FOR AGENDA

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November 5, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Madagascar - Staff Report for the 1993 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1993 Article IV consultation with Madagascar, which is proposed to be brought to the agenda for discussion on Wednesday, November 24, 1993. A draft decision appears on page 14.

Mr. Carstens (ext. 38388) or Mr. Youm (ext. 38735) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Communities (EC), and the GATT Secretariat, following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

Staff Report for the 1993 Article IV Consultation

Prepared by the Staff Representatives
for the 1993 Consultation with Madagascar

Approved by E. L. Bornemann and Anupam Basu

November 5, 1993

I. Introduction

The 1993 Article IV consultation discussions with Madagascar were held in Antananarivo during the period August 5-19, 1993, and were concluded in Washington during September 27-October 5, 1993. 1/ The mission was received by the then-Prime Minister, Mr. Guy Willy Razanamasy and by the then-Prime Minister-designate, Mr. Francisque Ravony; the latter invited the mission to a working session with the team set up to prepare his policy program, which was approved by the National Assembly, on August 24, 1993.

On May 15, 1989, the Fund approved a three-year arrangement for Madagascar under the enhanced structural adjustment facility (ESAF) in an amount equivalent to SDR 76.9 million (85.4 percent of quota), with annual access of SDR 25.6 million (28.4 percent of quota). The amounts under the first and second annual arrangements were fully disbursed. Negotiations on a program that could be supported by a third annual arrangement under the ESAF could not be completed in July 1991 because of civil unrest. Madagascar entered a period of political tensions, which greatly hampered economic management and decision making. This situation precluded approval of the third annual arrangement before May 14, 1992, the date of expiration of the three-year commitment period under the ESAF.

Madagascar continues to avail itself of the transitional arrangements under Article XIV, Section 2. It is on the standard 12-month Article IV

1/ The Malagasy representatives included Mr. Evariste Marson, Minister of Finance of the Transitional Government; Mr. José Raserijaona, Minister of Finance and Budget; Mr. Tovonanahary Rabetsitonta, Minister of Economy, Planning and Social Recovery; Mr. Blandin Razafimanjato, Governor of the Central Bank of Madagascar; Mr. Gaston Ravelojaona, Director General of the Central Bank of Madagascar; and other senior officials. The staff representatives were Messrs. Carstens (head), Youm, Verreydt (all AFR), Nascimento (PDR), De Callatay (FAD), and Miss Orraca-Tetteh (Assistant-AFR). Mr. Abu-zobaa, the Fund's resident representative in Madagascar, assisted the mission. Mr. Ismael, Advisor to the Executive Director for Madagascar at the Fund, participated in selected meetings.

consultation cycle; the last Article IV consultation was concluded on July 22, 1992. On that occasion, Directors expressed concern over the severe deterioration of Madagascar's economy in 1991-92, in large part related to social and political unrest. They emphasized that, notwithstanding greater efforts at revenue collection, expenditure restraint would have to play a significant role in fiscal adjustment. Directors stressed that, along with fiscal restraint, the Central Bank would need to exercise firm control over the monetary aggregates, so as to ease pressure on domestic prices and the balance of payments. Considering the weakness in the balance of payments and the depletion of freely available reserves of the Central Bank, Directors underlined the need to strengthen the external position and agreed that the restoration and maintenance of financial discipline should constitute the first priority. Noting that progress in structural reforms had largely come to a halt in 1991, Directors urged the authorities to renew the implementation of structural measures in a number of areas with a view to improving the allocation of resources and attracting foreign investment.

Summaries of Madagascar's relations with the Fund and the World Bank Group are presented in Appendices I and II, respectively; social and demographic indicators in Appendix III; and basic data in Appendix IV.

II. Background and Recent Developments

Following encouraging signs of improvement resulting from the economic reforms undertaken in the late 1980s, including steps toward liberalizing the trade system, Madagascar's economic and financial situation deteriorated markedly during 1991-92 with the outbreak of civic strife and the halt in the implementation of adjustment measures. Real per capita GDP fell by about 10 percent over the two-year period; inflation, as measured by the GDP deflator, averaged about 13-14 percent per annum (Chart 1, and Table 1). The overall fiscal deficit widened, as revenue performance continued to be disappointingly weak. The overall balance of payments deficit rose due to the loss of competitiveness as reflected in an appreciation in the real effective exchange rate, a deterioration in the terms of trade, and increased demand for imports. Freely usable gross official reserves were virtually depleted, and a parallel foreign exchange market flourished; in the absence of debt rescheduling, the large overall deficit was financed by the accumulation of external payments arrears (Table 1).

The extent of the deterioration of the fiscal situation in recent years is striking. Government savings, which exceeded, on average, FMG 100 billion per annum during 1986-90, became negative in 1991, and the deficit on current operations, after grants, reached FMG 50 billion in 1992. As capital expenditure was not adjusted to existing and foreseeable resources, the attendant overall deficit, on a commitment basis and including grants, rose from an average FMG 170 billion per annum in recent years to FMG 368 billion in 1992 (Table 2). Relative to GDP, the overall fiscal deficit, on a commitment basis and including grants, reached 6.6 percent in 1992, compared with 5.6 percent in 1991. Thanks to taxes levied on imports and on goods and services, current tax revenues improved noticeably, but

still amounted to only 8.7 percent of GDP. The share of noninterest current expenditures in GDP did not change significantly, as a sharp increase in purchases of goods and services was offset by a relative decline in the public wage bill. Substantial capital expenditures also contributed to the overall fiscal deficit. The fiscal deficit was financed by large recourse to bank financing and some increase in domestic arrears, while net external borrowing was reduced.

Outstanding claims of the banking system on the Government averaged some FMG 291 billion during 1989-91. These claims more than doubled in 1992, to FMG 679.1 billion, from a 1991 level of FMG 308.9 billion. The 1992 increase is partly due to the impact of the consolidation agreement reached with the Central Bank in the context of the transfer of the responsibility for rescheduled debt to the Treasury. Before consolidation, however, net claims of the banking system on the Government stood at FMG 444.2 billion (Table 3). In parallel, notwithstanding an accelerated depletion of official reserves, money supply expanded steadily, fueling inflationary pressures. At the same time, the portfolios of the two government-owned commercial banks (60 percent of total credit to the economy) included large volumes of nonperforming loans and led to the weakening of these banks. Broad money expanded by 19.5 percent in 1992, well above the rate of increase in nominal GDP. For the year as a whole, total domestic credit grew by 19.2 percent of beginning broad money, with credit to the Government increasing by 13.1 percent, and credit to the private sector and parastatal enterprises by 6.1 percent (Table 1).

The deterioration of the external sector is evidenced by the turnaround of the trade balance from an approximate equilibrium during 1986-89 to a large deficit amounting to SDR 126.5 million in 1992. Simultaneously, the overall deficit nearly doubled to about SDR 200 million in 1992 (Table 4). These developments are due to the loss of competitiveness, the widening of an underground economy as reflected in the pronounced increase in illegal exports, the breakdown of the system of allocation of foreign exchange, and an expanding parallel foreign exchange market, where the premium over the official rate for the French franc is reported to be at around 50-60 percent. The worsening of the external position in 1992 is reflected in a drop in officially recorded exports, in the large increase in imports without the official provision of foreign exchange, and serious shortages of foreign exchange for imports of raw materials, spare parts, and basic necessities, including medicines. Official shipments of traditional export crops (mainly vanilla) fell sharply, owing to illegal exports and keen competition from new producers, mainly Indonesia. The enlarged overall balance of payments deficit was financed by the accumulation of substantial external payments arrears, raising the total stock at end-1992 to SDR 340 million, or 16 percent of GDP (Tables 1 and 4).

III. Report on the Discussions

The 1993 consultation discussions took place at the time when Madagascar was completing its transition toward multiparty democracy. Madagascar has now peacefully resolved the political difficulties that had prevailed since late June 1991. The Transitional Government, drawn from the major parties representing the entire political spectrum that took office in January 1992, organized a national conference in March 1992; subsequently, a new constitution was drawn up and adopted by a large majority in a referendum on August 19, 1992. The former President was defeated in presidential elections, and the new Head of State was sworn in on March 26, 1993. The most recent round of voting took place on June 16, 1993, with the election of deputies to the National Assembly. The last act in the setting up of the institutions of the Third Republic was the designation by the National Assembly of a Prime Minister; the program of his Government was approved on August 24, 1993. The new Government's policy program outlines measures designed to enhance security, restore the authority of the State, reduce financial imbalances, and improve the investment climate. Local elections are scheduled in the spring 1994 in the context of the decentralization of the Government's political and administrative functions. These elections will be followed by the election of the upper house of Parliament, the Senate.

Against the backdrop of a difficult economic and financial situation, the discussions centered on the need for immediate action in a number of areas in order to arrest the continuing economic deterioration and lay the foundation for sustained economic recovery and financial viability over the medium term. The staff representatives emphasized the urgency of a rigorously revised budget for 1993 and the importance of implementing a tight fiscal policy in 1994 and beyond, accelerating the restructuring of the banking system as a fundamental building block in the conduct of a cautious monetary policy, and adopting an exchange rate policy geared to strengthening the international competitiveness and the external position of Madagascar.

1. Fiscal policy

With regard to fiscal policy, the authorities stated that they were determined to redress past slippages, and they presented the main targets of the new Government with respect to 1993. On the revenue side, receipts would be increased by an enhanced efficiency of the tax administration and, later, by a global tax reform designed to broaden the tax base. The outline of this tax reform has yet to be sketched out in detail, but the authorities intend to implement it rapidly once agreed on, and simultaneously with the decentralization reform. They do not plan to raise the rates of major taxes, partly to avoid fueling claims for wage increases. On the expenditure side, current outlays will be strictly controlled, with the aim of a reduction of FMG 20 billion in total expenditures, equivalent to about 0.3 percent of GDP. The number of ministries has been reduced from 36 to 24. To curtail the wage bill, the authorities agreed with the target of an overall stabilization of the number of civil servants, but are contemplating

a redeployment of staff between the different departments with a view to increasing efficiency. The authorities also raised the issue of the growing wage gap between private and public sectors, and pointed to rising pressures for future general salary increases in the public sector.

