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AGENDA**

EBS/84/195
Correction 1

CONFIDENTIAL

September 19, 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

The following corrections have been made in EBS/84/195 (9/12/84):

Page 3, Table 1, lines 7-9: figures revised

Page 5, Table 2, column 3, line 13: for "(-88.7)" read "(-80.7)"
column 4, line 7: for "(36.8)" read "(36.0)"
column 5, line 21: for "(-22.8)" read "(-21.8)"
column 6, line 10: for "(1.9)" read "(3.0)"
line 12: for "158.2" read "-158.2"

Page 9, Table 4, column 5, line 19: for "-200.5" read "-2.9"

Corrected pages are attached.

Att: (3)

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

	1980	1981	1982	1983		1984	
				Prog.	Est.	Prog.	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 percent 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		1984	
				Prog.	Actual	Prog.	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 Péréquation (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 4. Madagascar: Balance of Payments, 1980-84

(In millions of SDRs)

	1980	1981	1982	1983	1984	
					Rev. prog.	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 (Excluding interest)	-460.4 (-428.4)	-360.2 (-292.9)	-329.8 (-241.6)	-296.3 (-197.5)	-260.6 (-142.4)	-261.7 (-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