

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

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July 13, 1982

To: Members of the Executive Board
From: The Acting Secretary
Subject: Madagascar - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Madagascar agreed at Executive Board Meeting 82/95, July 9, 1982.

Att: (1)

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 July 9, 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

- (iii) the target for the reduction in external payments arrears, other than those relating to dividends, and for the transfer of dividends described in paragraph VI-C of the same memorandum; or
- (iv) the limit on contracting of government and government guaranteed nonconcessional foreign borrowing described in paragraph VI-D of the same memorandum;

is not observed; or

b. during any period after January 31, 1983, if suitable performance clauses with regard to total bank credit and bank credit to the Government as defined in paragraph V of the memorandum and with regard to a further reduction in external payments arrears and to further transfers abroad of dividends as defined in paragraph VI-C of the memorandum have not been established in consultation with the Fund as contemplated in paragraph 14 of the attached letter, or if such clauses, having been established, are not observed; or

c. during any period after January 31, 1983, in which understandings have not been reached or are not being observed on exchange and interest rate policies as contemplated in paragraph 14 of the attached letter and paragraphs II and V of the memorandum annexed thereto; or

d. during the entire period of this stand-by arrangement, if Madagascar

- (i) imposes or intensifies restrictions on payments and transfers for current international transactions, or
- (ii) introduces or modifies multiple currency practices, or
- (iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or
- (iv) imposes or intensifies import restrictions for balance of payments reasons.

When Madagascar is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Madagascar and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Madagascar's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally

to suppress or to limit the eligibility of Madagascar. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Madagascar and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Madagascar, the Fund agrees to provide them at the time of the purchases.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Madagascar will consult the Fund on the timing of purchases involving borrowed resources.

8. Madagascar shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. a. Madagascar shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Madagascar's balance of payments and reserve position improves.

b. Any reductions in Madagascar's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

c. The value date of a repurchase in respect to a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchases will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement, Madagascar shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Madagascar or of representatives of Madagascar to the Fund. Madagascar shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Madagascar in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

11. In accordance with paragraph 14 of the attached letter Madagascar will consult the Fund on the adoption of any measures that may be appropriate

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,

thus worsening the unemployment problem. Agricultural operations were also subject to unaccustomed delays through lack of fertilizers or spare parts, jeopardizing production prospects for 1982. The lack of both domestic and imported consumer items has led to serious shortages, which stimulate the development of parallel markets, a rapid increase in domestic price levels, and a rise in social tensions.

6. The balance of payments deficit would have been much greater without the rescheduling of external debts and the consolidation of arrears that took place during the year. The negotiations required for these reschedulings and consolidations necessarily produced a prolonged period of uncertainty and an on-going liquidity crisis, because the credits required to finance imports could no longer be obtained. Furthermore, a large share of export receipts was appropriated by certain banking institutions to cover external payment arrears. Furthermore, although the Government's program called for a reduction of FMG 12.8 billion in external payments arrears on the basis of net cash payments, they increased by FMG 21.0 billion in 1981. Through consolidation of FMG 36.7 billion in arrears, the level of arrears outstanding was reduced during the year by FMG 15.7 billion to FMG 34.6 billion (SDR 103.3 million).

7. The stagnation of exports and the decline of imports inevitably had repercussions on government revenue. Whereas the financial program had set a target of FMG 122.4 billion, actual revenue totaled only FMG 104.3 billion compared with FMG 100.4 billion in 1980. However, it must be stressed that the targets for collection of direct taxes were exceeded. The receipts of the Fonds National Unique de Péréquation (FNUP) ^{1/} were also affected by the adverse evolution of exports. Current expenditures for the year were slightly below both the target and their 1980 level, reflecting the severity of Government measures to restrict expenditure commitments. However, because of concern over the accumulation of new domestic arrears, the Government decided, in the course of 1981, not only to reinforce its expenditure control systems but also to reduce as much as possible such arrears and, more generally, financial obligations carried over from previous fiscal years. In the same spirit, FMG 5 billion was released at the end of 1981 and paid to rural development agencies to redress their financial situation. These expenditures along with the decline in revenue explain why the overall Treasury deficit in 1981 was FMG 115.3 billion compared with the program target of FMG 70.8 billion.

8. The increase in money supply, which was practically the same as in 1980 (18.5 per cent compared with 19 per cent in 1980), was almost entirely caused by the borrowing requirements of the Treasury.