The fiscal goal set by the authorities for the fiscal year 1994 is that current revenue, excluding grants, would cover current expenditure. In 1993, however, current revenue will still fall short of current expenditure, and the current deficit is projected at 3.6 percent of GDP. Regarding the decentralization reform that will absorb considerable resources, the authorities have expressed the intention of covering all the operating costs of the local governments by raising new local revenues as and when required.

The staff representatives expressed disappointment with respect to recent fiscal developments. They drew the attention of the authorities to the need to achieve, in the short run, a substantial improvement in fiscal performance. The FMG 20 billion savings expected for the remainder of 1993 should come from real and lasting expenditure reduction, mainly with respect to current expenditure. As for the medium term, the primary fiscal balance should be improved by at least 2 percentage points of GDP in 1994 relative to 1993, and continue on the same trend during the rest of the three-year period 1994-96. This progress could be achieved through a combination of measures to reduce expenditures and strengthen expenditure control and to raise revenue vigorously, by streamlining the tax system and putting more stress on improving the performance of the various tax departments. While initially it had been expected that the fiscal situation would improve in 1993 compared to the two previous years, which had been adversely affected by the political turmoil, the final outcome was likely to be even worse than in 1991 and 1992. The deterioration was mainly due to a shortfall in tax revenue, to the cost of destruction of large excess stocks of vanilla, and to an increase in accrued interest charges.

To raise revenue, the staff representatives indicated that improvements in the tax administration are obviously desirable, but may not be sufficient in themselves to mobilize the resources needed. Discretionary measures may therefore be required to raise the tax effort, in the medium term, from the current low level of 7.7 percent of GDP, to about double that rate. Special attention should also be given to recovering tax arrears accumulated during 1991 and 1992. In agreeing with these views, the authorities stated their intention to implement more forcefully a number of revenue-enhancing measures and a program to recover tax arrears now that the new Government was in place. To this end, the adoption of a new exchange system should go a long way in raising receipts from import duties as well as official vanilla exports. In the framework of the preparation of the 1994 budget, a number of discretionary measures are also under consideration, namely an increase in the rate of the sales tax, a rise in the minimum corporate tax, and the elimination of numerous exemptions.

The staff representatives expressed the view that in order to achieve the authorities' target of fully financing current outlays from tax revenue, the former should be curtailed through rigorous expenditure control and a

large reduction in nonproductive expenditure 1/ that would more than offset any possible need for additional social expenditures. These savings were possible not only in the operating budget, but also in transfers and subsidies. As for development expenditure, the most striking feature of past expenditure trends was the size of the investment outlays, executed in the framework of a Public Investment Program (PIP); for several years, capital expenditures were at about the same level as current primary expenditures. However, the poor performance of the economy, and the deterioration of infrastructures as well as social services indicated the need for setting new priorities, and improving project selection, as well as a significant curtailing of the size of investment outlays.

The staff representatives added that to attain the objective of financial stability, the Treasury must cut down on its recourse to the banking system and cover its financing requirements without increasing external indebtedness. They underscored that the credibility of the Government was at stake with respect to the scrupulous observance of the terms of the recent agreements signed by the Treasury and the Central Bank; these pertain to the consolidation of cross debts, the transfer to the Treasury of external debt service obligations resulting from previous debt rescheduling agreements, and more importantly, the limitation of central bank financing of the Treasury. With regard to the fiscal stance in 1994, the authorities stressed that an important element would be to limit domestic bank financing either directly from the Central Bank or through the issuance of treasury bills. The staff representatives agreed that it was indeed important that domestic financing is contained to avoid crowding out the private sector.

2. Monetary and financial policies

The Malagasy representatives explained that, due to the excess liquidity of the banking system that had built up during the transitional period, the Central Bank had encountered difficulties in influencing interest rates on the money market. They noted that when the reform of monetary policy was begun in November 1990, the decision to phase out the credit ceiling instrument had been taken in principle. However, this decision was not carried out due to the worrying increase in banks' liquidity. Therefore, the Central Bank intended to maintain direct controls over credit ceilings for individual commercial banks for the immediate future.

The Treasury is expected to finance its deficit by issuing notes, as opposed to borrowing from the Central Bank, 2/ thus contributing to the absorption of commercial banks' excess liquidity while improving the daily

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1/ In 1992, military expenditures were equivalent to FMG 60 billion, or 1.1 percent of GDP and about 9 percent of current expenditures.

2/ A convention agreed between the Central Bank and the Treasury in mid-1993 limits the Treasury's recourse to ordinary advances to 15 percent, or in special circumstances to 20 percent, of the previous year's budgetary revenues.

management of the liquidity position of the Treasury. The Malagasy representatives added that the Treasury was planning to auction bills on a regular basis, adjusting the auction techniques as required. They also confirmed their intention of repaying the consolidated advance to the Government that resulted from the clearing of cross-debt between the Central Bank and the Treasury outstanding as of December 31, 1992, to improve the profitability of the Central Bank. However, given the precarious fiscal position, they foresaw that this goal could be achieved only in the medium term.

The staff representatives noted that the excess liquidity of the banking system could in principle be absorbed by raising mandatory reserve requirements, from 6 percent of deposits to 8 percent and, if necessary, 10 percent. The Malagasy representatives stated that this possibility had already been carefully examined. However, they held the view that raising the reserve requirement rate from 6 to 8 percent would create problems for the banks that were in financial difficulty. The staff urged the authorities to reconsider their position in the light of the recommendation of the last MAE technical assistance mission (August 29-September 10, 1993). Its recommendations pertaining to the excess liquidity of the banking system included: (i) raising reserve requirements to 8 percent of the deposit base and subsequently to 10 percent counting the cash in vault as reserves, and, if needed, above 10 percent with the provision that additional reserves would earn interest at the average cost of deposits to banks; (ii) improving the issuance of treasury bills by adopting a regular schedule, setting maturities that coincide with the date of future issues, eliminating the tax exemption on interest, and making the bills negotiable instruments. The MAE team also recommended a greater flexibility in the management of global credit ceilings and the elimination of the so-called encadrement subceilings targeted at particular credit categories.

Turning to banking sector restructuring, the staff representatives stressed the paramount importance of a sound banking sector, which entailed immediate action to sign management contracts to rehabilitate and improve the operations of the Bankin'ny Tantsaha Mpamokatra (Bank for Rural Development, or BTM) and the Bank Fampandrosoana ny Varotra (National Bank of Commerce, or BFV). The authorities concurred with the staff views and indicated that the Government was trying to find a partner to take over the management of the BFV with a view to privatizing the bank as soon as possible. As for the BTM, they indicated that the authorities were considering separating its commercial portfolio from its agriculture-lending activities and offering the commercial part for privatization.

3. External policies

The authorities underscored the impact of the political transition and the unfavorable environment on external transactions in 1992. Major products (e.g., vanilla and shellfish) were smuggled out, while others (e.g., coffee and chromite) suffered from adverse world market conditions. Food

imports rose due to the drought in the south. Foreign aid fell. 1/ Thus, for a second consecutive year, the balance of payments deficit was mostly financed through a buildup of new external arrears--of which two thirds vis-à-vis Paris Club creditors; they included arrears on both post-cutoff date debt and interest on debt previously rescheduled on Toronto terms.

The staff representatives remarked that external imbalances were also rooted in the loss of external competitiveness and the limited capacity to absorb project aid. With exchange rate adjustments to make up for inflation differentials discontinued in late 1991 and expansionary demand policies pursued in 1992, the real effective exchange rate had appreciated by 15 percent in the 12-month period to end-1992 (Chart 2). 2/ The real exchange rate appreciation crippled nontraditional export growth, fostered illegal exports (e.g., vanilla to the Comoros), and stimulated import demand, which was largely met by imports without recourse to foreign exchange. It also fostered the gradual weakening of the 40-60 transitory exchange arrangement, 3/ and the deepening of the parallel exchange market, as (i) exporters directed banks to allocate foreign exchange to designated importers who, in return, paid a predetermined exchange premium, and as (ii) 100 percent foreign exchange retention schemes were granted to major firms operating in the textile, fishing, and vanilla export sectors. The staff representatives expressed concern at these worsening trends during the first half of 1993 and at their impact on external arrears. Indeed, by mid-1993, the real effective exchange rate had appreciated by 18 percent since end-1991 and the volume of official vanilla exports had reached only one seventh of its level in the first half of 1992.

The projected balance of payments deficit was expected to be financed again by a buildup of new external arrears, including to multilateral creditors (arrears to AfBD, IFC, BADEA, OPEC, and the Arab League already totaled about SDR 8 million at the end of September 1993). The stock of arrears was projected at SDR 552 million by year-end, excluding arrears to non-Paris Club creditors (former U.S.S.R., Algeria, Iraq, and Libya), which emerged as a result of Madagascar's failure to conclude bilateral rescheduling agreements with these creditors since 1984. 4/ The staff team pressed the authorities to initiate contacts rapidly with the above non-Paris Club creditors in order to conclude bilateral rescheduling agreements with these creditors on terms at least comparable with those granted under the Paris Club debt rescheduling. The staff also emphasized the need to eliminate arrears on nonrestructurable debt (i.e., post-cutoff date debt and

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1/ This assistance fell by 18 percent to SDR 176 million in 1992, due to a 33 percent drop in foreign loans. Indeed, official grants rose moderately.

2/ Based on INS data using the official CPI, which underestimates inflation, since the consumer basket reflects outdated weights.

3/ For a detailed description of the 40-60 transitory exchange arrangement, see SM/92/117.

4/ For the former U.S.S.R., these arrears are in addition to the overdue interest payments on the debt restructuring.

previously rescheduled debt on Toronto terms). These two actions would be needed to obtain a new debt rescheduling from Paris Club creditors, which would, in turn, be necessary to achieve balance of payments viability.

