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CONFIDENTIAL

June 11, 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

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Madagascar and a request by Madagascar for a stand-by arrangement. A draft decision to be taken in concluding the 1982 Article XIV consultation, in the light of the 1982 Article IV consultation, appears on page 29. The text of a proposed decision on the stand-by arrangement for Madagascar will be circulated after the meetings of the Aid Coordination Conference for Madagascar to be held in Paris on June 17-18, 1982.

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

Att: (1)



INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF MADAGASCAR

Staff Report for the 1982 Article IV Consultation  
Request for Stand-by Arrangement

Prepared by the African Department and the Exchange  
and Trade Relations Department

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

Approved by J.B. Zulu and W.A. Beveridge

June 11, 1982

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## I. Introduction

The 1982 Article IV consultation discussions with Madagascar were held in Antananarivo during the period March 4-28, 1982. Discussions on a one-year stand-by arrangement took place at the same time. Both sets of discussions were concluded during the visit of a Malagasy delegation to Washington during the period April 12 to May 11, 1982. The representatives of Madagascar included Mr. P. Rakotomavo, Minister at the Presidency in charge of Finance, Mr. N. Andriamanerasao, Minister for Rural Development and Agrarian Reform, Mr. L. Rajaobelina, Governor of the Central Bank and Mr. J. Robiarivony, Director-General of Planning. The head of the mission also met with the President, H.E. Didier Ratsiraka. The staff representatives were Mr. J. Kratz (head-AFR), Mr. N. Abu-zobaa (AFR), Mrs. M. Tyler (ETR), Mr. D. Goldsbrough (AFR), Mr. J. Tavares (FAD), and Mrs. I. Klotz (secretary-AFR). Mr. Nana-Sinkam (Executive Director) attended most of the policy discussions during the last week of the negotiations in Antananarivo and Mr. Alfidja (Alternate Executive Director) attended most of the policy discussions during the negotiations in Washington.

In the attached letter (Appendix II) to be signed shortly, which is supported by an annexed more detailed memorandum on economic and financial policies, the Government of Madagascar requests a stand-by arrangement for a period of one year, in an amount equivalent to SDR 51 million, representing 100 per cent of quota. Of this amount, SDR 24.95 million would be from the Fund's ordinary resources, and SDR 26.05 million from the enlarged access resources. The Fund's holdings of Malagasy Francs 1/ (as of May 31, 1982) amounted to SDR 125.2 million or 245.4 per cent of quota; excluding purchases under the compensatory financing facility (SDR 29.2 million), the Fund's holdings totaled SDR 95.9 million (188.1 per cent of quota), of which SDR 22.2 million represented purchases under the supplementary financing facility.

Madagascar is also requesting a purchase of SDR 21.8 million (42.7 per cent of quota) on account of a shortfall in exports during the calendar year 1981. This purchase and those under the proposed stand-by arrangement, if fully utilized, would increase the Fund's holdings of Malagasy Francs (after taking into account scheduled repurchases) to 381.2 per cent of quota (or 281.2 per cent of quota excluding holdings under the compensatory financing facility). The proposed phasing, as well as scheduled repurchases, are summarized in Table 1. As indicated in this table, SDR 10.2 million would be available after Executive Board approval of the arrangement, whereas the second purchase, available after August 14, 1982, would be subject to Madagascar's meeting the performance criteria for end-June 1982. A summary of Madagascar's relations with the Fund is provided in Appendix IV.

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1/ Hereafter abbreviated to FMG. FMG 397.28 = SDR 1 as of May 18, 1982.

Table 1. Madagascar: Proposed Schedule of Purchases and Repurchases  
During the Period July 1982 - June 1983

	1982		1983		Total
	July-Sept.	Oct.-Dec.	Jan.-March	April-June	
<u>Purchases:</u>	<u>42.20</u>	<u>10.20</u>	<u>10.20</u>	<u>10.20</u>	<u>72.80</u>
Stand-by arrangement	20.40 <u>1/</u>	10.20	10.20	10.20	51.00
Ordinary resources	(11.04) <u>1/</u>	(4.64)	(4.64)	(4.63)	(24.95)
Enlarged access resources	(9.36) <u>1/</u>	(5.56)	(5.56)	(5.57)	(26.05)
Compensatory financing facility	21.80	--	--	--	21.80
<u>Repurchases:</u>	<u>1.18</u>	<u>1.18</u>	<u>--</u>	<u>--</u>	<u>2.36</u>
Credit tranches	1.18	1.18	--	--	2.36
Compensatory financing facility	--	--	--	--	--
<u>Net purchases:</u>	<u>41.02</u>	<u>9.02</u>	<u>10.20</u>	<u>10.20</u>	<u>70.44</u>
<u>Total Fund holdings (cumulative):</u>	164.99	174.01	184.21	194.41	
As per cent of quota					
Total holdings	323.51	341.20	361.20	381.20	
Holdings excluding CFF	223.51	241.20	261.20	281.20	

1/ Represents two separate purchases: the first available after Executive Board approval of the arrangement, the second available after August 14, 1982 provided the end-June performance criteria have been met.

To date Madagascar has received 23 IDA credits and 5 IBRD loans. Total debt outstanding (including undisbursed) under these credits and loans amounts to US\$347.2 million. In addition, there are IFC investments of US\$12.5 million. Madagascar has submitted a request for a structural adjustment loan to the World Bank and a revised investment program is being formulated with World Bank technical assistance. 1/ The Malagasy authorities are now discussing this program and other medium-term targets and policies with the Bank, and the Fund has cooperated actively in these discussions. The Bank, with the cooperation of the Fund, has organized an aid coordination conference in Paris on June 17-18, 1982, to help mobilize the additional financial assistance needed to cover the residual balance of payments

1/ A World Bank staff team visited Antananarivo in March to discuss the investment program with the Malagasy authorities, and further discussions were held in Washington in May 1982.

deficit for 1982. It is envisaged that further meetings will be held to mobilize the additional resources needed for the continued adjustment and development efforts in the coming years. Madagascar's relations with the World Bank Group are set out in Appendix V.

The characteristics of the Madagascar economy and longer term economic trends are reviewed in the second section of this paper. Section III describes economic developments in 1981 and performance under the last stand-by arrangement. Section IV consists of a review of the prospects for 1982, the report on the Article IV consultation discussions, and the elements of the proposed 1982 financial program. Section V concludes with the staff appraisal and the proposed decisions. Basic economic data on the Madagascar economy are set out in Appendix Table I.

## II. Background--Economic Developments and Policies

Madagascar is essentially an agricultural economy, highly vulnerable to droughts and cyclones and changes in the terms of trade. Three products, coffee, vanilla, and cloves, generally account for around two-thirds of total exports. Although generally well-endowed with natural resources, the country is characterized by sharp economic disparities between regions, in part explained by insufficient transportation links because of a very rugged topography. Madagascar's economic growth has been slow and erratic. Real per capita GDP in 1980 was some 15 per cent below that of 1970. Domestic economic policies have had the effect of encouraging consumption through a system of subsidies and price controls on many basic consumption goods, rather than providing incentives for private investment, saving and production.

Production of the staple food crop, rice, and of the principal export crops stagnated during the 1970s, as a result of insufficient price incentives, inadequate extension services, and a deteriorating transportation system which has greatly hampered the distribution of agricultural products and basic consumer goods. These constraints on production have been exacerbated by serious financial and management problems in various regional rural development agencies (Sociétés d'Aménagement). Subsidies designed to hold down the consumer price of rice have placed an increasingly heavy burden on internal and external financial balances. From being a net rice exporter in the early 1970s, Madagascar now imports over ten per cent of its total rice needs in times of normal crops, and in recent years rice subsidy payments have been the equivalent of around one and a half per cent of GDP and have accounted for around one-tenth of the overall fiscal deficit. Since the mid-1970s, Government has greatly extended its control and management of economic activity. Virtually all medium- and large-scale enterprises now have some form of government participation, and the inherited system of widespread price regulation has been intensified, with particularly close control over the prices of essential commodities.

Until late 1978 the poor growth performance was combined with conservative demand management policies. The current budget deficit remained small and capital expenditures were limited, so that overall budgetary deficits were relatively low, usually less than 4 per cent of GDP. As a result, and with the help of favorable movements in the terms of trade, deficits on the current account of the balance of payments were not large. They were financed by capital inflows, so that the overall balance of payments remained in virtual equilibrium; by end-1978 the ratio of external debt service payments to export receipts was still less than 6 per cent.

Disappointment with low economic growth led to a deliberate break with such more prudent policies and to a major expansion of public sector investment, with the share of capital formation in GDP rising to over 22 per cent in 1979 compared to around 13 per cent in earlier years. However, most of the new investment had little immediate impact on productive capacity. It consisted mainly of social investments, in particular the construction of a number of regional university centers, and of a number of industrial projects with long gestation periods. Proposed investments were not subjected to any systematic economic and financial appraisal and increasingly took place outside the 1978-80 Plan, which had lost its role as a policy guide. Current budgetary expenditures, especially on education and health services throughout all regions of the country, also increased rapidly in 1979 and 1980. As a result, the overall fiscal deficit increased sharply, to over 13 per cent of GDP in 1979, and to over 18 per cent in 1980. The rapid expansion in aggregate domestic demand led to a drastic widening of the external current account deficit, which went from around 5 per cent of GDP in 1978 to over 17 per cent in 1979 and 1980. The deficit was financed by a rundown of foreign reserves, a major increase in foreign borrowing, on increasingly onerous terms, and, since 1980, by an accumulation of external arrears. Madagascar's hitherto low debt service ratio made it a relatively good credit risk in the eyes of individual banks. However, because of lack of central control in Madagascar over foreign borrowing, this situation changed precipitously.