In fact, the sharp decline in economic activity combined with the reduction of imports, led to a marked decline in credit demand from the state enterprise and private sector (9 per cent increase between 1980 and 1981 compared with 24 per cent in 1980).

^{1/} The Fund which receives the surpluses from the sale of the major agricultural exports.

The growth of money supply together with lower private credit demand caused a new expansion in banking resources, particularly sight deposits (24.6 per cent). This development led the Central Bank to reform the money market system during the year, which enabled it to suspend almost entirely its advances to national banks.

9. The numerous price increases decreed by the Government early in 1981, and the persistence of strong domestic demand spurred on by the increase in the money supply resulting from the Treasury's deficit and exacerbated by the shortage of consumer goods, produced a strong surge of price increases. The official consumer price index recorded a 30.5 per cent increase in 1981, compared with 13.2 per cent in 1980. At the same time, however, the Government firmly adhered to its stringent wage policy, both in the government sector and in the parapublic and private sector.

10. The external financial tensions which had characterized 1981 continued during the first few months of 1982. A slight increase in imports occurred thanks to external assistance obtained at the end of 1981. This permitted a slight recovery in economic activity, which nonetheless remains insignificant in the light of the very low level registered in 1981. Hence, problems of supplies, employment and prices have persisted over the last several months. To these difficulties should be added the effects of the cyclones that followed one another from December 1981 to March 1982. In this situation, and taking into account the rhythm of government receipts and expenditures, recourse to the banking system by the Treasury has been contained within limits that are compatible with the credit objectives for the year as a whole. On the other hand, there has been a fresh accumulation of foreign payments arrears. These increased by SDR 41.5 million (FMG 15.8 billion) in the first quarter to a level of SDR 144.8 million (FMG 50.3 billion). This development makes it absolutely imperative, in the shortest possible time frame, to conclude an arrangement with the IMF based on a financial recovery program, and also to obtain foreign balance of payments assistance and a new rescheduling of foreign debts.

11. The economic and financial program that the Government has adopted for 1982 is tailored to the dimensions of the crisis. It is the first stage of a longer-term adjustment effort aimed at restoring a viable balance of payments position in the medium term.

The aim of the program is to reduce internal and external financial disequilibria and lay the foundations for sustainable economic growth. The core of the program will be a series of measures designed to achieve a better resource allocation, supported by restrictive demand management policies. Improved resource allocation will be achieved through a reorientation of the 1982-84 investment program, with a shift away from the previous emphasis on social investments and industrial projects with long gestation periods toward quick-yielding projects in the agricultural sector, with priority given to the rehabilitation of existing capacity.

The program puts greater emphasis on the price mechanism, including exchange and interest rate policies. Therefore, the Government has already

switched the peg of the Malagasy franc to a basket of currencies, with weights for the currencies in the basket based on their trade pattern, and has also decided to devalue the local currency by 15 per cent. Domestic industrial prices and producer prices for agricultural products will also be adjusted as part of the move toward greater flexibility. Already, the consumer price of rice has been raised substantially so as to eliminate government subsidies on both imported and locally produced rice. Interest rates have also been substantially increased: as of June 1, 1982, the Central Bank's base rate has been raised from 8 per cent to 12.5 per cent, and similar increases have been applied to lending and borrowing rates.

12. The principal demand management policies will consist of a reduction in the overall fiscal deficit to the equivalent of 9.4 per cent of GDP compared with 14.7 per cent in 1981, through a combination of expenditure restraint and new measures to increase revenue. This will be accompanied by a sharp restraint on credit expansion and a continuation of the Government's stringent wage policy. Therefore, the Government has decided to limit wage increases in the public and parapublic sectors to 4.5 per cent, despite an anticipated rise of about 50 per cent in the official consumer price index for Antananarivo.

In addition, the Government has begun a major effort to attract increased domestic savings to help finance its investment program, through the introduction of a special nationwide government loan, at particularly attractive rates of interest.

13. The Malagasy Government believes this program deserves the renewed support of the International Monetary Fund. It consequently requests a stand-by arrangement in an amount of SDR 51 million for a period of one year.

14. The Government believes that the measures described above and detailed in the attached memorandum are sufficient to achieve the objectives of the program. It will take any additional measures that may become necessary for this purpose. In the context of the mid-term review planned before the end of 1982, the Government will reach understandings with the Fund on its exchange rate and interest rate policies; credit ceilings; targets for the reduction of external payments arrears; and transfers of dividends for the remaining period of the arrangement in 1983. Furthermore, it will consult with the International Monetary Fund in accordance with the policies of the Fund.