The staff representatives urged the authorities to adopt a floating exchange regime, with bureaux de change, with a view to legalizing the existing quasi-float, allowing the official exchange rate to reflect market conditions, and promoting a more efficient allocation of foreign exchange. The last MAE mission that visited Antananarivo recently also assisted the authorities in preparing for the implementation of a float. Exchange restrictions on current transactions would need to be liberalized, beginning with the abolition of the foreign exchange surrender requirement, while demand policies would need to be tightened and interest rates managed flexibly. 1/

The authorities acknowledged the precariousness of the official reserve position, pointing out that arrears vis-à-vis multilateral creditors arose because the foreign exchange shortages compelled them to give priority to oil imports over debt service payments. They expressed their commitment to adopting a comprehensive policy package, including a floating exchange regime, to redress the economic situation. On the float, they noted that a six-month transition period might be needed to lay the technical groundwork and, thus, to prevent a plunge of the exchange rate. Meanwhile, an appropriate devaluation would be effected. The staff team underscored the dangers of delaying action to validate the quasi-float (e.g., higher illegal exports; shortage of intermediate inputs and medicines; and speculation against the domestic currency) and urged the authorities to speed the reform of the exchange system and, meanwhile, to tighten monetary policy.

In the wake of the socio-political strains on the economy since 1991, structural reforms had taken an added importance. Structural reforms would be required to boost the traded goods sector; for that, the vanilla export price needed to be aligned to the world price to recoup lost market share, while a coherent and transparent fishing license policy was required to rekindle shrimp exports. Besides the adoption of a more appropriate exchange system, the Government was currently re-examining its commercial strategy for vanilla and had begun reviewing the question of a three-year reform program with the World Bank. Moreover, the liberalization of the administrative and legal framework with regard to foreign investment was envisaged, as was that for external transactions in services. With regard to public enterprises, there was a need to make clear on what basis the Government intended to withdraw, with particular reference to a comprehensive restructuring effort. The mechanisms to be established should aim at making the economy more efficient and promoting competition. In this context, the authorities' capacity to collect data and to formulate and monitor policies in a timely manner had to be accorded increased priority.

1/ A description of the exchange system is given in SM/92/133.

IV. Medium-Term Outlook

Reflecting the authorities' stated commitment to adjustment policies, the medium-term outlook is expected to improve markedly. Staff projections, discussed with the authorities, assume that a strong and comprehensive adjustment effort would be implemented to enable the Central Bank to rebuild official reserves, which are projected at 8 weeks of imports by end-1993. 1/ The medium-term policy package assumes that the float of the exchange rate will commence on January 1, 1994; the foreign exchange surrender requirement is abolished; appropriate demand policies are adopted; structural measures (e.g., decontrol of the vanilla export price) are carried out; and debt relief from Paris Club creditors on similar terms to those which have been applied since December 1991 to low-income IDA-only countries, and from non-Paris Club creditors on comparable terms, would be obtained. Assuming an average adjustment of the fiscal deficit by 2 percentage points per annum, external viability is expected to be reached by 1998.

Export volume growth would average 12 percent per annum during 1994-98, compared to 1 percent per annum in 1992-93. Export volume would be expected to soar in 1994, reflecting the return of smuggled exports into official channels and the impact of structural measures. Nonfood import volume growth would average 7 percent per annum during 1994-98, reflecting a rebound of intermediate and equipment imports, resulting from the adoption of the float and increased foreign aid inflows. Export prices, in SDR terms, are expected to fall in 1994 but to firm up thereafter, increasing on average by 3 percent per annum during 1994-98. However, with nonfood import prices projected to grow at an average rate of 2 percent per annum, the terms of trade are expected to improve only marginally over the medium term. With the decline in scheduled external interest obligations, the deficit in the services account is projected to narrow, though slowly.

Reflecting the depreciation of the official exchange rate, the current account deficit (excluding official transfers) is projected to jump to 13 percent of GDP in 1994 but to decline afterward, averaging 9 percent per annum in 1994-98, compared to 10 percent in 1992-93. With improved project-aid absorption and the release of aid flows, official grants are projected to grow at 14 percent per annum; concessional loan disbursements to grow at 3 percent per annum, reflecting donors' intentions to provide financial aid to Madagascar mostly as grants. The overall balance of payments deficit is projected to decline over the medium term, even recording a small surplus by 1998. Taking into account Fund repayments, a reserve buildup to 21 weeks of imports by 1998, and the settlement of nonreschedulable arrears in 1994, the cumulative financing gap amounts to SDR 1,158 million during 1994-98 and is expected to be filled by debt relief from rescheduling, and by additional foreign aid.

1/ Most of these reserves are actually earmarked, resulting in liquid international reserves being nearly nonexistent.

Madagascar's outstanding use of Fund resources is projected to drop from 116 percent of quota at end-1992 to a low of 23 percent in 1998. The ratio of debt service to the Fund in relation to external current account receipts is projected to decline from 5 percent in 1992 to 3 percent in 1997, when repayments of SAF and ESAF loans reach their peak, and fall to 2 percent in 1998 (Table 6). Provided a strong adjustment effort is sustained over the medium term, and given that Madagascar has to date discharged its financial obligations to the Fund on schedule, it is not expected that Madagascar will experience difficulties in meeting its financial obligations to the Fund in a timely manner. The projected strong increase in foreign reserves from eight weeks of imports in 1993 to nearly 22 weeks in 1998, would provide not only a much needed cushion against adverse shocks but also a stronger assurance that all debt will be serviced in a timely manner. However, in case of an unfavorable outlook characterized by lower export unit prices (e.g., due to weak coffee prices) and lower foreign aid inflows, the financing gaps would increase, and the reserves buildup would be lower. Without a countervailing strengthening of macroeconomic policies, debt service ratios 1/ would be higher, and repayment capacity to the Fund correspondingly weakened.

V. Staff Appraisal

The economy of Madagascar, which had shown encouraging signs of improvement in the late 1980s, suffered major setbacks since 1991, owing mostly to the pervasive influence of civic strife that started in the second half of the year, with real GDP contracting by 6.4 percent for the year as a whole. Modest growth is estimated to have resumed in 1992, and a 2 percent rate of growth is projected for 1993. However, financial imbalances have widened significantly, inflationary pressures have built up, and large domestic and external payments arrears were accumulated, while structural reforms virtually came to a halt. The Transitional Government that took office in January 1992, with the mandate to guide the country on its path to multiparty democracy and the formation of the Third Republic, has efficiently set up the new institutions, but at the same time little attention was paid to the most urgent economic adjustment requirements, with the consequence that economic and financial problems in Madagascar have deepened. Against this backdrop the main challenge for the authorities is to establish rapidly a stable macroeconomic environment. Hence, a comprehensive economic reform program is urgently required to reduce the financial imbalances and reduce the constraints to economic growth. This, in turn, is dependent on significant improvements in the design and implementation of macroeconomic policy under the new institutional framework.

A critical prerequisite for stabilization will be a tightened fiscal policy stance. Taking into account the large financing gaps and the need

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1/ The ratios of debt service repayments to the Fund would rise from 7.3 percent to 8.7 percent of total gross reserves, and from 2.4 percent to 2.5 percent of exports of goods and services.

for the Government to make rapid progress in reducing the financial imbalances in order to achieve medium-term viability, the authorities should tighten fiscal policy already during the remainder of 1993 as well as in 1994 and beyond. Obviously, this will require rapid and sustained progress in the implementation of a wide range of measures. Regarding revenues, it is crucial that the customs administration be reinforced, and in this context, that the current, already improved, customs collections procedures be strengthened further with the objective of covering at least 90 percent of imports; and that the collection of taxes on domestic transactions be improved. In addition, serious consideration should be given to new tax measures, including increases in the rates of the sales tax and the minimum corporate tax, and the elimination of tax exemptions. Every endeavor must also be made to recover tax arrears.

Notwithstanding the efforts to improve revenue performance, part of the burden of fiscal adjustment will have to be borne by government spending, to signal forcefully the intent and direction of the new Government's policies. In the first place, it is of great importance that the authorities implement rigorously the measures that have already been initiated, and put in place additional strict measures to control and monitor expenditures. In order to contain the wage bill at the targeted level, it is imperative that the freeze on the size of the civil service be scrupulously observed and that government incomes policy remain prudent. Determined steps are needed to shift expenditure allocations to urgent social sector priorities, while reducing nonproductive outlays. The staff would note that despite an ambitious public investment program, there has been little impact on growth and the economic and social infrastructure appears to be deteriorating. Therefore, the authorities should, in close cooperation with donors, as agreed on during the recent informal donors' meeting in Paris, downsize development expenditures and increase selectivity in project identification. This should go a long way in improving average project performance and enhancing growth.

A restrictive monetary policy in conjunction with fiscal restraint will be essential in easing inflationary pressures and improving the competitiveness of the economy. As part of the effort to enhance the effectiveness of monetary policy, reserve requirements will need to be increased to around 10 percent of deposits, and the Central Bank must stand ready to raise, as necessary, this ceiling to ensure strict adherence to monetary targets. Interest rate policy should be geared to ensuring that rates are positive in real terms and increasingly determined in the money market in a transparent and flexible way. Treasury bill volumes should relate to the monetary management requirements as established for the reserve money program. This would take on added urgency with a freely floating exchange rate system. The establishment of conditions more favorable to a stringent monetary policy requires the rapid cleaning up of the portfolios of BFV and BTM. This could be achieved through the separation of the commercial portfolio of BTM from its agriculture-lending activities and offering the sale of both banks to the private sector. A step toward that end might consist in signing management contracts with an option to buy majority holdings for each of the three new entities.

