

EBS/82/103
Correction 1

CONFIDENTIAL

July 2, 1982

To: Members of the Executive Board

From: The Secretary

Subject: Madagascar - Staff Report for the 1982 Article IV Consultation
and Request for Stand-By Arrangement

The following corrections have been made in EBS/82/103 (6/11/82):

Page 9, Table 4: texts of footnotes 1 and 2 have been reversed.

Page 10a, Chart 1, footnote 2: for "Normal...index for Antananarivo"
read "Nominal...index for Antananarivo"

Page 11, 2nd full para., line 5: for "1981" read "1980"

Page 30, para. 1, line 1: insert "June 8" after "dated"

Page 34, line 1: for "Antananarivo, June , 1982"
read "Antananarivo, June 8, 1982"

para. 4, line 8: for "less than" read "reduced by"

Page 39, numbered para. 1, line 3: for "notably" read "not only"

Corrected pages are attached.

Att: (5)

Table . Madagascar: Balance of Payments, 1978-82

(In millions of SDRs) 1/

	1978	1979	1980	Program 1981	Actual Est.	Proj. 1982
Exports, f.o.b.	323.5	320.2	335.6	373.2	285.5	314.3
Imports, f.o.b.	-308.7	-542.5	-620.3	-474.9	-455.7	-519.3
Trade balance	<u>14.8</u>	<u>-222.3</u>	<u>-284.7</u>	<u>-101.7</u>	<u>-170.2</u>	<u>-205.0</u>
Service receipts	31.5	42.2	43.6	39.0	40.0	40.5
Service payments	-143.7	-199.4	-223.2	-254.3	-211.1	-222.6
Freight and merchandise insurance	(-63.0)	(-86.6)	(-101.5)	(-82.2)	(-78.7)	(-73.2)
Other transportation	(-18.8)	(-24.0)	(-24.7)	(-26.1)	(-20.9)	(-21.8)
Travel	(-18.0)	(-22.2)	(-20.4)	(-24.4)	(-20.3)	(-21.8)
Investment income	(-10.6)	(-19.3)	(-29.8)	(-60.6)	(-50.9)	(-65.3)
Other services	(-33.3)	(-47.3)	(-46.8)	(-61.0)	(-40.3)	(-40.5)
Services (net)	<u>-112.2</u>	<u>-157.2</u>	<u>-179.6</u>	<u>-215.3</u>	<u>-171.1</u>	<u>-182.1</u>
Private unrequited transfers (net)	<u>6.4</u>	<u>5.5</u>	<u>0.7</u>	<u>5.2</u>	<u>7.2</u>	<u>9.4</u>
Current balance	<u>-91.0</u>	<u>-374.0</u>	<u>-463.6</u>	<u>-311.8</u>	<u>-334.1</u>	<u>-377.7</u>
Official unrequited transfers (net)	<u>41.8</u>	<u>48.8</u>	<u>48.0</u>	<u>45.6</u>	<u>50.0</u>	<u>56.1</u>
Nonmonetary capital (net)	<u>27.0</u>	<u>142.7</u>	<u>223.8</u>	<u>162.4</u>	<u>224.2</u>	<u>180.4</u> 2/
Direct investment (net)	-5.0	-5.1	-0.7	-4.9	-0.6	-0.6
Public (net)	18.1	128.4	160.3	136.6	190.4	166.4
Credit	(22.0)	(133.9)	(169.4)	(164.8)	(204.2)	(211.2)
Debit	(-3.9)	(-5.5)	(-9.1)	(-33.4)	(-32.2)	(-59.8)
Debt relief obtained	(—)	(—)	(—)	(5.2)	(18.4)	(15.0)
Private (net)	28.0	66.2	50.5	27.2	13.7	14.6
Credit	(31.5)	(73.5)	(64.7)	(54.0)	(25.9)	(48.0)
Debit	(-3.5)	(-7.3)	(-14.2)	(-26.8)	(-25.3)	(-42.1)
Debt relief obtained	(—)	(—)	(—)	(—)	(13.1)	(8.7)
Trust Fund	10.8	—	14.5	—	—	—
Other, including errors and omissions, and valuation changes	-24.9	-46.8	-0.8	3.5	20.7	—
Banks (net)	<u>21.6</u>	<u>20.0</u>	<u>5.1</u>	<u>17.4</u>	<u>-18.1</u>	<u>—</u>
Allocation of SDRs	<u>—</u>	<u>3.5</u>	<u>3.5</u>	<u>3.5</u>	<u>3.5</u>	<u>—</u>
Overall balance	<u>-0.6</u>	<u>-159.0</u>	<u>-183.2</u>	<u>-82.9</u>	<u>-74.5</u>	<u>-141.2</u> 2/
Financing 3/	<u>0.6</u>	<u>159.0</u>	<u>183.2</u>	<u>82.9</u>	<u>74.5</u>	<u>141.2</u>
Central Government exceptional balance of payments financing (net)	—	52.9	56.1	19.5	30.3	32.7
Drawings	(—)	(52.9)	(56.1)	(...)	(30.3)	(32.7)
Repayments	(—)	(—)	(—)	(...)	(—)	(...)
IMF (net)	-2.6	-3.5	33.0	66.6	31.9	47.0
Drawings	(—)	(—)	(39.2)	(74.0)	(39.0)	(52.4)
Repurchases	(-2.6)	(-3.5)	(-6.2) 4/	(-7.4)	(-7.1)	(-5.4)
Changes in arrears (-decrease)	—	—	174.5	-42.9	-71.2	-7.6
Of which: Net cash basis	(—)	(—)	(174.5)	(-42.9)	(38.6)	(-7.6)
Other Central Bank						
Assets (net)	3.2	109.6	-80.4	-4.9	83.5	-46.7
Assets (- increase)	(14.9)	(43.5)	(-14.7)	(-4.9)	(-11.8)	(...)
Liabilities related to consolidation of arrears	(—)	(—)	(—)	(—)	(95.5)	(...)
Of which: New consolidations	[—]	[—]	[—]	[—]	[109.8]	[...]
Repayments of consol. arrears	[—]	[—]	[—]	[—]	[-14.3]	[-46.7]
Other liabilities	(-11.7)	(66.1)	(-65.7)	(—)	(-0.2)	(...)
Expected additional rescheduling of debt service due in second half 1982						52.6
Expected rescheduling of previously rescheduled debt service and arrears						9.0
Remaining financing gap				44.6		54.2