In view of the deteriorating external position, Madagascar requested assistance from the Fund which, in June 1980, approved a two-year stand-by arrangement in a total amount equivalent to SDR 64.45 million. The core of the financial program supported by the stand-by arrangement was to be a reduction in aggregate demand to a level compatible with real output and sustainable foreign borrowing. However, key elements of the program, especially a reversal of the expansionary fiscal policy, were not implemented, and after an initial purchase of SDR 10 million no further purchases were made under the arrangement. Internal and external financial imbalances in the economy grew even wider (Table 2). The debt service burden continued to grow rapidly, and control over external debt remained a serious problem because of the continuing lack of a centralized system of debt management. External payments arrears, which were to have been eliminated under the program, grew rapidly and by end-1980 were the equivalent of 46 per cent of receipts from exports of goods and services. They continued to grow during early 1981 and became a major constraint on Madagascar's ability to conduct normal trade operations.



Table 2. Madagascar: Selected Economic and Financial Indicators, 1980-82

	Program 1980	Actual 1980	Program 1981	Estimate 1981	Program 1982
(Annual per cent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	3.5	0.8	1.5	-9.2	0.9
GDP deflator	15.0	15.1	14.3	25.2	35.2
Consumer prices <u>1/</u>	15.0	18.2	15.0	30.5	51.0 <u>2/</u>
External sector (on the basis of SDRs)					
Exports, f.o.b.	24.6	4.8	14.6	-14.9	10.1
Imports, c.i.f.	9.2	14.8	-17.4	-26.0	10.9
Non-oil imports, c.i.f.	4.3	8.6	-24.0	-29.1	11.8
Export volume	...	-22.2	15.0	9.9	3.0
Import volume	...	-0.7	-23.4	-31.5	8.7
Terms of trade (deterioration -)	...	14.3	-10.0	-21.9	6.0
Nominal effective exchange rate (depreciation -)	...	-5.6	...	-8.8	-15.5
Real effective exchange rate (depreciation -)	...	4.1	...	4.7	...
Government budget					
Revenue and grants	19.0	6.0	17.0	3.0	29.0
Total expenditure	8.0	27.9	-12.0	-3.3	8.4
Money and credit					
Domestic credit	22.2	48.2	13.4	22.2	20.1
Government	31.5	77.4	13.6	33.7	14.9
Private sector	14.5	25.1	13.2	9.0	27.5
Money and quasi-money (M <sub>2</sub> )	11.1	19.0	12.7	18.4	26.2
Velocity (GDP relative to M <sub>2</sub> )	3.33	3.32	3.27	3.22	3.48
Interest rate (annual rate, one year savings deposit)	6.75	5.65	6.75	6.75	10.50
(In per cent of GDP)					
Overall public sector deficit	...	...	...	...	...
Central government savings	1.6	-2.8	1.1	-3.1	-0.1
Central government budget deficit	-10.8	-18.4	-9.2	-14.7	-9.4
Domestic bank financing	4.8	11.4	3.3	7.4	3.3
Foreign financing	5.5	6.9	5.0	7.1	5.6
Gross domestic investment	20.6	20.7	17.7	14.9	14.5
Gross domestic savings	3.8	3.4	5.9	3.3	3.4
Current account deficit <u>3/</u>	-16.6	-18.5	-11.7*	-13.6*	-13.4*
External debt					
Inclusive of use of Fund credit	30.0	35.6	34.5	53.3 <u>6/</u>	47.1 <u>7/</u>
Debt service ratio (in per cent of exports of goods and services)	21.9	14.5	30.0 <u>5/</u>	30.0 <u>6/</u>	54.3 <u>7/</u>
Interest payments (in per cent of exports of goods and services)	10.7	7.9	14.7 <u>5/</u>	15.1 <u>6/</u>	17.6 <u>7/</u>
(In millions of SDRs, unless otherwise specified)					
Overall balance of payments <u>4/</u>	-84.6	-183.2	-82.9** <u>5/</u>	-74.5** <u>6/</u>	-141.2 <u>7/</u>
Gross official reserves (months of imports) (end of period)	...	0.4	...	0.8	0.8
External payments arrears <u>8/</u> (end of period)	--	174.5	120.6	103.3	95.7

1/ CPI index for Antananarivo, based on officially controlled prices.

2/ Reflects increase in officially controlled prices, including rice.

3/ \* indicates severe constraint on foreign exchange availability.

4/ \*\* indicate severe constraint on foreign exchange availability.

5/ Before debt rescheduling.

6/ After debt rescheduling, but excluding arrears.

7/ After debt rescheduling already obtained from the Paris Club, through June 1982, but excluding arrears.

8/ Excluding arrears on dividend transfers. Programmed reduction in arrears is on a net cash basis. The reduction in the stock of arrears in 1981 was more than accounted for by consolidations.

Despite the sharp growth in foreign financing during 1979 and 1980, the bulk of the public sector deficit continued to be financed by borrowing from the Central Bank. As a result net domestic credit increased at an average annual rate of over 47 per cent during the two years, and broad money supply at an average rate of over 22 per cent, despite the downward influence of large balance of payments deficits. This expansion in liquidity was a major factor behind the increasing inflationary pressures, although the true rate of inflation is difficult to measure because consumer price indices are available only for Antananarivo and are based mainly on controlled prices.

### III. Economic Developments in 1981 and Execution of the 1981 Program

On April 13, 1981 the Executive Board approved a stand-by arrangement with Madagascar in an amount of SDR 109 million (214 per cent of quota), to run until June 26, 1982, i.e., the remaining period under the cancelled two-year arrangement. The objectives of the financial program supported by the new arrangement were to limit the 1981 current account deficit of the balance of payments to SDR 311.8 million (11.7 per cent of projected GDP) and the overall balance of payments deficit (before debt rescheduling) to SDR 82.9 million (3.3 per cent of projected GDP) (Table 2). These targets were based on the assumptions of coffee exports of 70,000 tons, an FOB export price for coffee equivalent to SDR 1.9 per kilo, rice imports of 173,000 tonnes, a terms of trade loss of 10 per cent, and a growth in real GDP of 1.5 per cent; domestic inflation was targeted to decelerate to 15 per cent. The major policy instruments designed to achieve these targets were a sharp reduction in the fiscal deficit through a decline in expenditures and new revenue measures, a tight credit policy, a continuing restrictive wage policy and a substantial increase in agricultural producer prices. In addition to the quantitative performance criteria, Madagascar was also to reach understandings with the Fund on its exchange rate policy at each half-yearly review of the program.

Many of the assumptions did not materialize and the performance under the arrangement has been below expectation in relation to the program's objectives, particularly as regards economic growth, the size of the fiscal deficit and the level of external arrears (Table 2). Purchases equivalent to SDR 39 million were made under this arrangement, but a review in July 1981 was not completed because understandings could not be reached on the substantial additional measures that were required to assure achievement of the objectives of the program throughout the whole of the year. When the authorities ultimately did take some additional fiscal measures, these were not sufficient and also too late to keep the program for 1981 broadly on track. Quantitative performance criteria and actual outturn are shown in Table 3.

Table 3. Madagascar: Quantitative Performance Criteria and  
Actual Outturn, 1981

(In billions of Malagasy francs)

	1980 Dec.	1981			
		March	June	Sept.	Dec.
Central bank net domestic credit					
Program	180.7	190.4	196.4	200.4	205.6
Actual outturn		183.7	194.9	202.4	222.0
Central bank net credit to Government					
Program	178.4	185.4	190.4	193.4	198.2
Actual outturn		182.8	189.4	195.9	220.5
Cumulative reduction through cash repayment of external arrears other than dividends (positive amounts imply accumulation on a net cash basis) <u>1/</u>					
Program		-1.0 <u>2/</u>	-4.0	-7.5	-11.5
Actual outturn		-1.0 <u>2/</u>	20.5	6.8	21.0
Cash repayment of external arrears with respect to dividend transfers					
Program		-0.2 <u>2/</u>	-0.4	-0.6	-0.8
Actual outturn		-0.2 <u>2/</u>	-0.4	-0.6	-0.7
				<u>During 1981</u>	
Contracting of new external debt of 1-10 years' maturity					
Program				7.5	
(equivalent in SDR million)				(26.1)	
Actual outturn				7.0	
(equivalent in SDR million)				(21.9)	
Of which: 1-5 years' maturity					
Program				2.0	
(equivalent in SDR million)				(7.0)	
Actual outturn				0.4	
(equivalent in SDR million)				(1.2)	

Source: EBS/81/77 and data provided by the Malagasy authorities.

1/ The difference between the reduction in the stock of arrears outstanding (Table 4) and the accumulation of arrears on a net cash basis represents consolidations.

2/ By April 30, 1981.

1. External policies

a. Balance of payments

Performance under the program was adversely affected by a substantial shortfall in export receipts, which were some 23 per cent below the program target in SDR terms, mainly because of a sharp decline in the volume and price of coffee exports. Coffee prices in SDR terms were some 15 per cent below those assumed in the program. Nontraditional exports also fell as a result of shortages of imported spare parts and raw materials. Sugar exports in particular were affected by the lack of imported spare parts and a deterioration in the irrigation network. The volume of chrome exports also declined sharply because of weak world demand and continuing internal transportation difficulties. The shortfall in export earnings, substantially higher interest payments on external debt, and the limited additional financing were reflected in an even sharper than anticipated fall in the volume of imports, to a level some 31 per cent below that of 1980. An increase in rice imports as a result of a drought meant that the decline in the volume of imported intermediate goods was even larger. The terms of trade are estimated to have declined by over 20 per cent.

