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IMF Concludes Article IV Consultation with Madagascar

The IMF Executive Board on September 10, 1997 concluded the 1997 Article IV consultation[1] with Madagascar.

Background

Over the past two and a half years Madagascar has been pursuing cautious financial policies, and it has achieved substantial progress toward macroeconomic stabilization while making strides in deregulation of key economic sectors. Macroeconomic developments were satisfactory in 1996 and early l997. Reflecting in part a good rice harvest, GDP growth in 1996 reached 2.1 percent. Inflation declined to 8.3 percent for the 12-month period ended December 1996 (compared with some 37 percent at end-1995), and it decelerated further to 3.2 percent in the year ended in July 1997. Owing to favorable external sector developments in 1996, the current account deficit of the balance of payments (excluding official transfers) declined to an estimated 3.6 percent of GDP, against 7.3 percent in 1995. Gross official reserves increased by US$131 million to the equivalent of 13 weeks of imports at end-1996; a further reserve buildup took place in the first semester of 1997.

Fiscal policy during 1996 was conservative. Expenditure restraint and higher-than-budgeted revenue reduced the fiscal deficit (on a commitment basis, including grants) to 4.9 percent of GDP, compared to 6.2 percent in 1995. Revenue benefitted from buoyant customs and direct tax receipts, whereas the collection of domestic indirect taxes continued to suffer from deficiencies in value-added tax administration. Total revenue, as a proportion of GDP, rose slightly, to 8.7 percent. As the wage bill remained below budget and other current outlays were compressed in

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[1]Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

the final months of 1996 in light of revenue uncertainties, non-interest current expenditure amounted to some 5.8 percent of GDP in 1996, against 6.2 percent in 1995. Nevertheless, total expenditure, at 17.8 percent of GDP, was slightly higher than in 1995, reflecting a pickup in public investment. Compared with the early 1990s, both revenue and expenditures in 1996 were still low relative to GDP.

The central bank was successful in bringing down inflation and in keeping the exchange rate within a narrow range during 1996 (FMG 771-822 per French franc). Confronted with appreciating pressures in connection with capital inflows, reflecting mostly renewed confidence in the local currency, the central bank purchased substantial amounts of foreign exchange in the market and began to ease the monetary stance. The central bank gradually reduced its key lending rate from 33 percent to 17 percent at end-1996, and the banks' high liquidity led to a decline in treasury bill rates. Credit to the economy remained sluggish, being subdued in part by the rigorous credit policy stance adopted by the two public banks, which sought to comply with prudential regulations.

In the first semester of 1997, financial developments continued along past years' trends, with inflation receding, money demand remaining strong, and credit to the economy growing slowly. The central bank further reduced its key rate, to 11 percent at end-June 1997. Reflecting the easing of monetary policy, the Malagasy franc depreciated moderately during the first semester of 1997. The budget deficit was contained, but continued weak domestic revenue collection underscored the need for reforms in tax administration. A supplementary 1997 budget law was approved on August 1, 1997, extending the coverage of the value-added tax to virtually all goods and services, and providing for additional resources to strengthen the large taxpayer unit, customs administration, and the monitoring of the export processing free zone.

Some progress in structural reforms was also achieved in the first half of 1997. As part of the divestiture program, 45 public enterprises were identified for privatization in 1997-98, including some key enterprises in the energy and air transport sector. The authorities are also committed to a comprehensive reform of civil service, the first phase of which involves the rationalization of three pilot ministries in 1998-99. Furthermore, the authorities are proceeding with the restructuring and privatization of the two ailing state-owned banks.

Madagascar is further liberalizing its trade and payments system, with the elimination of the vanilla export tax as of June 1997, the lifting of remaining restrictions on imports, and the reduction of tariff rates in the context of the Cross-Border Initiative. The government is seeking to conclude bilateral agreements with all Paris Club members and on comparable terms with non-Paris Club creditors.