Sources: Data provided by the Malagasy authorities; and staff estimates.

1/ Transactions converted at the following annual average rates per SDR 1: FMG 282.50 (1978); FMG 274.83 (1979); FMG 275.01 (1980); FMG 287.0 (1981 program); FMG 320.20 (1981 actual estimate); and FMG 380.0 (1982).

2/ Excluding an estimated amount of SDR 52.6 million of debt relief expected to be obtained in the second half of 1982.

3/ Converted at the following end of period rates per SDR 1: FMG 272.28 (1978); FMG 264.28 (1979); FMG 287.99 (1980); and FMG 334.52 (1981).

4/ Includes reserve asset subscription.

restrictions on payments for invisibles and imports to cope with the continuing severe foreign exchange constraints.

In addition to external payments arrears described above, arrears in respect of dividend transfers have existed since about 1973. In 1981, payments of outstanding arrears on dividends were made in accordance with the programmed schedule through September 1981, but fell short of the December 1981 target by FMG 100 million. However, since about the beginning of 1981, the Central Bank has discontinued processing applications for the transfer of dividends submitted to it, in the knowledge that the shortage of foreign exchange would in any event prevent the remittance of such dividends. As a result, it has not been possible to determine the exact amount of bona fide dividends outstanding for which the transfer of foreign exchange is in arrears. During 1981, unprocessed applications (not all of which necessarily constituted bona fide dividends eligible for transfer) accumulated in the Central Bank increased by FMG 2.3 billion.