Madagascar successfully rescheduled its debt obligations to public creditors within the framework of the Paris Club, as well as to a number of private creditors including banks, and also received substantial capital inflows from bilateral sources in the last quarter of 1981. This helped reduce the overall balance of payments deficit to SDR 74.5 million (Table 4). External arrears (other than those relating to dividends) which have emerged since the beginning of 1980 were reduced by some SDR 71 million during 1981, but this was entirely due to the success in negotiating agreements for their consolidation, at the expense of increasing the future debt service burden. If reductions by net cash payments only are considered, external payment arrears other than those relating to dividends actually increased by SDR 38.6 million. Under the impact of the persistent foreign exchange difficulties, the outstanding stock of external payment arrears increased further during the first quarter of 1982 by SDR 41.5 million to SDR 144.8 million on March 31, 1982.

b. Restrictive system

Madagascar avails itself of the transitional arrangements of Article XIV but maintains exchange restrictions under Article VIII, Sections 2 and 3 of the Articles of Agreement. Madagascar continues to apply a comprehensive system of exchange and trade restrictions. A detailed description of the system and the changes which have taken place since the previous Article IV consultations and the modifications reported in the "Extension of Approval of Exchange Restrictions" (EBS/81/75, 4/7/81) is contained in the paper on Recent Economic Developments to be issued shortly. The principal developments in the restrictive system in 1981 and the first quarter of 1982 related to the persistence of external payments arrears and to the intensification of

Table 4. Madagascar: Balance of Payments, 1978-82

(In millions of SDRs) 1/

	1978	1979	1980	Program 1981	Actual Est. 1981	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	14.8	-222.3	-284.7	-101.7	-170.2	-205.0
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)	-112.2	-157.2	-179.6	-215.3	-171.1	-182.1
Private unrequited transfers (net)	6.4	5.5	0.7	5.2	7.2	9.4
Current balance	-91.0	-374.0	-463.6	-311.8	-334.1	-377.7
Official unrequited transfers (net)	41.8	48.8	48.0	45.6	50.0	56.1
Nonmonetary capital (net)	27.0	142.7	223.8	162.4	224.2	180.4 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)	21.6	20.0	5.1	17.4	-18.1	--
Allocation of SDRs	--	3.5	3.5	3.5	3.5	--
Overall balance	-0.6	-159.0	-183.2	-82.9	-74.5	-141.2 2/
Financing 3/	0.6	159.0	183.2	82.9	74.5	141.2
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						54.2

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

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

2/ 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).

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.

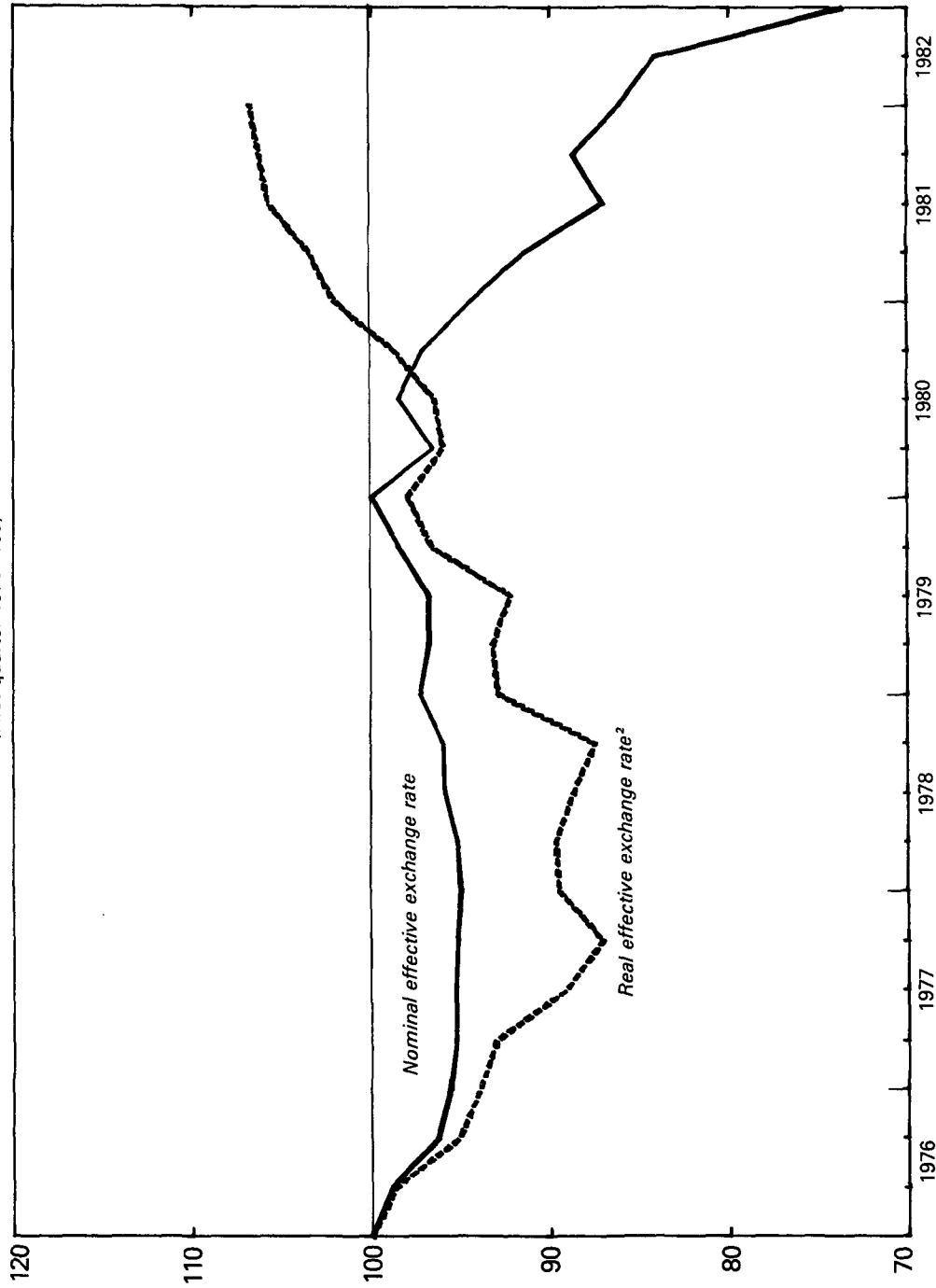
Madagascar continues to apply limits on the sale of foreign exchange for certain payments and transfers for current international transactions, e.g., travel, student expenses, the transfer of savings from wages and salaries by foreigners working in Madagascar, and remittances of dividends when distributed 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 RATES<sup>1</sup>  
(First quarter 1976=100)



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

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

<sup>2</sup>Normal 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 1981, 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	1981	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 <sup>1/</sup>
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 <sup>2/</sup>
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) <sup>3/</sup>	-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 <sup>4/</sup>	-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.

<sup>1/</sup> Includes the supplementary tranche.

<sup>2/</sup> Includes FMG 8.0 billion of budgetary allocation earmarked to payment of arrears to state enterprises.

<sup>3/</sup> Includes net receipts of grants and commodity aid, excluding rice, and local expenditures financed by this aid.

<sup>4/</sup> Including grants.

subsidies increased because of the larger volume of rice imports. The authorities made substantial efforts to contain personnel expenditures; the cost-of-living adjustment in the public sector was held to 3.4 per cent; and during August-December 1981 new recruitment was limited to those graduating from government professional schools.

The overall deficit, including grants and onlending, amounted to FMG 115.3 billion (14.7 per cent of GDP), as against a program target of FMG 70.8 billion (9.2 per cent of GDP). The staff has estimated that the impact on total fiscal receipts of the greater-than-anticipated deterioration in the world coffee market, which was beyond the authorities' control, was over FMG 10 billion, or around one quarter of the excess of the actual over the programmed deficit. Net foreign financing was larger than expected as a result of substantial bilateral assistance received towards the end of the year, but even then the banking system's net credit to Government rose by some FMG 58 billion, compared with a program target of FMG 25 billion.

#### 4. Monetary and price developments

Reflecting the depressed level of economic activity, credit to the private sector (including state enterprises) grew by only 9 per cent in 1981 (Table 6). Therefore the increase in broad money supply, which grew by 18 per cent compared with a program target of 13 per cent, was due mainly to the higher bank financing of the fiscal deficit. As part of the financial program, the principal discount rate of the Central Bank, on which other borrowing and lending rates are based, was raised by 2.5 percentage points to 8 per cent.

Apart from the higher rate of monetary growth, the high rate of inflation in 1981 (at 30.5 per cent, for the Antananarivo low-income cost-of-living index based mainly on controlled prices) is attributable mainly to shortages of local and imported goods and to the large increases in administered prices introduced as part of the program. These included increases for sugar and flour (over 80 per cent), petrol (over 50 per cent), cement (65 per cent), butter and cooking oil (40 per cent) and rice (17 per cent).