Executive Board Assessment

Executive Directors commended the authorities for the adherence to fiscal discipline and a prudent monetary policy, which had resulted in improvements in Madagascar's economic performance: growth had begun to recover, inflation had decelerated, and international reserves had increased. A start had also been made in structural reforms, particularly with respect to the liberalization of external current account transactions, deregulation of key economic sectors, and fiscal reform. Nevertheless, Madagascar's debt burden remained high, and the economy continued to be vulnerable to external shocks. Directors emphasized that much more remained to be done to meet Madagascar's pressing development needs and to reduce poverty. To foster conditions conducive to investment and sustainable growth, Directors encouraged the authorities to persevere with disciplined macroeconomic policies, push forward with structural reforms, and establish a transparent regulatory and legal framework.

Directors welcomed the authorities' adoption of the supplementary budget for 1997, which aimed at broadening the tax base and strengthening tax administration. Noting the weaknesses in revenue performance, Directors emphasized that safeguarding the revenue target would require a decisive follow-up to strengthen the large taxpayer unit and the customs administration, elimination of tax exemptions, and the rigorous collection of tax arrears. Directors also attached importance to applying the new mechanism for the collection of petroleum taxes and the speedy broadening of the value-added tax.

Directors urged the authorities to maintain strict expenditure control and to accord priority to infrastructure and human capital development. They also emphasized the importance of improving the government's payment records. Directors urged the authorities to proceed expeditiously to devise a comprehensive long-term strategy for civil service reform so as to achieve an efficient and reliable public service, which was crucial to improve the business environment.

Directors noted that the continued pursuit of a prudent monetary stance was needed to consolidate the progress with reducing inflation. Further fiscal consolidation and a prudent monetary stance would also support exchange rate stability. Directors stressed that the orderly restructuring and privatization of the two ailing state-owned banks would be essential in enhancing the efficiency and soundness of the banking system.

Directors urged the authorities to accelerate structural reforms, particularly privatization and trade liberalization. They welcomed the government's decision to prepare some 50 public enterprises for privatization within a year. Priority should be given to the privatization of the largest enterprises, while ensuring transparency in the process and using proceeds foremost to cover divestiture costs and debt-service payments of privatized enterprises.

Directors welcomed the normalization of Madagascar's relations with external creditors. They observed that continued progress with macroeconomic and structural reforms would help to maintain donor support and investor confidence.

Press Information Notices (PINs) are a new series of IMF press notices (see Press Release 97/21). PINs are issued, at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

Madagascar: Selected Economic Indicators

	1993	1994	1995	1996	1997 Proj. 1/
Domestic economy			*In percent*		
Change in real GDP	2.1	0.0	1.7	2.1	3.5
Change in consumer prices (end of period)	8.2	61.2	37.3	8.3	7.0
External economy			*In millions of U.S. dollars 2/*		
Exports, f.o.b.	332.0	447.0	502.0	509.0	527.0
Imports, f.o.b.	-510.0	-546.0	-628.0	-629.0	-663.0
Current account balance (including grants)	-176.0	-208.0	-231.0	-144.0	-65.0
Capital account balance	-129.0	-100.0	-55.0	15.0	139.0
Gross official reserves	81.0	62.0	110.0	241.0	298.0
Current account balance (in percent of GDP)	-5.2	-7.0	-7.3	-3.6	-1.6
External debt service (in percent of exports of goods and services) 3/	75.1	59.8	54.7	42.2	18.0
External debt (in percent of GDP)	114.3	136.6	141.1	112.8	99.2
Change in real effective exchange rate (in percent) 4/	10.6	-12.2	-9.3	27.3	-6.2
Financial variables			*In percent of GDP 2/*		
Government revenues	9.9	8.3	8.5	8.7	9.8
Total grants	3.5	3.0	2.9	4.2	5.4
Total expenditures	20.6	19.8	17.6	17.8	16.8
Overall fiscal balance (commitment basis)	-7.2	-8.4	-6.2	-4.9	-1.6
Change in broad money (in percent)	26.2	49.5	16.2	17.9	12.0
Change in credit to the economy (in percent)	17.4	25.6	15.3	2.3	15.5

Sources: Malagasian authorities; and IMF staff estimates.
1/ IMF staff projections.
2/ Unless otherwise noted.
3/ For 1997, after debt relief.
4/ (+) = appreciation.