Very truly yours,

Pascal RAKOTOMAVO
Minister at the Presidency
in Charge of Finance

MADAGASCAR

MEMORANDUM ON THE ECONOMIC AND FINANCIAL

RECOVERY PROGRAM FOR 1982

This memorandum explains in detail the sectoral policies, which, taken together, make up the recovery program to be implemented in 1982 and continued in 1983, and whose main aspects have been described in the letter of intent.

I. Investment policy

Under the 1982-1987 Plan, the Government has adopted an investment program for the 1982-1984 period in support of its request for a structural adjustment loan from the World Bank. This program reflects the new guidelines defined and presented by the Head of State in his speech of January 10, 1982. It has been drawn up taking into account domestic and foreign financial constraints.

The Government has, therefore, defined strict criteria for the selection of projects and decided to strengthen project evaluation, approval and follow-up procedures.

A. Investment selection criteria

1. Priority to investments for rehabilitation and maintenance of existing capital;
2. Priority to projects with a relatively quick impact on the supply of goods, the improvement of government finances and the balance of payments, as well as employment;
3. Priority to integrated investments in the agricultural and infrastructure sectors. While investments in 1978-1981 were mostly directed toward industry and the social sector, in 1982-1984 investments in agriculture are expected to reach 30 per cent of total investments as compared to 15.3 per cent in the preceding period, and social investments will represent only 11.8 per cent of the total as against the earlier 40 per cent. The Government hopes this intensive effort in the agricultural sector will reduce rice imports by 60 to 70 per cent over a six-year period, while maintaining production of traditional exports as a minimum at their present levels.

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.

In addition to these price measures, special attention will be devoted to supplying the rural areas with essential goods and agricultural inputs. Such action constitutes a vital incentive to production. Its implementation, however, is dependent upon import possibilities and on the rehabilitation of the road network, whose deterioration was further heightened as a result of the natural disasters at the beginning of 1982.

B. Administered prices

The main purpose of the steps to be taken with regard to administered prices is to simplify and streamline procedures for setting and controlling them. This implies in particular that enterprises will be allowed to pass on automatically the effect devaluation has on domestic costs. Furthermore, the arrangements currently applied to certain enterprises (e.g., the national water and electricity company) involving formulae for revising rates will be extended to all public utility enterprises. As most of these enterprises are monopolies, however, maximum ceilings on increases will have to be established, which can only be exceeded with government approval. These arrangements will be introduced gradually through the remainder of 1982 and into early 1983.

C. Consumer prices

The increase in the consumer price for rice is the cornerstone of price policy, and even of the Government's entire economic and financial program. The 87 per cent rise in the price of ordinary rice has brought the consumer price up from FMG 75 to FMG 140 per kilogram; it will permit the complete elimination of all rice price subsidies on both domestically produced and imported rice. The elimination of subsidies was the most important consideration in the Government's decision, despite the socio-political risks attendant on such a sudden increase.

Simultaneously, the Government decided to increase the consumer price of top quality rice from FMG 155 to FMG 300 per kilogram. At the same time, the price of flour has been raised by FMG 150 per kilogram, an increase of 100 per cent.

Furthermore, and despite the fact that prices for petroleum products in Madagascar are among the highest in the world following the adjustments carried out in 1981, the Government has decided to increase these prices by an average of 18 per cent effective May 17, 1982. As a result of this decision, receipts from petroleum taxes will be maintained.

Other increases were already in effect at the beginning of 1982 and specifically affected water and electricity rates, the price of sugar, and transportation.

IV. Government Finance

The range of measures implemented in respect of government finance will reduce the overall Treasury deficit in 1982 to the equivalent of 9.4 per cent of GDP as opposed to 14.7 per cent in 1981.

Some of these measures are already included in the 1982 Finance Law promulgated in December 1981. Others require an amended finance law. A bill has been submitted by the Government to the National Assembly at its current session for approval.

A. Revenue

1. The 1982 Finance Law introduced new tax measures chiefly designed to increase the share of tax revenue from domestic transactions by:

- raising the rate of the value added tax by 50 per cent from 10 per cent to 15 per cent, half of this increase being transferred to local governments; this measure is expected to produce a FMG 4.7 billion increase in revenue for the general budget;
- increasing the rate of the consumption tax on certain products;
- adjusting fees for the issue of documents and various other sources of revenue.