#### IV. Prospects for 1982, Report on the Discussions, and the 1982 Program

After the failure, during the discussions between the Malagasy representatives and the staff in August and November 1981, to reach agreement on additional measures suited to bring the 1981 program back towards its major objectives and thereby make it possible for Madagascar to resume purchases under the arrangement, the Malagasy authorities decided to undertake a major review of their economic policies before resuming the discussions with the staff. They recognized that a continuation of simply applying ad hoc measures was no longer appropriate and that a more fundamental change in their policy approach was called for. The first public expression that the immediate planning objectives would have to be scaled down to levels

Table 6. Madagascar: Monetary Survey, 1979-82

(In billions of Malagasy francs: end of period)

	1979	1980 <u>1/</u>	1981		1982 <u>2/</u>
			Program	Actual	Proj.
Foreign assets (net)	-40.8	-94.4	-90.0	-125.8	-133.2
Central bank (net)	-34.5	-86.7	-104.8	-123.9	-131.3
Of which liabilities related to:					
Exceptional BOP financing	(-14.6)	(-31.4)	(-37.7)	(-46.6)	(-59.0)
Payments arrears <u>3/</u>	(--)	(-47.3)	(-31.4)	(-32.2)	(-29.3)
Consolidation of arrears	(--)	(--)	(...)	(-29.3)	(-11.6)
State banks (net)	-6.3	-7.7	14.8	-1.9	-1.9
Domestic credit (net)	220.0	326.1	368.7	398.8	478.8
Claims on Government (net)	99.1	175.8	211.2	235.0	270.0
Central bank (net)	88.6	174.2	198.2	220.5	255.5
State banks (net)	-2.5	-11.5	-2.0	-0.5	-0.5
Other (net)	13.0	13.1	15.0	15.0	15.0
Credit to private sector and state enterprises	120.9	150.3	157.5	163.8	208.8
On-lending	12.1	11.2	11.2	11.1	11.1
To Government	2.4	2.6	2.6	2.5	2.5
To state enterprises	9.7	8.6	8.6	8.6	8.6
Broad money	172.9	205.8	234.2	243.6	307.4
Money	137.7	164.7	172.6	200.8	253.4
Quasi-money	35.2	41.1	61.6	42.7	54.0
Long-term foreign borrowing	14.5	31.7	31.7	51.9	68.4
Central bank	11.6	20.6	20.6	19.7	19.7
State banks	2.9	11.1	11.1	14.7	14.6
Rescheduling agreements	--	--	--	17.5	34.1
Other items (net) <u>5/</u>	3.9	5.4	24.0 <u>4/</u>	-11.4	-19.1

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

1/ Revised.

2/ Assumes that entire remaining financing gap is eventually reflected above the line in the balance of payments.

3/ Excludes payments arrears accumulated directly by the Treasury, amounting to FMG 0.6 billion at end 1979; FMG 1.8 billion at end 1980, and FMG 2.4 billion at end 1981.

4/ Including liabilities resulting from rescheduling agreements.

5/ Includes valuation adjustments and financial costs related to exceptional balance of payments financing.

more compatible with internal and external financial constraints, and that changes in the management and monitoring of economic affairs were necessary occurred in the President's speech of January 10, 1982. This was followed a few days later by a number of shifts of senior personnel with responsibilities in the economic field and by certain institutional changes.

When, in early March, the 1982 Article IV consultation discussions started and the negotiations toward a stand-by arrangement resumed, a substantial rethinking on the part of the Malagasy representatives had already taken place. With Madagascar having displayed in recent years a tendency to shift toward a state-controlled, less market-oriented economy (although basically remaining a mixed economy), it was not surprising to find that most of the authorities' rethinking and revisions had occurred in areas of quantitative and physical planning such as a reduction and reorientation of total investment. While details remained to be worked out, broad understandings in these areas were reached relatively quickly. The more difficult and time-consuming dialogue between the authorities and the staff occurred on such subjects as pricing and the exchange rate, where no or only nominal adjustments had been made in recent years, thereby contributing to emerging distortions and scarcities. However, progress was made during the discussions and the final policy package underlying the rehabilitation program contains a substantial number of price adjustments as well as a change in the exchange rate. At the time of the implementation of these measures in mid-May, the Malagasy authorities went even further with regard to certain prices than their undertakings in the discussion with the staff a few days earlier.

The stabilization program covers the one-year period ending June 1983. Specific targets and policies are defined only for 1982 and are summarized in Table 7. Targets and policies for the remainder of the program period will be quantified, and understandings reached with the Fund, at the time of a mid-term review planned before the end 1982, in the context of the final formulation of the 1983 budget. The principal supply, fiscal, monetary and external policies are reviewed below, followed by a summary of the applicable performance criteria.

#### 1. Supply policies

The overexpansionary and relatively unproductive investment expenditure of recent years have been one of the major causes of the serious financial imbalances in the economy. Therefore, a key element of the longer term adjustment effort will be a reorientation of investment policy. The Malagasy authorities have now prepared an investment program for 1982-84 which gives priority to agriculture and the transportation network, including rural feeder roads, with special emphasis on the rehabilitation of existing capacity. The agricultural sector will receive 30 per cent of all public and state enterprise investment, double its share in the 1978-80 Plan, while the share of socially-oriented investments will be cut from 40 per cent to 12 per cent. Within the agricultural sector, priority will be given

Table 7. Madagascar: Summary of the 1982 Financial Program

<u>Assumptions:</u>	Real GDP growth	0.9 per cent
	Terms of trade gain	6.0 per cent
	Exchange rate (average for year)	SDR 1 = FMG 380
	Exports of 60,500 tons of coffee at an average FOB price of U.S.\$1.00 per pound.	
	Additional external financial assistance (including debt rescheduling) of SDR 115.8 million will be made available.	
<u>Targets:</u>	Balance of payments	
	Current account deficit	SDR - 377.7 million (13.4 per cent of GDP)
	Overall deficit (before additional external assistance)	SDR - 141.2 million (5 per cent of GDP)

Principal elements of the program

1. Supply-side measures: A reorientation of the investment program towards the agricultural sector; increases in the producer (27 per cent) and consumer (87 per cent) prices of rice, so as to eliminate subsidies; increase of 26 per cent in the producer price of cotton; and greater flexibility in the setting of domestic ex-factory prices.

2. Exchange rate: A 15 per cent devaluation (in local currency terms). Since April 1, 1982, the Malagasy franc has been pegged to a currency basket, with weights based on foreign trade shares.

3. Wage policy: Cost of living increases in the public sector will be limited to 4.5 per cent.

4. Public finance: The 1982 overall deficit (including grants and onlending) to be reduced to 9.4 per cent of GDP (14.7 per cent in 1981), including a reduction in internal arrears equivalent to 0.7 per cent of GDP. Discretionary revenue measures (excluding the impact of the devaluation) equal 1.1 per cent of GDP.

- Policies for 1983 to be set at the time of the mid-term review, with the target of reducing the overall deficit to 7 per cent of GDP.

5. Monetary policy: Limit of 20.5 per cent on the growth of the banking system's total domestic credit, with appropriate quarterly ceilings and with subsceilings on net credit to Government (performance criteria).

- A further increase in the Central Bank's basic discount rate by 4.5 percentage points, with similar adjustments for other borrowing and lending rates.

6. External arrears: Reduction by end-1982 in arrears other than dividends by SDR 49.1 million on a net cash basis, from the level of end-March 1982, and an FMG 1 billion payment of arrears on dividend transfers, with appropriate quarterly ceilings (performance criteria). Targets for further reductions in 1983 will be set at the mid-term review.

7. External borrowing: New commitments within the 1 to 10-year range limited during the period of the stand-by arrangement to the French Francs 167.6 million (SDR 24.8 million) line of credit already agreed upon in 1981 with the French authorities (performance criteria).

to improving yields, through, for example, the restoration of irrigation networks in the major rice producing regions, rather than to capital-intensive efforts to expand the area under cultivation. The proposed investment program has been reviewed by the staff of the World Bank, and their reaction has been favorable. To ensure that the investment program is respected, the authorities have strengthened the powers and responsibilities of the Planning Office (Direction Générale du Plan), which is now attached directly to the Presidency. It will approve all government and state enterprise investment projects and, with the aid of a special technical committee, will ensure their consistency with overall financial planning and external debt management. The special technical committee will also be responsible for approving the terms and conditions of all external borrowing. An analysis of the import requirements of each project will also be undertaken, to ensure compatibility with the proposed import program.

The investment program aims at a reduction in rice imports by up to 70 per cent over the next six years. To help achieve this, the producer price of rice has been raised from FMG 47 to FMG 60 per kilo (27.7 per cent) and the consumer price of ordinary rice has been raised from FMG 75 to FMG 140 per kilo (86.7 per cent), thereby eliminating all subsidies on rice. The consumer price of high-grade rice, which is mainly imported, has been virtually doubled to FMG 300 per kilo. The financial position of the regional development authorities operating in the principal rice surplus regions has already been strengthened by government transfers in late 1981, in the context of lender-supported rehabilitation programs. In addition, a recently-approved World Bank-supported project is designed to improve the management of parastatals operating in the agricultural sector, partly through the preparation of company-specific action plans for each parastatal, with greater emphasis on their financial performance.

Producer prices for cotton were raised by an average of 26 per cent in January 1982. Because of the currently unfavorable world market prices the producer price of coffee will be raised only modestly from FMG 250 to FMG 260 per kilo (4 per cent); the producer price for cloves will be increased by FMG 5 to FMG 435 per kilo. Vanilla producer prices, which have been raised sharply in recent years and are now considered sufficiently profitable, will remain at present levels. The authorities will keep producer prices, and in particular that of coffee, under review in the light of future developments in world market prices.

The move toward greater price flexibility which began with the 1981 financial program will be continued. In particular, the price of imported goods and domestic ex-factory prices, including prices of petroleum products, have been allowed to adjust to reflect the cost impact of the exchange rate depreciation. More generally, the system of price controls will be relaxed. Combined with a drive for greater operational efficiency, enterprises will be allowed to adjust prices by up to a certain percentage, based on identified cost increases, without prior government approval.