The weak external position and the virtual depletion of the freely usable reserves of the Central Bank call for a package of strong corrective actions designed to lead to a more sustainable situation. In this context, the authorities should implement a freely floating Malagasy franc, authorize foreign exchange dealers to operate in the market, and liberalize the exchange and trade system as soon as possible. The new system should strengthen the external competitiveness of Madagascar, stimulate the volume of exports, especially of nontraditional goods, and generally redirect resources toward the tradable goods sector. It should be emphasized that prudent domestic financial policies will have to play an important role in shoring up the competitiveness of Madagascar. Progress in implementing structural measures, particularly with regard to the banking sector, must be resumed to overcome the specific bottlenecks and impediments to output, which in the past have thwarted efforts to improve export performance on a lasting basis, and to attract foreign investment. The needed reforms should cover a number of areas, but focus on the public enterprise and vanilla sectors.

Madagascar will need the support of the financial international community to carry out these adjustment policies and structural reforms. In this context, adequate consensus and a comprehensive treatment of its external debt--including arrears--by official Paris Club and non-Paris Club creditors would be necessary in order to achieve a debt service profile consistent with its balance of payments prospects and debt service capacity. Finally, since a new debt rescheduling agreement with Paris Club creditors would be necessary to achieve balance of payments viability, the authorities should deploy greater efforts to conclude quickly bilateral debt rescheduling agreements with non-Paris Club creditors (including Russia) on terms at least comparable with Paris Club rescheduling and should eliminate all arrears on nonrestructurable debt.

Madagascar maintains exchange restrictions under the transitional arrangements of Article XIV, Section 2. It also has exchange restrictions that are subject to Fund approval under Article VIII, in the form of limits on the availability of foreign exchange for travel and for education abroad, of administrative allocation of foreign exchange for the making of certain current payments, and as evidenced by the accumulation of some external payments arrears. The authorities have expressed the intention, in the context of a comprehensive adjustment program, which, it is hoped, would be negotiated with Fund staff before the end of December 1993 or in early 1994, to eliminate gradually all restrictions on current international transactions, together with the introduction of a free float for the Malagasy franc, and thereafter to accept the obligations of Article VIII. However, in the absence of a definitive timetable for the removal of Madagascar's existing restrictions that are subject to Article VIII, their approval is not recommended at the present time.

It is recommended that the next Article IV consultation with Madagascar be held on the standard 12-month cycle.

VI. Proposed Decision

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

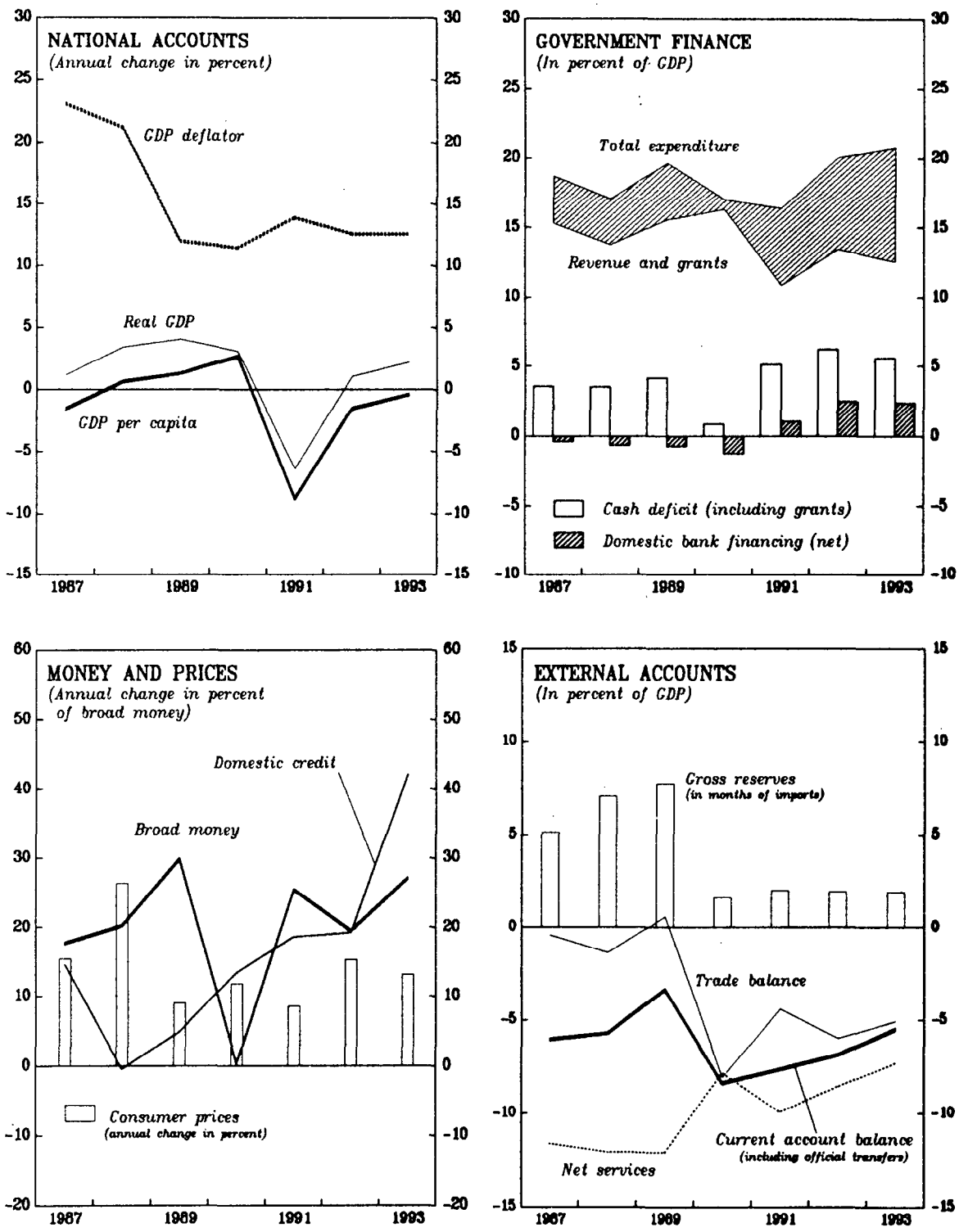
1. The Fund takes this decision relating to Madagascar's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1993 Article XIV consultation with Madagascar, in the light of the 1993 Article IV consultation with Madagascar conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended ("Surveillance Over Exchange Rate Policies").

2. Madagascar maintains the restrictive exchange measures described in SM/93/231, in accordance with Article XIV, except that the limits on the availability of foreign exchange for travel, the administrative allocation of foreign exchange for the making of certain current payments, and the restrictions evidenced by some external payments arrears are subject to Fund approval under Article VIII, Section 2(a). The Fund urges Madagascar to abolish these restrictive measures as soon as possible.

CHART 1

MADAGASCAR

MAIN ECONOMIC INDICATORS, 1987-93



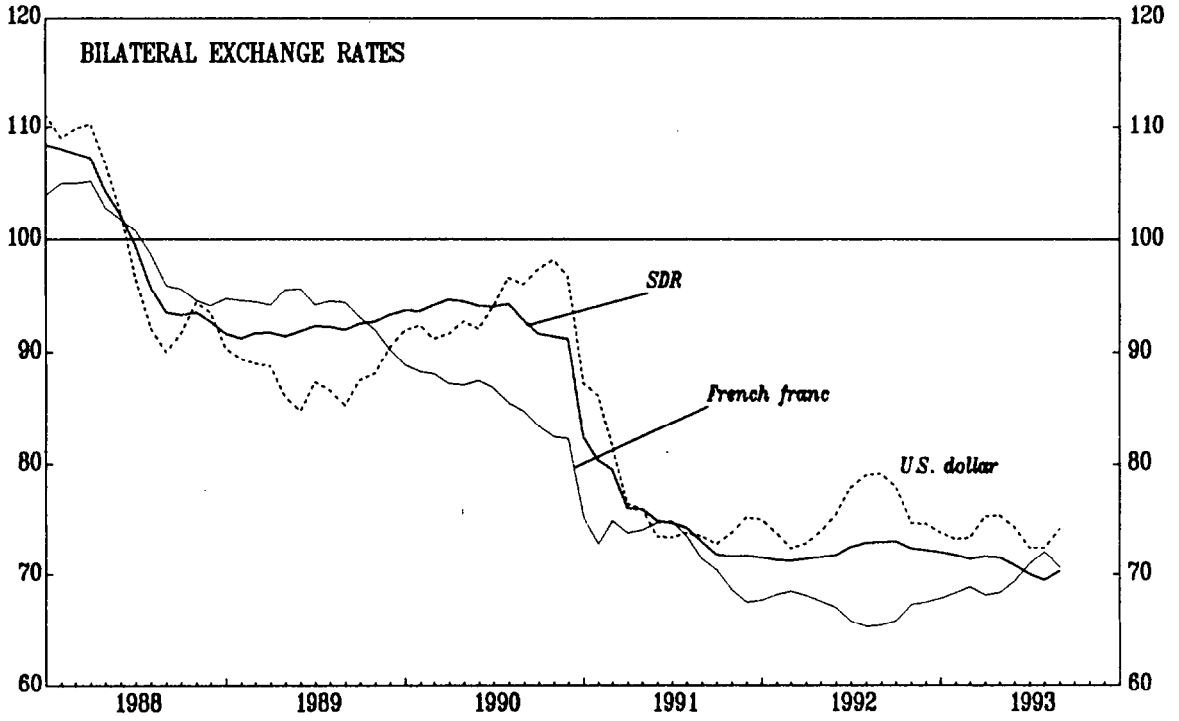
Sources: Ministère des Finances; Central Bank of Madagascar; and staff estimates.