The latter two steps should bring in FMG 1.2 billion in additional revenue.

Price adjustments for both local and imported products subject to the monopoly of the régie nationale (RMMF) ^{1/} will help to increase the latter's revenue considerably: an increase of some FMG 3 billion is expected.

The 1982 Finance Law also introduced a new system for assessing individual income which should better assist in combating tax fraud.

2. The Government intends to continue and intensify its efforts to collect arrears in direct taxes from previous fiscal years: the aim in 1982 will be to improve collections in cash by FMG 2 billion.

Furthermore, a new system of collecting export tax and duties and FNUP receipts has been established to reduce delays to a minimum. In future, such revenue and collections shall be automatically withheld by banks before transfer of the counterpart export receipts in national currency to the exporting companies.

Finally, with a view to reducing excessive delays in recovering yields from the sale of imported rice to distributors, especially local governments, it shall only be shipped cash on delivery.

^{1/} State monopoly for tobacco, matches, certain alcoholic beverages, flour etc.

B. Expenditure

As a large part of Government revenue is linked to foreign trade, and in view of the already considerable tax burden, a substantial adjustment effort will also be necessary with regard to expenditure.

1. Personnel expenditure

The need to stabilize personnel expenditure has led the Government to adopt a new recruitment policy by limiting personnel increases in 1982 to 4 per cent over the level of those actually employed at end-1981; this will result in 6,000 budgeted positions being eliminated under the amended Finance Law, by comparison with posts opened under the initial budget. The 4 per cent increase will almost entirely consist of the year's civil service training school graduates. The maximum rate of increase in 1983 and 1984 will be 3 per cent and 2 per cent, respectively. From 1985 onwards, recruitment will be solely to replace personnel leaving government service.

The Government has decided to limit wage increases in 1982 to 4.5 per cent, even though the consumer price index is expected to reach about 50 per cent. The same limitation will be applied in the parapublic and private sectors.

2. Other current expenditure

In 1982, the Government will pursue its policy of strictly limiting other current expenditure (excluding interest on the foreign public debt) which will not exceed FMG 47.4 billion.

3. Deferred payments

Disbursement for deferred payments will amount to FMG 8.8 billion (representing expenditure approved and committed in 1981 but which could not be settled in that year owing to accounting constraints). This is a sharp drop from 1981 and was made possible by the decisions taken at the end of 1981 to eliminate in every way possible charges carried over from one year to the next.

4. Domestic payments arrears

The resolve to reduce domestic payments arrears will lead the Government to allocate under the amended finance law an amount of FMG 8 billion for partial settlement of such arrears. At the same time, efforts to identify arrears will be stepped up so that an exhaustive settlement program can be established which, however, will need to be spread over several years.

5. Investment expenditure

As already noted, the Government has revised the 1982-1984 investment program, which now takes into account the new priorities. Under this program,

government investment expenditure in 1982 will amount to FMG 70.8 billion, including FMG 15 billion in reserve funds (i.e., investment expenditure carried over from preceding years). With a view to limiting domestically financed investment expenditure to a level consistent with financial resources, the Government will include within the program an optional tranche of FMG 11.3 billion, only to be committed if foreign financial resources are found.

The Government will continue to strictly apply the rule canceling "reserve funds" if they are not used within two years.

6. Other Treasury operations

Treasury onlending to government enterprises will amount to FMG 29.0 billion in 1982. This entire sum is to be spent on on-going investments financed with long-term resources.

In future, the Government intends to progressively reduce Treasury transfers. For 1982, advances to public sector enterprises will be limited to FMG 3 billion. However, the need to strengthen the capital of some enterprises, and the opening of new industrial units requires an allocation amount of FMG 6 billion in connection with government equity investments. The Treasury's operations with its correspondents will yield a surplus balance of FMG 8 billion. Therefore, the total under "special Treasury accounts (net)" will show a deficit of FMG 1.0 billion, i.e., the same amount as in 1981.

7. Counterpart of grants and aid

The gain in momentum of international solidarity shown in the wake of the natural disasters in early 1982 will enable the Treasury to set aside counterpart funds in an amount of FMG 8.6 billion. In view of anticipated expenditure from these funds (FMG 5.3 billion), these operations will result in a surplus of FMG 3.3 billion as compared to FMG 0.3 billion in 1981.