Only modest growth, of 0.9 per cent, in real GDP is expected during 1982. A series of cyclones and heavy flooding early in the year have seriously damaged the current rice crop, and total production is now expected to be below the drought-affected level of 1981. Fortunately, production of the major export crops has not been seriously affected. Industrial production has remained depressed during the first quarter, because of the continuing shortage of imported raw materials and spare parts, but is expected to improve significantly later in the year, as foreign exchange becomes available.

## 2. Fiscal policies

The major aim of fiscal policy in 1982 is to reduce the overall deficit (including grants and onlending) to the equivalent of 9.4 per cent of GDP, from 14.7 per cent in 1981. The new revenue and expenditure reduction measures have already been incorporated into a revised Finance Law for 1982 and will serve as the base for further fiscal adjustments to be incorporated into the 1983 budget, with the aim of containing the 1983 deficit to around 7 per cent of GDP.

The increase in total receipts (including those of the FNUP) is projected at around 31 per cent (Table 5). New discretionary revenue measures, excluding the impact of the devaluation, are the equivalent of 1.1 per cent of GDP and without the new measures the projected increase in receipts would be some 22 per cent. The principal new measures are an increase in the rate of value added tax from 10 per cent to 15 per cent (with half of the additional revenue allocated to local government), increases in the rate of consumption tax on various products, including a new 10 per cent tax on pharmaceutical products, and increases in prices charged by the fiscal monopoly for alcohol, tobacco, matches and flour; the price of the latter has been doubled to FMG 300 per kilo. Prices for petroleum products have been increased by an average of 18 per cent, to maintain the high rates of petroleum taxation introduced as part of the 1981 financial program. The price of regular grade petrol is now the equivalent of about US\$3.45 per gallon.

FNUP receipts consist of the surpluses from the export of coffee, cloves and vanilla, after deduction of payments to producers, processing costs and normal export taxes. Since most of these deductions are fixed for the entire crop year, FNUP receipts are highly sensitive to fluctuations in export prices. They are projected to increase by 75 per cent, although the FMG value of the three principal exports is projected to increase by only 37 per cent, because of the windfall impact of the devaluation and an expected improvement in world coffee prices. Any further changes in producer prices during 1982 will have virtually no impact on 1982 FNUP receipts since exports in the second half of the year will be almost entirely from stocks or products already at the processing stage. The current projections are based on an f.o.b export price for coffee of US\$1.00 per pound (SDR 1.96 per kilo).



With respect to personnel policies, the authorities explained that, because of the large number of students who will graduate from government professional schools during the year and because of already existing commitments by the Government to many of them, the central government labor force will continue to grow during 1982, but the increase will be held to a maximum of 4 per cent (compared with a growth rate of over 8 per cent in the original 1982 Finance Law). A major rationalization of personnel and training policies is now underway, with a view to gradually reducing the rate of growth in personnel to 3 per cent in 1983, 2 per cent in 1984 and zero growth from 1985 onwards. The authorities will continue to apply restrictive wage policies and the cost-of-living increase for employees of both Government and state enterprises will be limited to 4.5 per cent during 1982. This measure and the price increases for numerous consumer goods are the main instruments to bring about the needed adjustments in real consumption.

Total capital expenditures, including on-lending and expenditures from the Reserve Fund (see below), are projected to decline by around 15 per cent in real terms. New locally-financed investments will be limited to the provision of the required local counterpart of foreign-financed projects. The projected budgetary capital expenditures include an optional tranche of FMG 11.3 billion which will be committed only if and when additional concessional external assistance becomes available. The authorities will discontinue the practice of charging capital expenditures to the FNUP account as a means of incurring additional expenditures outside the normal budgetary process. Budgetary allocations for long-term projects which have not been fully utilized by the end of the fiscal year are normally transferred to the Reserve Fund. The composition of allocations to, and expenditures from, this fund have not been closely monitored in the last few years. The Government has already started to make a complete inventory of all projects covered by the fund so that in future it will be able to enforce its policy of cancelling the allocations for all projects which have not been used within two years.

As indicated above, as a consequence of the new price policy, subsidies on both locally produced and imported rice have now been eliminated. The remaining subsidy payment of FMG 1.5 billion for local rice in 1982 is in respect of past operations. A small surplus is projected for operations on imported rice because of the sale of luxury rice, imported on concessional terms, at a price of FMG 300 per kilo. As a further step to reduce delays in recovering yields from the sale of imported rice to distributors, all deliveries are now made on a cash-on-delivery basis. However, no special allowance has been made for this in the projections of receipts on rice imports.

With regard to special Treasury accounts, government transfers to enterprises, which include both advances and capital participation, are projected to increase to FMG 9 billion, up from FMG 6 billion in 1981. The increase is due to a high level of new capital subscriptions resulting from the opening of a number of new industrial units. The Government will

be much stricter with regard to advances, which in the recent past had become a euphemism for subsidies to state enterprises. In the future, such advances are to be kept to a minimum, are expected to be repaid, and, where possible, to be replaced by bank credit with the appropriate scrutiny by the banks. The Treasury's operations with its correspondents (Post and Telecommunications, Ports, University, etc.) are projected to be in surplus by FMG 8 billion, a conservative figure and below the average of the last three years.

In addition to the normal carry-over of deferred payments, estimated at FMG 8.8 billion, the authorities have undertaken in the revised Finance Law to pay FMG 8 billion of internal arrears during 1982, which will help reduce the liquidity problems of various state enterprises. The authorities are now now making a complete inventory of all arrears which exist at the level of each individual ministry and will establish a comprehensive program for their gradual elimination. Should the Government's financial position turn out more favorably than projected, it would then wish to accelerate the settlement of these internal arrears.

The overall deficit is projected at FMG 100.3 billion, with net foreign financing of just over FMG 60 billion. This includes the projected financing of FMG 11.3 billion for the optional tranche of budgetary capital expenditures. The Treasury itself will not benefit from the impact of any rescheduling of principal or interest on external debt, but will continue to be debited according to the original maturities. The impact of the debt rescheduling will be treated as a long-term loan to the Central Bank, and the domestic credit ceilings have been established on this basis. The authorities will introduce shortly a special nation-wide government loan (Emprunt National) with rates of interest between 15 per cent and 18 per cent, to mobilize domestic savings to help finance the government investment program. This, together with normal Treasury bond issues, is expected to raise FMG 4.9 billion, so that bank financing of the deficit will be curtailed to FMG 35 billion, a performance criterion.

### 3. Monetary and credit policies

The principal monetary policies will consist of restraint on domestic credit expansion and a substantial increase in the level of interest rates. Growth in the banking system's total credit to the private sector (including state enterprises) will be limited to FMG 45 billion or around 27 per cent, well below the projected growth of 36 per cent in nominal GDP, and total domestic credit will grow by some 20 per cent. In addition to the existing selective credit controls, which operates through a system of required prior authorization for all medium- and large-scale credit users, the Central Bank has reactivated a system of quantitative credit controls. Under this system, the Central Bank establishes quarterly global ceilings for three separate categories of credit for each of the three national banks. Infringement of the ceilings results in reduced access to the Central Bank discount window or in the requirement to make special non-interest-bearing deposits with the Central Bank.

In the light of the domestic credit ceilings and projected movements in the banking system's net foreign assets position, broad money supply is projected to grow by some 26 per cent (Table 6). This takes account of the expected growth in long-term liabilities of the Central Bank as a result of debt rescheduling and its payments of financial charges on this debt rescheduling and on other balance of payments loans.

The Central Bank's principal discount rate, which was already increased by 2.5 percentage points in 1981, was raised further from 8.0 to 12.5 per cent on June 1, 1982, i.e., an upward adjustment of 127 per cent within a 16-month period. Other borrowing and lending rates have been adjusted accordingly. Interest rates paid on time deposits now range from 9 to 13 per cent, according to length of maturity and commercial bank lending rates are within the range from 12.5 to 17 per cent, with the average rate around 14.5 per cent. The authorities intend to keep interest rate policies under review and in this respect will reach an understanding with the Fund in the context of the mid-term review.

#### 4. External policies

##### a. Balance of payments

The authorities expect that the balance of payments position will continue to be very difficult in 1982. Exports are expected to grow by about 10 per cent in SDR terms, largely as a result of improved prices, particularly for coffee, as export volumes are projected to remain virtually unchanged (Table 4 and Appendix Table II). The volume of imports is projected to grow by around 9 per cent from the depressed levels of 1981, so as to permit an improvement in the level of economic activity in the second half of the year. The latest World Economic Outlook projects an increase in the export prices of Madagascar's suppliers of 4.8 per cent in SDR terms, which would imply an increase in the value of imports of around 14 per cent. The terms of trade are expected to improve by around 6 per cent. The volume of rice imports is expected to grow by over 50 per cent, as a result of heavy cyclone damage to the domestic crop, thus accounting for 16.5 per cent of all imports (Appendix Table III). However, a large part of the increased imports will be financed by grants or long-term concessionary loans. A deterioration in the services account is expected, as a result of larger interest payments on the external debt. In all, the current account deficit is projected to reach some SDR 378 million, or the equivalent of 13.4 per cent of GDP and only a slight improvement from the 13.6 per cent of 1981.