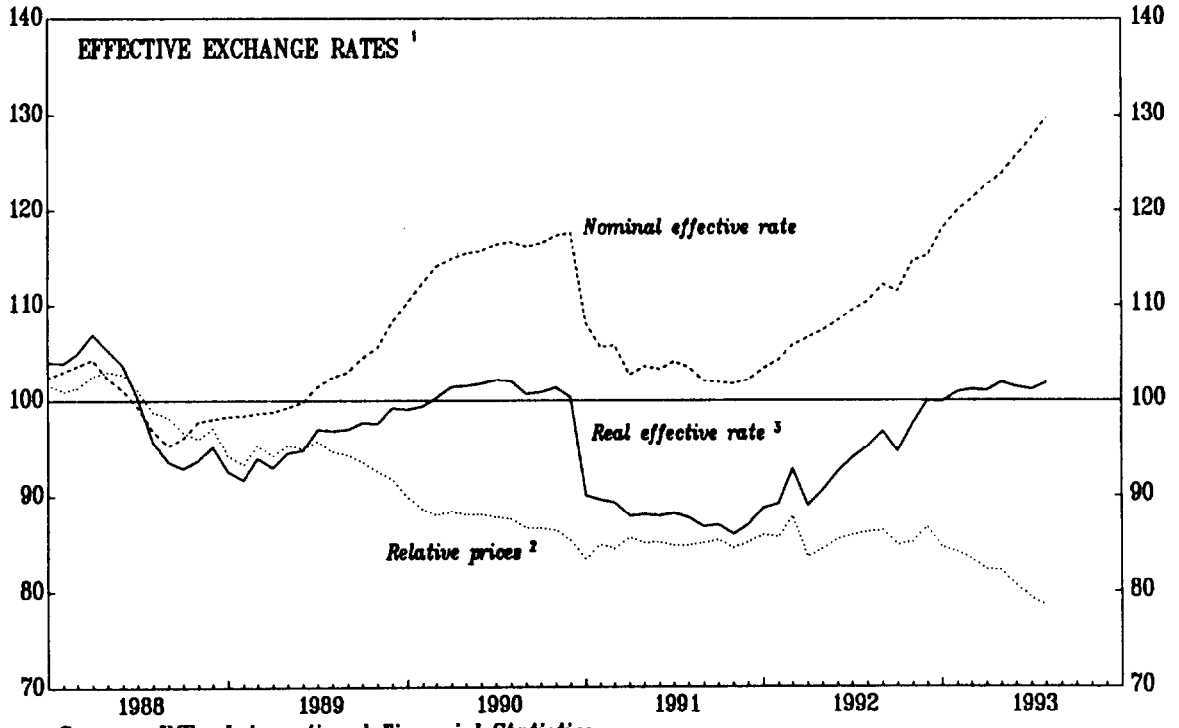
CHART 2

MADAGASCAR

SELECTED EXCHANGE RATE INDICES, 1988-93

(1988=100; foreign currency per Malagasy franc)





Source: IMF, *International Financial Statistics*.

1/ Information Notice System multilateral weights based on the geographical pattern of trade and tourism and including third-market effects in 1980-82 on average.

2/ Relative consumer price; domestic price index/weighted partner price indices.

3/ Based on relative consumer prices.

Table 1. Madagascar: Selected Economic and Financial Indicators, 1989-93

	1989	1990	1991	1992	1993 Proj.
		(Annual changes in percent)			
National income and prices					
GDP at constant prices	4.1	3.1	-6.4	1.0	2.2
GDP deflator	12.0	11.4	13.9	12.6	12.6
Consumer prices 1/	9.0	11.8	8.5	15.3	13.2
External sector (in terms of SDRs)					
Exports, f.o.b.	20.4	-6.3	0.3	-12.1	3.3
Imports, c.i.f.	2.7	64.9	-20.9	3.7	0.4
Non-oil imports, c.i.f.	(12.3)	(50.4)	(-17.3)	(3.4)	(-1.3)
Export volume	28.7	18.3	8.0	-4.9	6.0
Import volume (nonfood)	-9.2	59.6	-16.0	-1.4	7.2
Terms of trade (deterioration -)	-12.0	-25.6	-2.2	-8.5	2.7
Nominal effective exchange rate (depreciation -)	1.5	13.5	-10.0	5.2	...
Real effective exchange rate (depreciation -)	-4.5	5.7	-12.8	6.2	...
Central government financial operations					
Current revenue, including grants	7.2	20.4	-25.4	33.4	5.0
Current expenditure	13.9	4.8	14.6	37.2	22.6
	(Annual changes in percent of beginning broad money)				
Money and credit					
Domestic credit	4.9	13.4	18.6	19.2	42.1
Government	-4.7	-7.4	7.0	13.1	31.3
Economy	9.6	20.8	11.7	6.1	10.8
Broad money (M2)	29.8	0.3	25.4	19.5	27.1
Income velocity of M2	5.5	5.6	5.3	4.9	4.6
		(In percent of GDP)			
Central government operations					
Current revenue, including grants	12.7	13.3	9.3	10.9	10.0
Current expenditure	10.0	9.1	9.8	11.8	12.6
Current fiscal balance (including grants) (commitment basis)	2.7	4.2	-0.5	-0.9	-2.6
Overall fiscal balance (including grants)					
(commitment basis)	-4.1	-0.7	-5.6	-6.6	-8.2
(cash basis)	-4.1	-0.9	-5.1	-6.2	-5.6
Domestic bank financing	(-0.7)	(-1.3)	(1.0)	(2.5)	(2.4)
Foreign financing (net)	(4.6)	(2.1)	(3.9)	(2.7)	(2.4)
Gross domestic investment	13.4	17.0	8.2	11.3	11.9
Gross domestic savings	9.4	6.3	0.3	1.6	3.0
Current account deficit (-)	-8.7	-13.6	-11.8	-11.0	-9.5
Including official transfers	-3.4	-8.4	-7.6	-6.9	-5.5
External debt outstanding (including IMF)	118.2	100.5	120.4	114.0	106.7
Of which: arrears	(1.1)	(--)	(6.9)	(16.0)	(23.1)
Nominal GDP in billions of FMG	4,005	4,602	4,906	5,580	6,418
Conversion rate (FMG/SDR)	2,055	2,027	2,511	2,625	2,684
Scheduled debt service 2/	105.3	88.1	87.0	81.2	79.7
Gross official reserves 3/	33.6	7.1	8.6	8.3	8.3

Sources: Ministère des Finances; Central Bank of Madagascar; and staff estimates.

1/ Low-income consumer price index for Antananarivo.
2/ Including the Fund and the net cash reduction in arrears, in percent of exports of goods and services.
3/ Central bank gross reserves in weeks of imports (c.i.f.) of the current year.

Table 2. Madagascar: Central Government Financial Operations, 1989-93

(In billions of Malagasy francs)

	1989	1990	1991	1992	1993 Proj.
Current revenue and grants	507.7	611.2	456.0	608.3	639.0
Budgetary revenue	373.8	465.5	353.9	503.6	541.2
Tax revenue	(354.1)	(434.3)	(336.3)	(484.1)	(495.0)
Nontax revenue	(19.6)	(31.4)	(17.7)	(19.5)	(46.2)
Extrabudgetary 1/	78.1	78.7	63.8	43.0	31.4
Grants	55.8	66.8	38.2	61.7	66.4
Current expenditure	399.8	418.9	480.2	658.6	807.5
Budgetary	369.6	404.8	473.2	623.7	740.1
Personnel	179.5	193.9	226.9	238.7	254.4
Other goods and services	66.3	78.7	76.3	143.2	153.6
Interest	65.1	69.5	99.4	191.7	278.3
Foreign	(44.9)	(47.5)	(55.7)	(77.2)	(219.0)
Domestic	(20.2)	(22.0)	(43.7)	(114.5)	(59.3)
Transfers and subsidies	58.7	62.7	70.6	50.1	53.8
Extrabudgetary and other	30.2	14.1	7.0	34.9	67.4
Balance--current	107.9	192.3	-24.2	-50.3	-168.5
Capital receipts	117.1	141.6	77.2	144.3	167.3
Of which: grants	(108.2)	(135.4)	(65.6)	(133.7)	(146.6)
Capital expenditure	388.2	365.2	325.4	462.3	527.9
Budgetary	166.0	146.6	154.3	193.7	227.6
Foreign-financed	(97.3)	(59.0)	(85.6)	(103.4)	(105.0)
Domestic-financed	(68.7)	(87.6)	(68.7)	(90.3)	(122.6)
Extrabudgetary 2/	33.2	30.2	32.0	41.0	43.3
Capital grants	108.2	135.4	65.6	133.7	146.6
Self-financing	8.9	3.4	8.3	7.7	12.1
On-lending	71.9	46.8	61.9	83.3	89.7
Other	--	2.8	3.3	2.9	8.6
Balance--capital	-271.1	-223.6	-248.2	-318.0	-360.6
Deficit on a commitment basis	-163.2	-31.3	-272.4	-368.3	-529.2
Adjustments to cash basis	-2.9	-8.4	21.1	22.0	171.8
Deficit on a cash basis	-166.1	-39.7	-251.3	-346.3	-357.4
Financing	166.1	39.7	251.3	346.3	357.4
Foreign (net)	185.2	97.2	190.7	151.5	153.2
Drawings	(262.3)	(186.9)	(289.7)	(215.9)	(219.5)
Amortization	(-47.2)	(-44.7)	(-37.7)	(-64.4)	(-66.3)
Domestic (net)	-19.1	-57.5	60.6	194.8	204.2
Banking system	(-28.9)	(-58.5)	(51.3)	(139.3)	(152.0)
Nonbank	(9.8)	(1.0)	(9.3)	(55.5)	(52.2)

Sources: Ministère des Finances; and staff estimates.

1/ Mainly FNUP (stabilization fund) until 1989 and Caisse Vanille from 1990. Also includes the net position of other treasury operations and that of rice imported by the Central Bank of Madagascar.

2/ Mainly financed through proceeds of foreign assistance-in-kind and financial aid. Also includes expenditures financed through FNUP revenue.