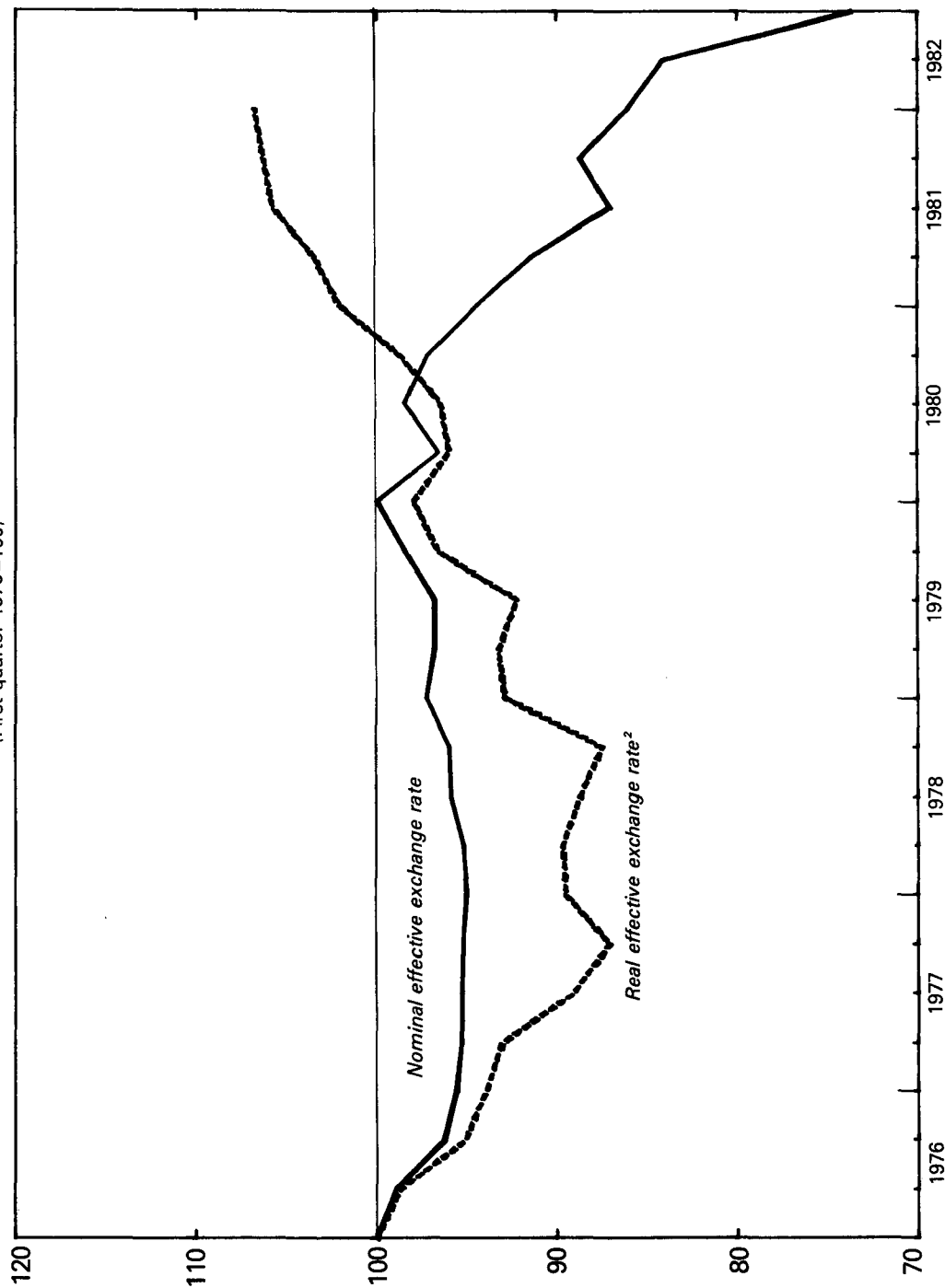
Madagascar continues to apply limits on the sale of foreign exchange for certain payments and transfers for current international transactions, e.g., travel, student expenses, the transfer of savings from wages and salaries by foreigners working in Madagascar, and remittances of dividends when distributed by non-industrial enterprises. Applications for the sale of foreign exchange for other categories of invisibles are considered on the merits of each case. The Malagasy authorities said that while there had been no legal changes in the regulations governing the sale of foreign exchange for payments and transfers for current international transactions, de facto delays in approving such sales had developed for virtually all invisible payments, reflecting the critical foreign exchange constraints.