Gross capital inflows, excluding any additional, as yet unidentified external assistance, are expected to increase slightly in 1982, partly because of the long-term concessionary loans linked to emergency rice imports, but net capital inflows (before any further debt rescheduling) will decline because of increasing amortization payments. The overall balance of payments deficit is expected to reach SDR 141.2 million. However, Madagascar also has payments obligations amounting to SDR 46.7 million with respect to previous arrangements

for the consolidation of arrears. Together with a projected net cash repayment of SDR 7.6 million of still outstanding arrears, this implies a total financing need of SDR 195.5 million. Net purchases from the Fund and already identified exceptional balance of payments financing amount to SDR 79.7 million, which leaves a gap of SDR 115.8 million to be filled by debt rescheduling and additional external financial assistance. The authorities anticipate that, in addition to debt already rescheduled, a further SDR 52.6 million of obligations due to official and private creditors in 1982 can be rescheduled. In addition, they expect to reschedule SDR 9 million of previously rescheduled debt service and arrears. This would leave a remaining financing gap of SDR 54.2 million, which the authorities hope to obtain through the aid coordination conference.

Debt service obligations on official and officially-guaranteed debt to the creditor countries within the framework of the Paris Club have already been rescheduled through June 1982. Taking this into account but without any further rescheduling, debt service payments, including obligations to the Fund, would amount to 54 per cent of exports of goods and services. The authorities noted that, although the rapid growth in external public borrowing was the major factor behind the sharp deterioration in the debt service ratio in recent years, the problem had been exacerbated by the high level of world market interest rates and by the stagnation of export receipts. As a first step towards an improvement in Madagascar's debt profile, the authorities have indicated that, during the period of the stand-by arrangement, they will not enter into any new foreign borrowing commitments within the 1 to 10 year maturity range, other than individual contracts under a line of credit for 167.6 million French francs (SDR 24.8 million), for which the global agreement was already signed in 1981.

The staff has made some preliminary projections for the balance of payments through 1986, to assist in analyzing possible developments in the debt service ratio. The projections are based on the price assumptions used in Scenario A of the latest World Economic Outlook and on the following additional assumptions: (i) export earnings increase by an average of around 8 per cent a year in nominal terms and by around 2.5 per cent in real terms; (ii) real GDP growth averages 4.8 per cent over the period 1983-86; (iii) the real volume of imports declines by an annual average of some 3 per cent, largely due to a two-thirds reduction, by 1986, in rice imports, which account for a projected 16.5 per cent of imports in 1982, and to an annual decline of around 5 per cent in the volume of capital goods imports, as a result of a smaller investment program; (iv) the smaller investment program leads to a virtual stagnation in the nominal value of capital inflows related to project financing; (v) all new external project financing is on concessional terms, with average terms of 5 per cent interest and 20-year maturity, with a 3-year grace period; (vi) some World Bank non-project assistance is made available in 1983 and 1984.

With these assumptions (and the additional one that debt rescheduling will be obtained), the current account deficit should gradually decline to

around 9 per cent of GDP in 1986. The decline is not more rapid because the required further debt relief and balance of payments support in the intervening years, and the increasing interest payments on rescheduled debt will, together, raise total interest payments to around one quarter of exports of goods and services by 1986. The total debt service ratio in 1986 is still likely to be over 50 per cent, before any rescheduling in that year (Table 8).

Repayments of outstanding arrears and payments arising from already-signed agreements for the consolidation of arrears are projected to amount to around SDR 50 million per annum through 1985. Together with the heavy debt service burden, this implies that additional balance of payments support (including purchases, if any, from the Fund and non-project-related capital inflows) of over SDR 100 million per annum or some 3.5-4 per cent of GDP would be required through 1985.

b. Exchange rate policy

Prior to April 2, 1982, the Malagasy franc had been pegged to the French franc at FMG 50 = F 1. Since then the Malagasy franc has been pegged to a basket of several currencies. The weight assigned to each currency in the basket is based on the distribution of Madagascar's trade during 1973-80. There is no single intervention currency, although the majority of transactions take place in French francs and U.S. dollars. On May 15, 1982 the Malagasy franc was devalued by 15 per cent (in local currency terms) compared to the exchange rate calculated on the basis of the currency basket. In the view of the Malagasy authorities, the new exchange rate arrangements, and the new level of the exchange rate, are well adapted to Madagascar's needs. Recognizing the importance of exchange rate policy as a tool for medium-term balance of payments adjustment, the authorities intend to keep such policy under review and reach an understanding with the Fund in this respect in the context of the mid-term review.

c. Policies with regard to exchange and import restrictions

With respect to external payment arrears, arrears other than dividends will be reduced on a net cash basis (excluding all consolidations) by SDR 49.1 million by end-1982 from the level of SDR 144.8 million outstanding on March 31, 1982. On a 1982 calendar year basis this implies a reduction on a net cash basis by SDR 7.6 million. Transfers relating to dividends will amount to FMG 1 billion during 1982. Furthermore, in order to improve the monitoring of arrears related to dividend transfers, the authorities will ensure that the backlog of applications accumulated since the beginning of 1981 will be processed promptly and that future requests will not encounter administrative delays. The authorities also intend to make the specified cash payments of all arrears in an orderly and non-discriminatory manner.

In reply to the mission's inquiry with regard to the authorization of imports, the Malagasy representatives noted that thus far in 1982 imports

Table 8. Madagascar: Debt Service Projections, 1982-86

(In millions of SDRs)

	1982	1983	1984	1985	1986
Interest	<u>69.1</u>	<u>89.8</u>	<u>98.0</u>	<u>103.9</u>	<u>118.8</u>
On medium- and long-term debt outstanding end-1981 <sup>1/</sup>	52.0	47.2	38.2	27.7	23.9
On consolidated arrears	8.4	8.4	4.4	1.0	--
On rescheduled debt <sup>2/</sup>	1.9	13.5	25.5	37.0	48.4
On medium- and long-term debt contracted since 1981 <sup>3/</sup>	--	8.4	18.0	28.5	39.7
Fund charges	6.8	12.3	11.9	9.6	6.8
Amortization	<u>154.0</u>	<u>166.2</u>	<u>186.7</u>	<u>164.7</u>	<u>129.2</u>
On medium- and long-term debt outstanding end-1981	101.9	139.0	129.7	108.0	91.0
On medium- and long-term debt contracted since 1981 <sup>3/</sup>	--	--	--	8.4	18.0
On use of Fund credit (below the line) <sup>4/</sup>	5.4	3.7	23.5	32.2	20.2
On consolidated arrears end-1981 (below the line)	46.7	23.5	23.5	16.1	--
Memorandum item:					
Dividends	3.1	3.1	3.1	3.1	3.1
Debt service before rescheduling (A)	<u>223.1</u>	<u>256.0</u>	<u>284.7</u>	<u>268.6</u>	<u>248.0</u>
Estimated debt rescheduling <sup>2/</sup>	96.7	120.2	123.4	112.2	112.2
Moratorium interest for the year of rescheduling	4.5	6.0	5.9	5.7	5.5
Debt service after debt rescheduling (B)	<u>130.9</u>	<u>141.8</u>	<u>167.2</u>	<u>162.1</u>	<u>141.3</u>
Exports of goods and services (C)	354.8	371.0	414.0	447.0	483.0
A/C ratio	62.9	69.0	68.8	60.1	51.3
B/C ratio	36.9	38.2	40.4	36.3	29.3

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

<sup>1/</sup> Rescheduled interest is included in the global figure of estimated debt rescheduling and the moratorium interest for the year of rescheduling is shown separately. In Table 4, rescheduled interest payments and the moratorium interest are netted out under investment income in the current account for 1982.

<sup>2/</sup> It is assumed that, as in the case of the June 1981 Paris Club renegotiation, 95 per cent of principal and interest will be rescheduled.

<sup>3/</sup> Excludes debt service payments on additional balance of payments assistance which will be required to maintain an import level assumed in the projections by the staff, as described in Section IV, 4. It is assumed that average terms for new debt contracted since end-1981 are 5 per cent interest and 20-year maturity, with a 3-year grace period. Based on projected capital inflows and deducting disbursements under contracts signed before end-1981, the projected stock of outstanding debt contracted since end-1981 is: (end-year SDR millions): 1983: 169.0; 1984: 359.2; 1985: 569.9; 1986: 794.2.

<sup>4/</sup> On the assumption that repurchases would be effected in accordance with existing schedules, i.e. 3 1/4 - 5 years in eight quarterly instalments for ordinary resources, and 3 1/2 - 7 years in eight semi-annual instalments for borrowed funds.

continued to be licensed on an ad hoc basis. For the year as a whole an import program has been prepared within the overall financial stabilization program, to provide for an increase in the volume of around 9 per cent so as to permit an improvement in the level of economic activity in the second half of the year.

The Malagasy representatives stated that the situation regarding the restrictive system was being kept under close and continuous review, and that a gradual relaxation of the present restrictions would be undertaken as soon as feasible.

#### 5. Performance criteria

The stand-by arrangement includes the following performance criteria: (a) quarterly ceilings on total domestic credit of the banking system, with subceilings on net credit to Government by the banking system, (b) cumulative reductions through net cash repayment of external arrears other than dividends; (c) cash payments of external arrears with respect to dividend transfers; (d) a limit on the contracting of new foreign debt in the 1 to 10-year range, which is set for the entire period of the stand-by arrangement; (e) the standard clauses relating to exchange and import restrictions; (f) the intention to consult and reach understandings with the Fund, in the context of the mid-term review, on Madagascar's exchange rate policy, interest rate policy and on quantitative credit ceilings and targets for the reduction in external arrears other than those relating to dividends, and for the transfer of dividends, for the remaining period under the arrangement in 1983. The purchases associated with the end of December 1982 performance criteria will also be subject to the satisfactory completion of the mid-term review. Quantitative ceilings already specified are shown in Table 9.