Table 3. Madagascar: Monetary Survey, 1989-93

(In billions of Malagasy francs; end of period)

	1989	1990	1991	1992		1993	
				Before Consolidation	After Consolidation	March	June
Net foreign assets	381.9	178.5	27.1	-398.3	274.3	252.2	292.2
Central Bank, net	288.5	111.9	-103.1	-560.5	112.1	116.8	122.3
National banks, net	93.3	66.6	130.2	162.2	162.2	135.4	169.9
Total domestic credit	919.9	1,029.9	1,183.4	1,382.2	1,617.1	1,607.3	1,679.9
Credit to the Government, net	312.5	251.5	308.9	444.2	679.1	687.8	732.7
Central Bank	309.7	292.5	393.0	552.7	787.7	798.0	840.4
National banks	-10.4	-51.7	-100.7	-121.2	-121.2	-127.0	-127.8
Treasury	13.3	10.7	16.5	12.6	12.6	16.7	20.1
Credit to the private sector and state enterprises	607.3	778.4	874.6	938.0	938.0	919.5	947.2
Central Bank	26.6	21.2	22.2	9.3	9.3	9.0	8.9
National banks	572.5	745.4	846.7	919.5	919.5	905.4	936.6
Treasury	8.3	11.8	5.6	9.2	9.2	5.1	1.8
Broad money	822.7	825.3	1,034.8	1,236.1	1,236.1	1,245.8	1,330.9
Money supply	613.1	588.6	768.0	915.0	915.0	874.1	915.2
Currency	216.6	214.9	287.3	317.2	317.2	302.0	319.9
Demand deposits	396.4	373.7	480.7	597.8	597.8	572.1	595.4
National banks	381.7	358.7	465.3	583.6	583.6	557.8	581.1
Post Office and Treasury	14.8	14.9	15.4	14.2	14.2	14.2	14.2
Quasi-money	209.7	236.7	266.8	321.1	321.1	371.7	415.7
National banks	182.4	229.1	260.1	313.5	313.5	364.1	408.1
National Savings Fund	6.8	7.6	6.7	7.6	7.6	7.6	7.6
Other	20.4	--	--	--	--	--	--
Long-term foreign liabilities	2,160.4	2,195.3	2,651.3	2,336.3	276.5	273.1	272.7
Central Bank	2,157.0	2,194.2	2,650.3	2,330.5	270.6	266.7	266.2
Of which: rescheduling agreements	(2,053.7)	(2,060.6)	(2,436.6)	(2,105.8)	(51.1)	(46.7)	(44.4)
National banks							
Long-term borrowing	3.4	1.1	1.1	5.9	5.9	6.5	6.5
Other items, net	-1,681.4	-1,812.2	-2,475.6	-2,588.6	378.9	340.5	368.5
Of which:							
valuation adjustment	(-1,413.1)	(-1,489.6)	(-2,087.2)	(-1,935.9)	(--)	(-0.0)	(1.7)
accumulated BCM losses	(-561.5)	(-588.8)	(-684.6)	(-844.5)	(--)	(-5.5)	(-12.4)

Source: Central Bank of Madagascar (BCM).

Table 4. Madagascar: Balance of Payments, 1989-93

(In millions of SDRs)

	1989	1990	1991	1992	1993 Proj.
Exports, f.o.b.	250.6	234.8	235.6	207.1	213.8
Imports, f.o.b.	-239.4	-417.5	-321.7	-333.6	-334.9
Trade balance	11.3	-182.7	-86.1	-126.5	-121.1
Service receipts	117.5	154.0	110.3	110.5	124.9
Service payments	-353.3	-331.4	-304.3	-292.3	-300.0
Freight	(-38.3)	(-44.7)	(-36.9)	(-49.6)	(-51.5)
Transport and travel	(-61.5)	(-67.9)	(-62.5)	(-65.8)	(-65.0)
Investment income	(-161.4)	(-128.5)	(-128.3)	(-101.4)	(-90.0)
Other	(-92.1)	(-90.3)	(-76.6)	(-75.5)	(-93.5)
Services, net	-235.8	-177.4	-194.0	-181.8	-175.1
Of which: interest	(-160.9)	(-128.1)	(-126.9)	(-100.5)	(-89.0)
Private unrequited transfers	55.9	51.7	48.8	74.0	68.4
Current account balance	-168.7	-308.5	-231.3	-234.3	-227.8
Public unrequited transfers	102.5	118.4	82.3	88.3	96.4
Nonmonetary capital (net)	-36.7	-43.8	-23.5	-66.0	-91.4
Drawings	149.6	110.3	131.8	88.2	88.9
Amortization	-167.2	-155.2	-148.9	-146.0	-171.1
Long-term liabilities	-7.6	1.2	-6.4	-8.2	-9.3
Petroleum financing (net)	-11.5	--	--	--	--
National banks (net)	-14.5	14.0	-17.4	-11.3	--
Direct investment	10.0	16.5	10.0	15.0	17.0
Other 1/	-27.7	-5.2	9.1	10.9	--
Overall balance	-135.1	-208.5	-170.8	-197.5	-205.8
Financing	135.1	208.5	170.8	197.5	205.8
Debt relief already obtained	182.6	131.4	47.8	2.6	3.7
Official creditors	(178.3)	(126.2)	(33.2)	(2.6)	(3.7)
Commercial banks	(4.3)	(5.2)	(--)	(--)	(--)
IMF (net)	-12.7	-21.9	-12.2	-11.5	-10.0
Purchases	(--)	(--)	(--)	(--)	(--)
Repurchases	(-38.3)	(-34.7)	(-25.0)	(-11.5)	(-7.4)
SAF and ESAF loans (net)	(25.6)	(12.8)	(12.8)	(--)	(-2.6)
Net change in arrears (decrease -)	-21.2	-24.3	135.5	207.0	212.1
Net central bank reserves, excluding IMF and arrears (increase -)	-13.2	123.1	-0.3	-0.6	--
Financing gap	--	--	--	--	--
Memorandum items:					
Outstanding arrears 2/	21.3	0.0	135.5	340.2	552.3
Gross official reserves	187.7	64.9	62.3	62.9	62.9
In weeks of imports, c.i.f.	(33.6)	(7.1)	(8.6)	(8.3)	(8.3)

Sources: Central Bank of Madagascar; and staff estimates.

1/ Includes valuation adjustment; short-term capital other than petroleum financing; and errors and omissions.

2/ Excluding arrears on dividends.

Table 5. Madagascar: Outstanding External Medium- and Long-Term Public Debt and Debt Service Payments, 1989-93

(In millions of SDRs)

	1989	1990	1991	1992	1993 Proj.
Medium- and long-term debt 1/	2,263.2	2,262.0	2,199.1	2,064.1	1,980.1
Official creditors	1,306.3	1,291.5	1,178.5	1,016.5	893.0
Of which: Paris Club	(825.2)	(834.1)	(784.2)	(731.1)	(659.6)
International organizations	868.4	896.1	965.0	997.4	1,044.4
Of which: IMF	(122.8)	(100.9)	(88.7)	(77.1)	(67.0)
Commercial banks	68.7	57.2	39.1	37.5	33.6
Other private	19.7	17.1	16.4	12.7	9.0
Medium- and long-term debt service	387.7	342.3	301.0	266.3	284.7
Scheduled interest 2/	160.9	128.1	126.9	100.5	89.0
Official creditors	113.0	94.0	99.4	78.2	67.2
Of which: Paris Club	(81.1)	(59.0)	(64.7)	(54.4)	(46.8)
International organizations	24.4	23.4	20.5	18.3	16.3
Of which: IMF	(10.9)	(8.6)	(5.8)	(3.3)	(2.0)
Commercial banks	9.4	6.1	4.1	2.0	1.6
Other private	3.8	1.1	0.9	0.8	0.6
Scheduled amortization	205.6	190.0	173.9	157.5	181.1
Official creditors	131.6	122.2	123.8	122.4	144.2
Of which: Paris Club	(82.0)	(68.9)	(75.8)	(76.9)	(93.6)
International organizations	55.0	52.9	42.2	27.9	29.2
Of which: IMF	(38.3)	(34.7)	(25.0)	(11.5)	(10.0)
Commercial banks	11.3	11.8	4.3	3.1	3.6
Other private	5.0	3.2	3.6	4.1	4.0
Debt-equity swap	2.6	--	--	--	--
Other debt service	21.2	24.3	0.2	8.3	14.7
Interest on new loans	--	--	0.2	8.3	14.7
Interest on financing gap	--	--	--	--	--
Payment of arrears	21.2	24.3	--	--	--
Memorandum items: 3/					
Outstanding debt/GDP (in percent)	118.2	100.5	120.4	114.0	106.7
Debt service ratio 4/	105.3	88.1	87.0	81.2	79.7

Sources: Central Bank of Madagascar; and staff estimates.

1/ After debt rescheduling by Paris Club and other official creditors, and by commercial banks, for data up to 1991. With effect from 1992 assumes that the remaining gaps will be financed by new debt.

2/ Including moratorium interest on rescheduled debt.

3/ Including short-term external debt.

4/ Before debt rescheduling obtained on current year obligations.