Regarding the import regime, the Malagasy representatives stated that during 1981 it had not been possible to adhere to the system of an annual import program. Beginning August 1981, it was decided to convene weekly meetings of an ad hoc committee, consisting of representatives of the Ministry of Economy and Commerce, the Ministry of Finance, the Central Bank, and the commercial banks. The task of this committee was to administer in the most effective way the limited available foreign exchange. Monthly foreign exchange "budgets" were prepared for priority payments, such as essential imports and invisibles. This ad hoc committee replaced the previous requirement introduced on October 15, 1979 of a Central Bank authorization for import payments by means of a letter of credit.

c. Exchange rate

With regard to exchange rate policy, the Malagasy franc continued to be pegged to the French franc at the rate of FMG 50 = FF 1. The nominal trade-weighted effective exchange rate continued to depreciate in 1981, reflecting the depreciation of the French franc in relation to the US dollar (Chart 1). However, a real effective exchange rate, calculated by using the consumer price index for low income families (with all the

CHART 1
MADAGASCAR
NOMINAL AND REAL EFFECTIVE EXCHANGE RATES¹
(First quarter 1976=100)



Sources: Data provided by the Malagasy authorities; and Fund staff estimates.

¹Trade-weighted; in foreign-currency terms, i.e. decline indicates depreciation.

²Nominal effective exchange rate adjusted by relative CPI, using official CPI index for Ankananarivo.

pointed out above), implies a continued appreciation of the Malagasy franc. (Table 2). In the light of the serious deviations from the program's objectives which were foreseeable by the time of the mid-term review and the lack of policy measures to deal with these problems, it was not possible to reach understandings on exchange rate policy.

2. Real sector

Instead of the modest growth anticipated in the program, real GDP declined by 9.2 per cent in 1981, as a result of the shortage of imported inputs and spare parts and a drought-induced decline in agricultural production. Combined with the deterioration in the terms of trade and a narrowing of the resource gap brought on by the scarcity of foreign exchange, this led to an even sharper decline, of around 13 per cent, in the level of real domestic demand. Capital formation fell by over a quarter in real terms and real private consumption expenditures fell by around 8 per cent. The drought affected mainly rice production, which fell by over 5 per cent, and was most severe in the major rice surplus areas. Combined with the relative unattractiveness of official prices, this led to a much sharper decline, of around 45 per cent, in the volume of officially marketed rice. Industrial production was hardest hit by the shortage of imported inputs and output fell by almost 24 per cent. Only the textile industry emerged relatively unscathed, because it was awarded priority access to scarce foreign exchange.

3. Fiscal performance

Because a major share of fiscal receipts are derived from taxes on international trade and because of the fall in the level of economic activity, total government receipts in 1981, including those of the Fonds National Unique de Péréquation (FNUP), were only 3 per cent higher than in 1980, or 19 per cent below the program target (Table 5). This was notwithstanding the introduction of several new tax measures, including a large new tax on petroleum products. The sharp price decline on the world coffee market had a major effect on the receipts of the FNUP, the government fund which receives the surpluses, after normal export taxes, from the sale of the major agricultural exports. By the end of the year, FNUP was making small losses on coffee operations.