Table 9. Madagascar: Quantitative Performance Criteria for 1982

	1981	1982			
	Dec.	March 30	April 1-	July 1-	Oct. 1-
		Actual	June 30	Sept. 30	Dec. 31
Total domestic credit of banking system <u>1/</u> (FMG billion)	391.0	404.5	429.0	453.0	471.0
Net credit to Government by banking system <u>1/</u> (FMG billion)	214.2	227.5	235.2	242.2	249.2
		<u>Outstanding</u>	<u>Amounts of reduction by net cash payments</u>		
External payments arrears other than dividends (SDR million)	103.3	144.8	--	19.1 <u>2/</u>	30.0 <u>2/</u>
External arrears with respect to dividends (FMG billion)	3.9 <u>3/</u>	...	0.1	0.4	0.5
			<u>During 1982</u>		
			<u>French franc million</u>	<u>SDR million</u>	
New external borrowing of 1-10 years' maturity			167.6 <u>4/</u>	24.8	
Of which: 1-5 years			167.6 <u>4/</u>	24.8	

1/ Differs from data in monetary survey (Table 6) because ceilings are defined to include onlending of foreign loans by the Central Bank but exclude deposits at the Treasury by the National Savings Bank and the Postal Checking System; furthermore advances to contractors in connection with government projects which are classified as claims on Government in the monetary statistics are classified under the private sector for the purpose of these credit ceilings.

2/ Net cash payments, i.e., excluding reductions through consolidation.

3/ Estimated amount after processing by the Central Bank of all applications received.

4/ Represents an overall loan agreement denominated in French francs already signed in 1981; individual contracts for utilization of the loan will be signed during 1982.



## V. Staff Appraisal

Although the adjustment efforts undertaken in 1981 did succeed in reducing internal and external imbalances in the economy, the overall objectives of the program were not achieved. Performance was adversely affected by unfavorable changes in external factors, including a greater than anticipated deterioration in the world coffee market, high international interest rates and slumping demand for Madagascar's mineral exports. The authorities made a number of commendable policy adjustments, particularly in increasing a large number of administered ex-factory prices and in adopting a strict energy pricing policy, which resulted in domestic prices for petroleum products being adjusted by substantially more than the effect of higher world prices and exchange rate movements so as to provide additional revenue. However, other internal policies, in particular the only partial success in containing government expenditure, contributed to the shortfall from the program's objectives. The extreme shortage of foreign exchange has resulted in a sharp decline in the level of economic activity and an increase in inflationary pressures.

The authorities have recognized that a fundamental realignment of economic policies is required, if renewed economic growth with progress towards medium-term balance of payments viability is to be achieved. The major policy elements, including action on exchange and interest rates, adoption of new revenue measures and expenditure reductions in a revised budget as well as the elimination of rice subsidies, have already been implemented. The measures taken, and in particular the crucial but difficult decision to abolish rice subsidies, have required great political courage on the part of the authorities. The preparation of a sound investment program which realistically takes account of the constraints imposed by available domestic and foreign resources has also greatly improved the prospects for successful medium-term adjustment. While the staff would have preferred a larger immediate increase in the producer price of coffee than that decided by the authorities, it recognizes that the authorities' course of action stemmed from a concern for prudence given prevailing world coffee prices. It trusts, however, that the Government will not defer unduly any decision concerning further increases should the international coffee price improve as anticipated. The staff agrees that the prevailing producer price of vanilla, which has been increased substantially in recent years, provides an adequate incentive to production and that further increases in the producer price for cloves are not crucial, given the limited possibilities for market growth.

The staff welcomes Madagascar's gradual shift away from almost exclusive reliance on a system of officially administered prices largely divorced from world prices to greater flexibility and decentralization in the price formation process. Such a move with its greater provision for incentives should help in correcting distortions and overcoming existing scarcities. It should also create an environment in which exchange rate policy will have a better chance of making a contribution in the necessary process towards balance of payments adjustment.

The medium-term outlook for the balance of payments remains very difficult, because of the size of the underlying imbalances as well as the heavy burden of debt service payments and external arrears caused by the overexpansionary policies and indiscriminate borrowing of recent years. Madagascar will need continued substantial balance of payments support and further debt rescheduling over the next three to four years. Therefore, a sustained adjustment effort will be required, including measures to increase export diversification through a careful choice of investment projects and continued close attention to exchange rate policy. Additional fiscal adjustment will be required and fiscal policies for 1983, to be finalized at the time of the mid-term review, will have the objective of reducing the overall deficit to around 7 per cent of GDP. In this context, it is the staff's view that the authorities may have to consider a more rapid reduction in the rate of growth of personnel, below the growth of 3 per cent they now propose.

The intensification of import restrictions and the continued existence of external payment arrears were caused by the serious foreign exchange constraints. The program incorporates a reduction of external payment arrears, other than dividends. Moreover, transfers relating to dividends will amount to FMG 1 billion, the backlog of unprocessed applications will be cleared and future requests for the transfer of dividends will be handled promptly. In the light of the intentions of the authorities to reduce dependence on these restrictions as quickly as possible, and Madagascar's program to deal with its severe current balance of payments difficulties, the staff recommends approval of the restrictions maintained by Madagascar on payments and transfers for current international transactions.

The staff considers that the adjustment efforts contained in the proposed program for 1982 represent substantial progress towards achieving a viable balance of payments position in the medium term and towards restoring internal financial stability and deserve the financial support of the Fund. The important measures that have already been implemented since mid-May bear witness to the authorities' resolve to carry out the program effectively.

The following draft decision is proposed for adoption by the Executive Board:

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 , 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

- (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 , 1982

X

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 less than 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) <sup>1/</sup> 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).

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<sup>1/</sup> 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) notably 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) <sup>1/</sup> 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.

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<sup>1/</sup> 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), <sup>1/</sup> 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.

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<sup>1/</sup> 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.

MADAGASCAR - Relations with the Fund

(As of May 31, 1982)

Date of membership:	September 23, 1963
Quota:	SDR 51 million
Fund holdings of Malagasy francs:	SDR 125.15 million, or 245.39 per cent of quota, including compensatory financing purchases of SDR 29.20 million (57.25 per cent of quota) and regular facilities, including supplementary financing under the stand-by arrangements of SDR 22.23 million (43.59 per cent of quota). Excluding holdings under the compensatory financing facility, the Fund's holdings are at 188.1 per cent of quota.
SDR position:	Holdings amount to SDR 0.6 million (or 0.3 per cent of net cumulative allocation of SDR 19.27 million)
Trust Fund loan disbursements:	
First period:	SDR 10.78 million
Second period:	SDR 14.63 million
Direct distribution of profits from gold sales:	
First period:	US\$1.16 million
Second period:	US\$2.97 million
Gold distribution:	22,252.0 fine ounces
Exchange rate system:	The Malagasy franc is pegged to a basket of currencies with weights based on the pattern of trade. SDR 1 = FMG 397.28 (May 18, 1982)
Intervention currency:	There is no single intervention currency.



Staff contacts:

The last Article IV consultation took place in November/December 1979. The staff report (SM/80/149) and recent economic developments (SM/80/152) were discussed at EBM/80/99 on June 27, 1980. Staff missions visited Antananarivo in November 1980 and January 1981 to negotiate a stand-by arrangement, which was approved by the Board on April 13, 1981 (EBS/81/77 and Supplements 1 and 2). A review mission visited Madagascar in July 1981 and a Malagasy delegation visited Washington in August and November 1981. A Fund mission visited Madagascar in October/November 1981 to provide technical assistance on a reform of the tax system.

After the last Article IV Consultation the following decision was adopted by the Executive Board.

1. The Fund takes this decision relating to Madagascar's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1979 Article XIV Consultation with Madagascar, in the light of the 1979 Article IV Consultation with Madagascar conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Madagascar continues to maintain restrictions on payments and transfers for current international transactions as described in SM/80/149 and in SM/80/152. The Fund welcomes the intention of the authorities to eliminate in 1980 the arrears in payment for imports and services that have arisen since early 1980 and to reduce, progressively, the arrears on dividend transfers. The Fund encourages the authorities to remove these restrictions as soon as possible. In the meantime, the Fund grants approval for their retention until December 31, 1980.

MADAGASCAR - Relations with the World Bank

(In millions of U.S. dollars)

Amounts Outstanding as of March 31, 1982	Disbursed	Undis- bursed	Total Commitments
Completed projects	<u>112.1</u>	<u>--</u>	<u>112.1</u>
IBRD	32.6	--	32.6
IDA	79.5	--	79.5
Projects in execution (IDA)	<u>93.0</u>	<u>149.1</u>	<u>242.1</u>
Forestry	--	20.0	20.0
Agriculture and rural development	26.5	30.1	56.6
Education	8.0	17.5	25.5
Energy, power, and utilities	33.9	42.1	76.0
Transportation	24.4	34.6	59.0
Industry and tourism	0.3	4.7	5.0
Total	<u>205.1</u>	<u>149.1</u>	<u>354.2</u>
IBRD	32.6	--	32.6
IDA	172.5	149.1	321.6
Repayments			<u>7.1</u>
IBRD			1.6
IDA			5.5
Debt outstanding (including undisbursed)			<u>347.2</u>
IBRD			31.0
IDA			316.2
IFC investments			<u>12.5</u>

Source: World Bank.