Table 6. Madagascar: Medium-Term Balance of Payments Scenario, 1990-98

(In millions of SDRs)

	1990	1991	1992 Est.	1993	1994	1995	1996	1997	1998
				Projections					
Exports, f.o.b.	234.8	235.6	207.1	213.8	269.2	314.1	350.0	392.0	440.3
Of which: coffee	(28.5)	(20.5)	(22.4)	(24.0)	(28.0)	(36.1)	(38.5)	(42.6)	(47.5)
Imports	-417.5	-321.7	-333.6	-334.9	-367.2	-395.5	-426.2	-458.9	-495.5
Trade balance	-182.7	-86.1	-126.5	-121.1	-98.0	-81.4	-76.2	-66.9	-55.2
Services (net, excl. interest)	-49.4	-67.1	-81.3	-86.1	-101.7	-108.1	-114.9	-121.9	-129.3
Private transfers	51.7	48.8	74.0	68.4	54.1	54.9	55.8	56.6	57.5
Public transfers	118.4	82.3	88.3	96.4	125.3	137.9	151.6	166.8	183.5
Direct investment	16.5	10.0	15.0	17.0	19.5	21.5	23.7	26.0	28.6
Drawings on loans	110.3	131.8	88.2	88.9	91.6	94.3	97.1	100.1	103.1
Long-term liabilities	1.2	-6.4	-8.2	-9.3	-9.3	-9.3	-9.3	-9.3	-9.3
Balance available for debt servicing	66.0	113.3	49.5	54.2	81.6	109.8	127.8	151.4	178.9
Total debt service	-318.0	-300.8	-258.0	-267.4	-246.5	-236.3	-215.6	-173.0	-153.8
Amortization	-190.0	-173.9	-157.5	-178.4	-162.5	-149.1	-129.0	-89.7	-73.4
Of which: IMF repurchases	(-34.7)	(-25.0)	(-11.5)	(-7.4)	(-4.5)	(-0.6)	(--)	(--)	(--)
Interest	-128.1	-126.9	-100.5	-89.0	-84.0	-87.2	-86.6	-83.2	-80.4
Of which: IMF charges	(-8.6)	(-5.8)	(-3.3)	(-2.0)	(-1.6)	(-1.4)	(-1.3)	(-1.3)	(-1.2)
Rescheduling already obtained	131.4	47.8	2.6	3.7	--	--	--	--	--
Short-term capital	14.0	-17.4	-11.3	--	--	--	--	--	--
Other 1/	-5.2	9.1	10.9	--	--	--	--	--	--
Balance after debt servicing	-111.8	-148.0	-206.4	-209.5	-164.9	-126.5	-87.8	-21.6	25.1
SAF and ESAF loans (net)	12.8	12.8	--	-2.6	-3.9	-9.0	-11.6	-12.9	-10.2
Change in arrears (decline -)	-24.3	135.5	207.0	212.1	-554.6	--	--	--	--
Change in central bank reserves (increase -)	123.1	-0.3	-0.6	--	-40.0	-35.0	-35.0	-35.0	-35.0
Financing gap	--	--	--	--	811.4	170.5	134.4	69.5	20.1
Memorandum items:									
Current account deficit 2/	-308.5	-231.3	-234.3	-227.8	-229.5	-221.8	-222.0	-215.4	-207.4
In percent of GDP	(-13.6)	(-11.8)	(-11.0)	(-9.5)	(-12.9)	(-10.4)	(-8.9)	(-7.5)	(-6.5)
Stock of outstanding debt 3/	2,280.6	2,353.2	2,422.9	2,551.0	2,588.2	2,656.2	2,679.3	2,676.3	2,646.7
In percent of GDP	(100.5)	(120.4)	(114.0)	(106.7)	(145.5)	(124.6)	(107.0)	(93.3)	(83.0)
Debt service ratios									
Before rescheduling 4/	88.1	87.0	81.2	79.7	75.3	54.3	45.6	33.6	26.6
After rescheduling	38.6	57.0	80.3	78.3	75.3	54.3	45.6	33.6	26.6
On Fund obligations 5/	11.9	8.9	4.7	3.5	2.5	2.4	2.6	2.6	1.9
Gross official reserves 6/	7.1	8.6	8.3	8.3	12.4	15.4	17.9	20.0	21.7

Sources: Central Bank of Madagascar; and staff estimates.

1/ Includes errors and omissions.
2/ Excluding official transfers and including the cost of rescheduling and of financing the remaining gap.
3/ Assuming that the remaining gaps will be partly financed by new debt.
4/ Total debt service, excluding net reductions in short-term debt, including the reduction in arrears, and interest on the financing gap, as a ratio of exports of goods and services.
5/ Repurchases and charges, including Trust Fund repayments, as a ratio of exports of goods and services.
6/ In weeks of the current year's imports of goods (c.i.f.).

Madagascar: Fund Relations
(As of September 30, 1993)

I. Membership Status: Joined September 25, 1963; Article XIV

II. General Resources Account:	SDR Million	% Quota
Quota	90.40	100.0
Fund holdings of currency	98.89	109.4
Reserve portion in Fund	--	--

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	19.27	100.0
Holdings	0.43	2.2

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Stand-by arrangements	8.49	9.4
SAF arrangements	11.95	13.2
ESAF arrangements	51.27	56.7

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ESAF	5/15/89	5/14/92	76.90	51.27
Stand-by	9/02/88	5/15/89	13.30	2.80
SAF	8/31/87	5/14/89	46.48	13.28

VI. Projected Obligations to Fund: (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	9/30/93	1993	1994	1995	1996	1997
Principal			8.5	9.7	11.6	12.9
Charges/interest			1.4	1.2	1.1	1.1
Total			9.9	10.9	12.7	14.0

Nonfinancial Relations

I. Exchange Rate Arrangement

FMG 1,896.59 per U.S. dollar on September 30, 1993. The Malagasy franc is adjusted flexibly with reference to a basket of currencies with weights based on the pattern of trade. The U.S. dollar and the French franc are normally used as intervention currencies.

II. Exchange Restrictions

Madagascar continues to maintain limits for certain invisible payments. Nonetheless, there has been some liberalization in the context of the adjustment programs supported by Fund stand-by and ESAF arrangements.

III. Last Article IV Consultation

Madagascar is on the standard 12-month cycle. The last Article IV consultation discussions with Madagascar were held during the period March 29 to April 12, 1992. The staff report (SM/92/117) and the paper on recent economic developments (SM/92/133) were discussed by the Executive Board on July 22, 1992, and the following decision was adopted:

1. The Fund takes this decision relating to Madagascar's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1992 Article XIV consultation with Madagascar, in the light of the 1990 Article IV consultation with Madagascar conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended ("Surveillance over Exchange Rate Policies").

2. Madagascar maintains the restrictive exchange measures described in SM/92/117, in accordance with Article XIV, except that the limits on the availability of foreign exchange for travel, the administrative allocation of foreign exchange for the making of certain current payments, and the restrictions evidenced by some external payments arrears are subject to Fund approval under Article VIII, Section 2(a).

IV. Technical Assistance

An FAD review mission visited the country in March-April 1987 to study the tax system and make recommendations for its improvement. The report of the mission was issued on August 26, 1987, and since then, most of its recommendations have been implemented. In September 1988, an FAD tax mission visited Madagascar and reviewed in detail the system of income and profit taxation. The report of the mission was issued on January 12, 1989, and far-reaching reforms were included in the 1989 budget. In May 1989, an FAD mission visited Antananarivo to examine export taxation and make

recommendations regarding the reform of export taxes. An FAD mission visited Antananarivo in November 1989 to evaluate tariff reform in Madagascar and made recommendations on the strengthening of the customs administration. As for government expenditure, an FAD mission visited Madagascar in November 1988; the mission's main recommendation was the introduction of an improved expenditure monitoring and control system, which would enable the authorities to compile expenditure data on a commitment, payment-order, and cash basis, beginning in January 1990.

A government finance statistics mission from the Bureau of Statistics visited Antananarivo in March 1988 for the purpose of training government officials in the GFS methodology. Another mission from the Bureau of Statistics visited Madagascar in November 1989 to examine distortions in the monetary statistics following the reorganization and restructuring of two commercial banks.

A CBD mission visited Antananarivo in August 1989 to examine with the authorities the adaptation of monetary policy to a more open and market-oriented economy; a follow-up mission took place in January 1992. In March 1990 and again September-December 1990 an expert visited Antananarivo to provide advice on open market operations. Bank supervision assistance was also provided for three months in 1990. During October 15-29, 1992, one staff and one expert visited Antananarivo to provide advice on the consolidation of public debt. During August 30-September 10, 1993, an MAE mission visited Antananarivo to assess the liquidity in the economy and to help the Malagasy authorities design an efficient exchange system. Starting on August 22, 1993, a bank supervision advisor began a one-year assignment. This advisor will also assist the authorities in establishing a foreign exchange interbank market and in drafting the rules and regulations for this market.

V. Resident Representative

Mr. Naguib Abu-zobaa, the Fund resident representative, has been stationed in Antananarivo since October 1992.

MADAGASCAR - Financial Relations with the World Bank Group

At end-May 1993, World Bank Group lending to Madagascar amounted to US$1,238 million, of which US$1,205 million was from IDA. Bank Group assistance has been concentrated on infrastructure (30 percent) and agriculture (24 percent), and has also included credits aimed at the industrial sector (17 percent), human resource sector (14 percent), public sector adjustment (11 percent), and energy sector (4 percent). IFC has five investments in Madagascar, in textiles, footwear, and fisheries.

In the agricultural sector, 22 IDA credits and two IBRD loans have been approved to date, including an Agricultural Sector Adjustment Credit in 1986. The agriculture portfolio includes projects in irrigation rehabilitation, livestock development, forestry, environment, research, extension services, rural finance, and institutional development. The infrastructure sector with 16 IDA credits and two IBRD loans, includes projects in highway maintenance and construction, railways and port rehabilitation, urban development, cyclone damage reconstruction, and flood protection. The energy sector (four IDA credits) includes projects in hydroelectric power development, petroleum exploration, and a project aimed at improving the efficiency of the energy sector--particularly that of the national utility company. In industry, an Industry and Trade Policy Adjustment Credit (1987) has been completed; a Financial Sector and Private Enterprise project (1990) is under implementation. A Public Sector Adjustment Credit (1988), and a Financial Institutions Technical Assistance project (1993) in support of reforms in the public enterprise/financial sectors, in public expenditures, and continued market deregulation and export promotion, is currently under implementation. Finally, the human resource sector (8 IDA credits and one IBRD loan) includes projects in education, health, manpower training, food security, and nutrition, as well as an Economic Management and Social Action Program credit.