Although the revenue shortfall was the major factor behind the higher-than-targeted deficit, total expenditures were also higher than in the program, and accounted for just over one-third of the overshooting of the deficit. A large part of the additional expenditures occurred in December when it had become evident to the authorities that a resumption of purchases under the stand-by arrangement was no longer possible. At that juncture, they decided to pay all known domestic arrears at the level of the Treasury and to provide some of the major regional rural development agencies (Sociétés d'Aménagement) with the necessary working capital, as required by foreign lenders. There remained internal arrears at the level of individual ministries, but their amount is not yet known precisely. The carry-over of deferred payments from 1980 was also much larger than expected, and expenditures on rice

Table 5. Madagascar: Overall Government Operations 1979-82

(In billions of Malagasy francs)

	<u>Provisional</u>		<u>Program Provisional</u>		<u>Program</u>
	1979	1980	1981	1982	1982
Current budgetary revenue	90.7	100.4	122.4	104.3	127.6
Current budgetary expenditure	-97.7	-112.9	-114.6	-112.2	-134.1
Of which: wages and salaries	(-50.8)	(-60.9)	(-75.4)	(-68.6)	(-77.4)
Current budgetary surplus or deficit (-)	-7.0	-12.5	7.8	-7.9	-6.5
Budgetary capital expenditure	-56.4	-74.4	-40.3	-62.1	-70.8 ^{1/}
Of which: reserved fund	(-10.5)	(-17.4)	(-5.0)	(-15.7)	(-15.0)
Deferred payments	-12.7	-12.9	-8.0	-14.6	-16.8 ^{2/}
FNUP receipts	19.3	15.6	25.4	15.2	26.6
FNUP expenditures	-10.0	-30.3	-16.6	-18.0	-6.9
Capital expenditure	-5.7	-18.1	-3.0	-7.0	--
Other	-4.3	-12.2	-13.6	-11.0	-6.9
Of which: subsidies on local rice	(-2.4)	(-5.0)	(-8.0)	(-5.1)	(-1.5)
Central Bank expenditure for rice imports (net)	-7.5	-4.1	--	-5.0	0.8
Special Treasury accounts (net)	-4.9	-7.9	-39.1	-22.6	-30.0
Of which: on-lending	(-9.3)	(-15.2)	(-35.8)	(-22.0)	(-29.0)
Grants and commodity aid (net) ^{3/}	-0.7	-0.3	--	-0.3	3.3
Total receipts	110.0	116.0	147.8	119.5	157.5
Total expenditures	-189.9	-242.8	-218.6	-234.8	-257.8
Current	-118.5	-135.1	-139.5	-143.7	-158.0
Capital	-71.4	-107.7	-79.1	-91.1	-99.8
Overall government deficit ^{4/}	-79.9	-126.8	-70.8	-115.3	-100.3
Financing	79.9	126.8	70.8	115.3	100.3
Foreign (net)	35.3	47.9	38.0	55.6	60.4
Drawings	36.8	50.4	47.6	64.3	75.1
Amortization	-1.5	-2.5	-9.6	-8.7	-14.7
Domestic (net)	44.6	78.9	32.8	59.7	39.9
Banking system	41.9	78.2	25.2	57.8	35.0
Central Bank	42.1	85.6	19.8	46.3	...
National banks	-0.2	-7.4	5.4	11.5	...
Nonbanking sector	2.7	0.7	7.6	1.9	4.9

Source: Data provided by the Malagasy authorities; and staff estimates.

^{1/} Includes the supplementary tranche.

^{2/} Includes FMG 8.0 billion of budgetary allocation earmarked to payment of arrears to state enterprises.

^{3/} Includes net receipts of grants and commodity aid, excluding rice, and local expenditures financed by this aid.

^{4/} Including grants.

