FMG 3.9 billion in expenditures unpaid as of the end of 1983 was recorded. In the view of the Government, this amount reflects a normal administrative delay from one year to the next. These bills will be paid during 1984 out of the budgetary appropriations for 1984.

(d) to reduce by SDR 6 million by end-September 1984, and by SDR 7.3 million by the end of 1984, the stock of external payments arrears, estimated at SDR 95.5 million as of the end of 1983 (following the Paris Club III consolidation), which was already scheduled to be reduced by SDR 4 million by end-June 1984. Taking into account the payments of SDR 2.7 million of consolidated arrears under the Paris Club agreement, the net reduction through cash payment of arrears will thus be SDR 10 million in 1984.

4. The import program for 1984 sets raw material imports (c.i.f.) at FMG 55 billion (SDR 94 million). Licenses were issued in the first half of 1984 for imports totaling FMG 33 billion. Considering the outlook with respect to foreign exchange receipts for the rest of the year and the priority accorded by the Government to economic recovery, the remaining licenses for raw materials and spare parts, in the amount of FMG 22 billion, will be issued before the end of August 1984. In addition, priority in the allocation of foreign exchange for this year will be given to the licenses for these imports. Credit policy will also take account of this priority.

5. The Government is now examining the recommendations of a recent report by the Fund's Central Banking Department on the present structure of the Malagasy banking system. Pursuant to this report, the Government has launched an external audit of each national bank in order to appreciate better their respective financial situation. The conclusions of these audits should be available by end-October 1984, in time to enable the Government to draw up and institute any needed program for reorganization of the banking system during 1985. With respect to interest rates, it should be noted that some types of depostits are already paid a positive rate in real terms. In furtherance of this policy, the Government has decided to raise to 14 percent (a 2-percentage point increase) by end-August the minimum interest rate on individuals' deposits with maturities between 6 months and 12 months.

6. This letter supplements my letter of November 21, 1983, February 23, 1984, and June 8, 1984.

Sincerely yours,

/s/

Pascal Rakatomavo