C. Overall financing

The overall 1982 Treasury deficit estimated at FMG 100.3 billion (including FMG 29 billion for onlending) will be financed as follows:

- FMG 60.4 billion from drawings on foreign loans (including funds earmarked for onlending);
- FMG 4.9 billion from net nonbank domestic government borrowing, either in the form of Treasury bond issues or through the special nationwide government loan (Emprunt National) that will be launched during the month of June, 1982, with a rate of remuneration of between 15 per cent and 18 per cent;

- FMG 35.0 billion from the banking system (compared with FMG 57.8 billion in 1981).

D. Monitoring and follow-up

Past difficulties in controlling revenue collection and execution of expenditures will lead the Government to strengthen the measures adopted in 1981.

1. Revenue:

- regular and systematic monitoring of collection units, particularly with a view to ensuring better coordination of enforcement activities; shorter delays in centralizing tax revenue to improve monitoring;

2. Expenditure:

- introduction of a personnel expenditure data-processing system, covering both personnel management and wage expenditure (with the assistance of a private Malagasy audit company);
- speeding up the introduction of a data-processing system to monitor expenditure commitments at the level of those responsible for the monitoring of appropriations and extension of the system to those responsible for the use of the appropriated funds (with the assistance of the above company);

3. Debt:

- improvement of the foreign debt management data-processing system attached to the Central Bank, with the assistance of IBRD and UNCTAD.

V. Credit Policy

Credit policy will play a role in achieving the general objectives of the adjustment program: it will be designed to support the restrictive demand management measures while creating the prerequisites for improved resource allocation and a recovery of production.

Selective and quantitative measures to control the distribution of credit will be implemented simultaneously. As regards the former, the Central Bank will maintain and strengthen existing selective control mechanisms, of which the most important is the system of prior authorizations, which sets a ceiling for each sector, and each enterprise, on the maximum amount of credit that can be granted by national banks in a given year.

As regards quantitative control, the Central Bank will activate the system of credit controls, which was reinstated in 1981 but never enforced. Under this system, ceilings by type are set for credit distributed by banks. It will be complemented by an overall ceiling on the volume of bank credit both to the Treasury and the parapublic and private sectors. This permits an increase in 1982 of 25.2 per cent in credit under the ceilings to state enterprises and the private sector proper compared with 1981.

In view of the above, the overall outstanding net domestic credit of the banking system (i.e., domestic credit of the Central Bank--including onlending on foreign borrowing--and of the national banks), ^{1/} which amounted to FMG 404.5 billion at the end of March 1982, will be limited to FMG 429.0 billion during the period April 1 to June 30, 1982, FMG 453.0 billion from July 1 to September 30, and to FMG 471.0 billion from October 1 to December 31. Under this ceiling, total net credit to the Government from the banking system (i.e., net credit from the Central Bank--including onlending to the Government on foreign loans--and from the national banks), which amounted to FMG 227.5 billion at March 31, 1982, will be limited to FMG 235.2 billion for the period from April 1 to June 30; to FMG 242.2 billion from July 1 to September 30, and to FMG 249.2 billion from October 1 to December 31, 1982. At the time of the mid-term review planned for late 1982, the Government will reach understandings with the IMF on ceilings for the remaining period of the arrangement in 1983.

The above amounts of overall credit have been established based on a forecast of a paddy collection of 120,000 tons. If it were to become evident that on account of a much higher level of collection, credit needs for marketing rice were to rise significantly, the Government would immediately consult with the Fund.

On the basis of these credit developments and of the balance of payments objectives, and taking into account the Central Bank's payments of financial charges on balance of payments loans, the increase in broad money supply will be approximately 26 per cent in 1982 compared with an estimated increase of some 36 per cent in nominal GDP.

Taking into account the important role of interest rates in the overall adjustment process and in the allocation of resources, the Government has introduced as of June 1, 1982 a new interest rate structure. The Central Bank's base rate has been raised to 12.5 per cent compared to the previous 8 per cent. Lending and borrowing interest rates have been adjusted accordingly, this adjustment being designed to support credit policy objectives.

The Government will continue to give special attention to the level of interest rates and will reach understandings with the Fund on its interest rate policy in the context of the mid-term review planned for late 1982.

^{1/} It being understood that the Central Bank will continue, as in the past, to debit the Treasury and the national banks at the original maturity date of any debts that have been rescheduled.

VI. Balance of Payments

The afore-mentioned policies should, if not produce an improvement in the balance of payments in 1982, at least halt its deterioration.