1. The Fund takes this decision in concluding the 1982 Article XIV consultation with Madagascar in light of the 1982 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/82/103 and in SM/82/ . 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 June 30, 1983 or the completion of the 1983 Article IV consultation with Madagascar, whichever is the earlier.

Madagascar - Stand-by Arrangement

Attached hereto is a letter, with annexed memorandum, dated June 8, 1982 from the Minister at the Presidency in charge of Finance of Madagascar requesting a stand-by arrangement and setting forth the objectives and policies that the authorities of Madagascar intend to pursue for the period of this stand-by arrangement. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period of one year from _____, 1982, Madagascar will have the right to make purchases from the Fund in an amount equivalent to SDR 51 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. a. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 10.2 million until August 14, 1982; the equivalent of SDR 20.4 million until November 14, 1982; the equivalent of SDR 30.6 million until February 14, 1983; and the equivalent of SDR 40.8 million until May 14, 1983.

b. None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund holdings of Madagascar's currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources until purchases under the arrangement reach the equivalent of SDR 3,246,810, then each purchase shall be made from ordinary and borrowed resources in the ratio of 1 to 1.2; provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Madagascar will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Madagascar's currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota:

a. during any period in which:

(i) the limit on total bank credit described in paragraph V of the memorandum annexed to the attached letter; or

(ii) the limit on bank credit to the Government described in paragraph V of the same memorandum; or

at the initiative of the Government whenever the Managing Director requests consultation because any of the criteria under paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Madagascar has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time at the initiative of the Government or at the request of the Managing Director, concerning Madagascar's balance of payments policies.

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431, USA

Antananarivo, June 8, 1982

Dear Mr. de Larosière:

1. The economic and financial difficulties which have beset Madagascar since the beginning of 1980, and which had led the Government to request the support of the International Monetary Fund in the form of two successive stand-by arrangements, increased rather than diminished during 1981.

The external payments crisis became more acute, bringing with it a breakdown of industrial production, intensified problems of employment and supplies, and soaring domestic prices. The measures taken in the course of the year to reduce the overall Treasury deficit produced only limited results, despite their determined application. The situation has deteriorated further in early 1982, owing to a series of consecutive natural disasters.

2. The Malagasy Government is determined to take all necessary measures to avoid a total collapse of the economy. It has re-examined the whole of its economic strategy and redefined accordingly the priorities for government action. Clearly, the financial crisis is merely a reflection of serious imbalances in the economic structure, which can be remedied only through in-depth measures affecting all sectors and through a sustained effort over a period of years. Without abandoning the fundamentals of its policy orientation and constantly bearing in mind the concern of preserving political and social stability, the Government is determined to make the necessary changes.

3. The external payments crisis was the dominant feature of 1981. While it is true that the overall balance of payments deficit was considerably lower than in 1980, this reduction, nevertheless, was due to a drastic drop in imports rather than an increase in export revenue.

4. Although the Government had established an export target of FMG 107 billion, the actual result was only FMG 91.4 billion, approximately the same level as in 1980. Higher export receipts for cloves and vanilla were not sufficient to offset lower receipts for other commodities, particularly coffee (FMG 31.8 billion in 1981 compared with FMG 45.1 billion in 1980). The sharp decline in coffee prices on the world market, together with domestic distribution difficulties, were such that the volume of coffee exported was reduced by 9,000 tons (13 per cent), although the level of production was the same as in 1980.