Table I. Madagascar: Basic Data, 1978-82

Area, population, and  
GDP per capita

Area	587,041 sq. km
Resident population (1981)	9.0 million
Population growth rate (1981)	2.8 per cent
GDP per capita (1981)	SDR 272 per capita

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u> Est.	<u>1982</u> Prog.
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GDP (in current prices)

Total (in billions of Malagasy francs)	486.6	595.1	689.8	784.0	1,070.0
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(In per cent of GDP)

Primary sector	38.6	35.7	36.1	36.3	36.1
Secondary sector	19.2	19.2	18.0	14.9	15.1
Tertiary sector	42.2	45.1	45.9	48.8	48.8
Consumption	92.2	94.7	96.6	96.9	96.0
Investment	14.1	22.1	20.7	14.9	14.5
Resource balance	-6.3	-16.8	-17.3	-11.8	-10.5
Gross domestic savings	7.8	5.3	3.4	3.1	4.0

Change in GDP

(Annual change; in per cent)

At current market prices	4.0	22.3	15.9	13.7	36.5
At 1970 prices	-2.6	9.8	0.8	-9.2	0.9

Prices

Implicit GDP deflator	6.8	11.4	15.1	25.2	35.2
Consumer prices (low income index for Antananarivo)	6.6	14.0	18.2	30.5	51.0
Export prices	-14.3	8.3	30.8	-16.0	11.0
Import prices	12.1	9.5	14.8	7.5	4.8
Terms of trade	-23.0	-1.8	14.3	-21.9	6.0

Public sector finance

(In billions of Malagasy francs)

Revenue	99.0	110.0	116.0	119.5	157.5
Expenditure and net lending	-126.7	-189.9	-242.8	-234.8	-257.8
Of which: current expenditure	(-106.0)	(-118.5)	(-135.1)	(-143.7)	(-158.0)
Overall surplus/deficit (-)	-27.7	-79.9	-126.8	-115.3	-100.3

Table I. Madagascar: Basic Data, 1978-82 (continued)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u> Est.	<u>1982</u> Prog.
Foreign financing (net)	8.2	35.3	47.9	55.6	60.4
Domestic financing (net)	19.5	44.6	78.9	59.7	39.9
Of which: banking system	(18.2)	(41.9)	(78.2)	(57.8)	(35.0)
(In per cent of GDP)					
Revenue	20.3	18.5	16.8	15.2	14.7
Current expenditure	21.8	19.9	24.8	18.3	14.8
Capital expenditure and net lending	4.3	12.0	10.3	11.6	9.1
Overall surplus/deficit (-)	-5.7	-13.4	-18.4	-14.7	-9.1
<u>Money and credit</u>	(In billions of Malagasy francs; end of period)				
Net foreign assets	7.8	-40.8	-94.4	-125.8	-133.2
Net domestic credit	149.5	220.0	326.1	398.8	478.8
Government	48.5	99.1	175.8	235.0	270.0
Private sector	101.0	120.9	150.3	163.8	208.8
Broad money	140.8	172.9	205.8	243.6	307.4
Income velocity (GDP/Broad money)	3.46	3.44	3.35	3.22	3.48
(Annual change in per cent)					
Net domestic credit	22.1	46.5	48.2	22.2	20.1
Of which: private sector	5.3	19.5	24.3	9.0	27.5
Broad money	17.9	26.2	19.0	18.4	26.2
<u>Balance of payments</u>	(In millions of SDRs)				
Exports, f.o.b.	323.5	320.2	335.6	285.5	314.3
Of which: coffee	(129.6)	(138.6)	(164.0)	(99.3)	(112.1)
Imports, f.o.b.	-308.7	-542.5	-620.3	-455.7	-519.3
Trade balance	14.8	-222.3	-284.7	-170.2	-205.0
Services (net)	-112.2	-157.2	-179.6	-171.1	-182.1
Private transfers (net)	6.4	5.5	0.7	7.2	9.4
Current account	-91.0	-374.0	-463.6	-334.1	-377.7
Official transfers	41.8	48.8	48.0	50.0	56.1
Nonmonetary capital (net)	51.9	189.5	224.6	203.5	180.4
Public	28.9	128.4	174.8	190.4	166.4
Private	23.0	61.1	49.8	13.1	14.0
Monetary capital	21.6	20.0	5.1	-18.1	--
Errors and omissions	-24.9	-46.8	-0.8	20.7	--
Allocation of SDRs	--	3.5	3.5	3.5	--
Overall surplus/deficit (-)	-0.6	-159.0	-183.2	-74.5	-141.2

Table I. Madagascar: Basic Data, 1978-82 (concluded)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u> Est.	<u>1982</u> Prog.
	(In per cent of GDP)				
Exports, f.o.b.	18.8	14.8	13.4	11.7	11.2
Imports, f.o.b.	17.9	25.1	24.7	18.6	18.4
Current account balance	-5.3	-17.3	-18.5	-13.6	-13.4
<u>Gross official foreign reserves</u>	(In millions of SDRs; end of period)				
Central Bank	44.5	1.0	15.7	27.5	27.5
<u>Public and publicly guaranteed external debt</u>	(In millions of SDRs)				
Disbursed and outstanding (end of period) <u>1/</u>	315.6	511.4	928.7	1,215.2	1,459.9
In per cent of GDP	17.7	22.6	35.6	53.3	51.8
Repayments of principal <u>2/</u>	10.0	16.5	25.2	55.9	130.0
Interest payments <u>2/</u>	10.6	19.3	29.8	48.4	62.3
Debt service ratio <u>2/</u>	5.8	9.9	14.5	32.8	55.1
<u>Exchange Rates</u>	(Malagasy francs per SDR)				
End of period	272.3	264.8	288.0	334.5	...
Period average	282.5	274.8	275.0	320.2	380.0

1/ Including obligations to Fund.

2/ On the basis of existing rescheduling agreements.

Table II. Madagascar: Exports, 1978-82

(Value in billions of FMG; volume in thousands of metric tons; and unit prices in FMG/kilo)

	1978	1979	1980	Prov. 1981	Proj. 1982
Coffee, value	36.6	38.1	45.1	31.8	42.6
Volume	55.2	63.1	69.5	60.5	60.0
Unit price	663	604	649	524	710
Cloves, value	17.2	15.0	6.6	21.1	28.4
Volume	14.8	13.5	4.4	9.3	10.1
Unit price	1,166	1,111	1,510	2,271	2,816
Vanilla, value	8.6	3.1	3.9	8.1	12.7
Volume	1.5	0.4	0.4	0.7	0.8
Unit price	5,925	7,126	9,621	12,162	15,875
Shellfish, value	3.1	3.7	3.9	4.6	5.4
Volume	3.5	3.6	3.4	3.2	3.2
Unit price	893	1,034	1,139	1,418	1,678
Petroleum products, value	1.4	2.2	1.4	3.0	4.7
Volume	73.9	94.9	40.5	59.9	76.5
Unit price	19	24	34	51	61
Sugar, value	1.4	1.4	2.5	2.3	1.4
Volume	23.2	19.6	24.0	15.0	10.1
Unit price	62	70	103	153	138
Meat, value	1.5	2.9	3.8	1.3	1.6
Volume	3.3	5.3	6.5	2.1	2.1
Unit price	464	555	576	640	757
Cotton, fabric, value	1.5	1.9	1.8	1.9	3.5
Volume	2.9	3.4	3.4	3.1	...
Unit price	510	542	518	615	...
Sisal, value	1.2	1.8	1.7	1.6	...
Volume	15.2	15.4	13.5	12.6	...
Unit price	79	115	127	129	...
Chrome, value	3.1	1.8	2.0	1.3	1.7
Volume	144.7	109.1	134.5	67.2	70.0
Unit price	22	17	15	19	25
Graphite, value	1.3	1.3	1.4	2.2	2.4
Volume	16.9	14.6	11.5	16.4	15.0
Unit price	76	88	125	135	160
Mica, value	0.2	0.3	0.3	0.2	...
Volume	1.3	1.2	1.1	0.9	...
Unit price	153	213	296	259	...
Other, value	14.3	14.5	17.9	12.0	15.0
Total, (f.o.b.)	91.4	88.0	92.3	91.4	119.4

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

Table III. Madagascar: Composition of Imports, c.i.f., 1978-82

	1978	1979	1980	Est. 1981	Proj. 1982	1978	1979	1980	Est. 1981	Proj. 1982
	(In billions of FMG, and metric tons)					(In per cent)				
Consumer goods other than foodstuffs	17.8	22.9	22.0	16.0	20.2	16.7	12.8	10.7	9.0	8.7
Foodstuffs	17.8	17.7	18.7	27.7	50.4	16.7	9.8	9.1	15.6	21.6
Of which: rice	(11.7)	(8.9)	(11.7)	(18.1)	(38.4)	(11.0)	(5.0)	(5.7)	(10.2)	(16.5)
volume	(167,000)	(156,000)	(177,000)	(192,000)	(...)	(...)	(...)	(...)	(...)	(...)
Energy 1/	12.7	20.7	33.6	35.6	43.7	12.0	11.5	16.3	20.0	18.8
Of which: crude oil	(7.8)	(11.9)	(26.1)	(29.3)	(...)	(7.3)	(6.6)	(12.7)	(16.5)	(...)
volume in										
metric tons	(330,974)	(375,445)	(492,090)	(427,368)	(...)	(...)	(...)	(...)	(...)	(...)
Raw materials and intermediate goods	28.2	36.0	43.6	31.9	49.4	26.5	20.1	21.2	17.9	21.2
Capital goods	25.9	71.5	70.3	62.7	59.5	24.4	39.9	34.1	35.2	25.6
For agriculture	(0.5)	(1.6)	(0.6)	(...)	(...)	(0.5)	(0.9)	(...)	(...)	(...)
For industry	(25.4)	(69.9)	(69.7)	(...)	(...)	(23.9)	(39.0)	(...)	(...)	(...)
Other	3.9	10.5	17.8	4.0	9.5	3.7	5.9	8.6	2.3	4.1
Total	106.3	179.3	206.0	177.9	232.7	100.0	100.0	100.0	100.0	100.0

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

1/ Crude oil, gasoline, gas, and coal.