A. Export receipts should reach SDR 314.3 million in 1982, as compared to SDR 285.5 million in 1981. This improvement will stem from a slight increase in export volume, made possible by an emergency infrastructure rehabilitation program (road network, ports) and from an improvement in world market prices, especially for coffee.

B. The import program calls for imports of SDR 519.3 million, on an f.o.b. basis, compared to actual imports of SDR 455.7 million in 1981. This target was set to permit a level of economic activity compatible with production recovery targets. The level of raw material and capital goods imports should prevent a repetition of the problems that occurred in 1981. These imports are intended primarily to maintain agricultural production, improve use of enterprises' productive capacity and facilitate rehabilitation of existing investments.

C. The Government will ensure that the amount of external payments arrears, on the basis of net cash payments (i.e., exclusive of consolidations) as at June 30, 1982 does not exceed the SDR 144.8 million outstanding as at March 31, 1982. Subsequently, the amount will be reduced (on the same basis of net cash payments) in accordance with the following timetable: a reduction of SDR 19.1 million by the end of September, and a further amount of SDR 30 million by the end of December 1982.

Furthermore, the Government will reduce arrears with regard to dividends by FMG 1 billion as follows: FMG 100 million before June 30, 1982, FMG 400 million between July 1 and September 30, 1982, and FMG 500 million between October 1 and December 31, 1982. The Government will ensure that decisions concerning requests for dividend transfers received by the financial authorities be taken promptly and will make sure that future requests are processed without delay and dividend transfers as well as reductions in arrears are carried out in an orderly and nondiscriminatory manner. In the context of the mid-term review planned for late 1982 the Government will reach understandings with the IMF on the targets for reducing external payments arrears and arrears on dividend transfers abroad for the remaining period of the arrangement in 1983.

D. The Government has contracted French francs 167.6 million (SDR 24.8 million) in loans with maturities of between one and five years for which subsidiary contracts governing utilization will be signed in 1982. Considering the sizable debt service burden, no other new loans with maturities of between a minimum of 1 and a maximum of 10 years will be contracted or guaranteed by the Treasury, the Central Bank or national banks during the program period, except for loans to refinance existing debt.

E. In view of the foregoing and based on latest estimates, the overall balance of payments deficit in 1982 will amount to SDR 141.2 million. It is expected that this deficit will be covered by:

- SDR 32.7 million in exceptional balance of payments assistance,
- SDR 45.6 million in net purchases from the IMF,
- the rescheduling of SDR 52.6 million of debts falling due in 1982, and not yet rescheduled,
- a further rescheduling of SDR 9.0 million of arrears already consolidated in 1981.

Furthermore, taking into account the payments in 1982 resulting from consolidation already achieved and the objective mentioned above with respect to reduction of foreign arrears, there remains a residual deficit of SDR 60 million.

The Government has therefore asked the World Bank to call an aid coordination conference to help mobilize the financial assistance needed to cover the residual deficit.

This conference, to be held in Paris June 16-18, will be followed by other meetings for the purpose of bringing together the additional funding needed to continue the adjustment program in 1983 and 1984. If the foreign funding obtained in 1982 and 1983 is less than foreseen, the Government will immediately consider further measures necessary to meet the program objectives, including a reduction in imports.

F. During the period covered by the stand-by arrangement, the Government does not intend to:

- (1) introduce multiple currency practices;
- (2) impose new or intensify existing restrictions on payments and transfers for current international transactions;
- (3) impose new or intensify existing import restrictions for balance of payments reasons;
- (4) conclude bilateral payments agreements with member countries of the Fund.

VII. The Outlook for 1983

The policies applied in 1982 will be pursued and strengthened in 1983.

Efforts will center on government finance, the 1983 objective being to reduce the overall Treasury deficit to approximately 7 per cent of GDP. This

target will be the Government's overriding consideration in the preparation of the 1983 budget. The Government has already been examining new tax measures, especially with regard to real property taxes; it will be guided in this matter by the studies of the IMF fiscal mission which visited Madagascar in late 1981. The personnel expenditure policies described above, the elimination of all subsidies on the price of rice, and improved supervision and monitoring of expenditures will help limit outlays in 1983 to a level compatible with the established target.

The reorientation of investments, and the priority thus placed on agricultural production, should set in motion in 1983 the process of improving the trade balance.

Nevertheless, projections show that the prospects for the overall balance of payments deficit remain bleak. Further foreign assistance will therefore have to be mobilized in 1983.