5. Imports declined from FMG 170.6 billion in 1980 to FMG 145.9 billion in 1981. While imports of petroleum products and foodstuffs increased in 1981, rising to 20 per cent and 15.6 per cent of total imports, respectively, (compared with 16.3 per cent and 9.1 per cent in 1980), raw materials for agriculture and industry and essential consumer goods were most severely affected by the reduction of imports. This reduction had serious repercussions on the economy. Lack of raw materials and spare parts forced many enterprises to reduce production drastically, or even halt it completely,

B. Institutional provisions

In the past, the lack of systematic measures and procedures in the preparation, approval, financing, and follow-up of investments explains to a great extent why the large volume of investments over the last few years has had only a limited impact on the supply of goods, while contributing to the sharp deterioration of government finances and the foreign debt. The system now established aims specifically at remedying these deficiencies. It combines a follow-up system both of the investments themselves and of the foreign debt, and is based on the following principles:

1. Restoring the central role of the General Directorate of the Plan (directly attached to the Office of the President of the Republic since January 1982) not only in the elaboration of investment programs, but also in the selection and economic appraisal and financial evaluation of specific projects, as well as the follow-up of project execution.
2. Setting up a financial coordination committee, with responsibility for assessing the suitability of projects selected in the face of domestic and foreign financial constraints, and using in particular the computerized foreign debt management system, connected with the Central Bank's data processing center, for whose improvement the Government has received UNCTAD technical assistance.
3. Instituting an investment committee composed of the top level economic and financial decision-makers, who, on the basis of reports from the financial coordination committee, will make any necessary final decisions and arbitrations.

II. Exchange Rate Policy

Following intensive discussions between the authorities and Fund staff in connection with the preceding two "stand-by" arrangements and in the light of balance of payments projections for the next three years, the Government adjusted the exchange rate for the Malagasy franc on May 15, 1982. Already on April 1, 1982 a basket of currencies, selected on the basis of their share in foreign trade during 1973-1980, was adopted to determine the daily exchange rate. The adjustment of May 15 represents a 15 per cent devaluation in local currency terms against the exchange rate based on this basket.

Forecasts prepared in cooperation with Fund staff show only a limited beneficial effect of the devaluation on government finances in 1982, whereas it will contribute to a faster rise in prices in the course of that year. Nevertheless, the Government hopes it will contribute in the medium term to an improvement in the balance of payments through a better allocation of resources and the greater diversification of exports that it will generate.

The Government intends to continue to devote special attention to the exchange rate, and will reach understandings with the Fund on its exchange rate policy in the context of the mid-term review planned for the latter part of 1982.

III. Price policy

The price policy that has been adopted is based on a desire for greater flexibility.

A. Agricultural prices

Producer prices have been reviewed to ensure that their levels--in absolute as well as relative terms--will continue to act as an incentive to production and will improve the farmers' standard of living. With this in view, the Government has set the new prices for the 1982/83 crop year.

1. More specifically, the Government intends to concentrate its efforts on increasing rice production. In this strategy known as "bataille du riz" the price of paddy constitutes the essential element. Hence, the Government has decided an increase in the producer price of ordinary paddy from FMG 47 per kilogram to FMG 60 per kilogram (i.e., 27.7 per cent) with prices for other categories of paddy ranging from FMG 61 to 65 per kilogram. This will be further reinforced by measures at the production level (improvement in the financial position of the major rural development agencies and establishment of a more effective fertilizer distribution system), at the marketing level (elimination of the monopoly of the Société d'Intérêt National de Production Agricole--SINPA), and at the consumption level (elimination of subsidies in connection with the consumer price for rice, cf. infra).

2. With regard to prices for other agricultural commodities, the policy to be implemented is designed so as not to run counter to the strategy centered on rice, while taking into account foreseeable fluctuations in world prices.

Vanilla producer prices, which are considered sufficiently profitable, remain at present levels.

For coffee, in spite of unfavorable world prices, a 16 per cent increase was decided for the 1981/82 crop year. An additional increase of FMG 10 per kilogram (4 per cent) will apply in the 1982/83 crop year. It is accepted in principle that this will be readjusted if the upward trend in world prices is confirmed, and once the crash program for rehabilitating plantations--based mainly on production and distribution of regenerated seedlings--enters the operational stage.

A further 26 per cent increase in the price of cotton occurred in January 1982, thereby raising the price of seed cotton from FMG 100 to FMG 126 per kilogram.