Bank strategy in Madagascar is to support the Government's efforts to rehabilitate and restructure the economy by providing financial and technical assistance for appropriate policy programs, and includes the following components:

(i) promoting policies and programs aimed at reforming incentive structures and creating a more favorable climate for private sector initiative and investments;

(ii) supporting sectoral strategies aimed at rehabilitating productive infrastructure, developing human resources, and establishing conditions for long-term growth;

(iii) strengthening the institutions responsible for central and sectoral policy formulation and management; and

(iv) helping Madagascar to mobilize and make effective use of donor and creditor financial, technical, and debt relief support.

In the future, the Bank will support government adjustment efforts with investment and, possibly, structural adjustment lending as its main vehicles of financial assistance. The Bank and Fund staffs have cooperated in developing the sectoral objectives, as well as in formulating broad macroeconomic policies.

MADAGASCAR - Financial Relations with the World Bank Group (concluded)

(In millions of U.S. dollars)

Amounts outstanding on May 31, 1993	Committed 1/	Disbursed 2/	Repaid	Out-standing 3/
Completed projects (IDA)				
Agriculture and rural development	151.65	166.50	4.67	180.53
Transportation	171.28	175.83	12.90	175.30
Forestry	23.48	21.84	0.99	25.10
Education 4/	27.51	26.06	7.62	21.98
Energy, power, and utilities	64.45	65.30	2.47	65.45
Industry	147.98	165.21	0.15	180.50
Urban development	13.50	13.50	0.47	13.03
Cyclone rehabilitation	25.00	27.97	--	33.49
Subtotal	624.85	662.21	29.27	695.58
Completed projects (IBRD)				
Agriculture and rural development	2.80	2.80	2.80	--
Transportation	18.50	18.50	10.81	7.70
Forestry	6.74	6.74	2.84	3.90
Education	4.53	4.53	3.17	1.36
Subtotal	32.57	32.57	19.62	12.96
Projects in progress (IDA)				
Agriculture and rural development	81.75	36.46	--	38.44
Environment	26.00	3.76	--	3.84
Transportation	86.50	28.88	--	30.06
Forestry	7.00	3.67	--	3.85
Education/manpower training	72.10	14.03	--	14.44
Energy, power, and utilities	25.00	18.50	--	19.23
Industry/financial sector 5/	62.85	9.37	--	9.48
Urban development	12.80	12.98	--	14.32
Public sector adjustment	131.97	82.21	--	87.33
Economic management and social action program	22.00	8.23	--	8.49
Health sector/food security and nutrition	52.30	1.38	--	1.37
Subtotal	580.27	219.47	--	230.85
Total	1,237.69	914.25	48.89	939.39
IDA	1,205.12	881.68	29.27	926.43
IBRD	32.57	32.57	19.62	12.96
IFC investments	28.88			

Source: World Bank.

1/ Original principal minus cancellations.

2/ Differs from amount committed owing to SDR/U.S. dollar exchange rate fluctuations.

3/ Differs from amount disbursed minus repayments because of exchange rate fluctuations.

4/ Includes general technical assistance, accounting, management, and audit organization and training.

5/ Includes mining.

Madagascar - Social and Demographic Indicators 1/

Area	Population	Density (1988)
587.0 thousand sq. km. Agricultural (percent of total): 63.2	11.7 million (1990) Rate of growth (1990): 3.1 percent	19 per sq. km. 30 per sq. km. of agricultural land

Population Characteristics	
Life expectancy at birth	51
Infant mortality (aged under 1, per thousand)	115.7
Child death rate (aged under 5, per thousand)	169.4

Health (in thousands)	
Population by physician	9.78
Population per nurse	...
Population per hospital bed	...
Access to health care % of population	65.0

Income Distribution (1990)	
Percent of national income	
Highest quintile	...
Lowest quintile	...

Distribution of Land (1990)	
Percent area exploited by top 11 percent of farmers	...
Percent area exploited by smallest 12 percent of farmers	...

Access to Safe Water	
Percent of population	
Total	31.0
Urban	81.0
Rural	17.0

Access to Electricity (1990)	
Percent of dwellings	
Urban	...
Rural	...
Energy consumption per capita kg of oil equivalent	40.2

Nutrition	
Daily calorie supply (1990)	2,158
Per capita protein supply (grams per day)	51.0
Prevalence of malnutrition (aged under 5, percent of age group)	52.5

Education (1990)	
Adult illiteracy rate (percent, over 15)	19.8
Primary school enrollment (percent)	92.0

Sources: World Bank, Social Indicators of Development, 1991-92; and staff estimates.

1/ Unless otherwise indicated, data are most recent estimates available, and refer to any year between 1980 and 1986.

MADAGASCAR - Basic Data

Area, population, and GDP per capita

Area:	587,000 square kilometers
Population: Total (1992)	11.8 million
Growth rate (1992)	2.6 percent
GDP per capita (1992)	180 SDRs

	1988	1989	1990	1991	1992 Est.	1993 Proj.
National accounts			(In billions of Malagasy francs)			
GDP at current market prices	3,437	4,005	4,602	4,906	5,580	6,418
			(Annual percentage changes)			
GDP at constant market prices	3.4	4.1	3.1	-6.4	1.0	2.2
Agricultural sector (at factor cost)	(2.2)	(5.2)	(2.1)	(0.5)	(1.7)	(3.3)
Industrial sector (at factor cost)	(1.8)	(1.2)	(-1.0)	(-1.0)	(-2.0)	(7.3)
Services sector (at factor cost)	(4.4)	(4.1)	(3.9)	(-7.7)	(1.1)	(2.1)
			(In percent of GDP)			
Consumption	92.8	90.6	93.8	99.9	98.7	97.0
Gross domestic investment	13.3	13.4	17.0	8.2	11.3	11.9
Resource gap	6.1	4.0	10.7	7.9	9.8	8.9
Gross domestic savings	7.2	9.4	6.3	0.3	1.6	3.0
Current account balance	-5.7	-3.4	-8.4	-7.6	-6.9	-5.5
Price movements			(Annual percentage changes)			
GDP deflator	21.2	12.0	11.4	13.9	12.6	12.6
CPI (traditional basket)	26.3	9.0	11.8	8.5	15.3	13.2
Government finance			(In billions of Malagasy francs)			
Current revenue and grants	473.5	507.7	611.2	456.0	608.3	639.0
Current expenditure	350.9	399.8	418.9	480.2	658.6	807.5
Capital expenditure	237.3	388.2	365.2	325.4	462.3	527.9
Overall cash deficit (-)	-120.5	-166.1	-39.7	-251.3	-346.3	-357.4
Net foreign financing	134.6	185.2	97.2	190.7	151.5	153.2
Net domestic financing	-14.1	-19.1	-57.5	60.6	194.8	204.2
Of which: domestic banks (net)	(-21.7)	(-28.9)	(-58.5)	(51.3)	(139.3)	(152.0)
			(In percent of GDP)			
Overall cash deficit (-)	-3.5	-4.1	-0.9	-5.1	-6.2	-5.6
Money and credit (end of period)			(In billions of Malagasy francs)			
Foreign assets (net)	297.2	381.9	178.5	27.1	-398.3	276.2
Domestic credit	888.9	919.9	1,029.9	1,183.4	1,382.2	1,902.1
Claims on the Government (net)	(342.7)	(312.5)	(251.5)	(308.9)	(444.2)	(831.1)
Claims on the economy	(546.2)	(607.3)	(778.4)	(874.6)	(938.0)	(1,071.0)
Money and quasi-money	633.9	822.7	825.3	1,034.8	1,236.1	1,570.6
			(Annual changes in percent)			
Domestic credit	-0.3	3.5	12.0	14.9	16.8	37.6
Money and quasi-money	20.2	29.8	0.3	25.4	19.5	27.1

MADAGASCAR - Basic Data (concluded)

	1988	1989	1990	1991	1992 Est.	1993 Proj.
Balance of Payments			(In millions of SDRs)			
Exports, f.o.b.	208.1	250.6	234.8	235.6	207.1	213.8
Of which: coffee	(54.8)	(59.9)	(28.5)	(20.5)	(22.4)	(24.0)
Imports, f.o.b.	-232.9	-239.4	-417.5	-321.7	-333.6	-334.9
Trade balance	-24.8	11.3	-182.7	-86.1	-126.5	-121.1
Services (net)	-219.5	-235.8	-177.4	-194.0	-181.8	-175.1
Of which: interest payments	(-142.6)	(-160.9)	(-128.1)	(-126.9)	(-100.5)	(-89.0)
Unrequited transfers (net)	140.6	158.4	170.1	131.1	162.3	164.8
Current account balance	-103.7	-66.2	-190.1	-149.0	-146.0	-131.4
In percent of GDP	(-5.7)	(-3.4)	(-8.4)	(-7.6)	(-6.9)	(-5.5)
Capital account (net)	10.6	68.9	-18.5	-21.8	-51.4	-74.4
Of which: drawings	(147.5)	(149.6)	(110.3)	(131.8)	(88.2)	(88.9)
amortization	(-149.6)	(-167.2)	(-155.2)	(-148.9)	(-146.0)	(-171.1)
direct investment	(--)	(10.0)	(16.5)	(10.0)	(15.0)	(17.0)
Overall balance	-93.1	-135.1	-208.5	-170.8	-197.5	-205.8
Debt relief	157.5	182.6	131.4	47.8	2.6	3.7
IMF (net)	-21.7	-12.7	-21.9	-12.2	-11.5	-10.0
Arrears (reduction -)	-12.7	-21.2	-24.3	135.5	207.0	212.1
Reserves (increase -)	-29.9	-13.2	123.1	-0.3	-0.6	--
Financing gap	--	--	--	--	--	--
Central bank gross reserves	167.1	187.7	64.9	62.3	62.9	62.9
In weeks of imports	(30.8)	(33.6)	(7.1)	(8.6)	(8.3)	(8.3)
Outstanding external debt 1/	2,224.3	2,303.1	2,280.6	2,353.2	2,422.9	2,551.0
Exchange rates (period averages)						
Malagasy francs per SDR	1,891.0	2,055.2	2,027.2	2,511.1	2,625.2	...
Malagasy francs per U.S. dollar	1,407.1	1,603.4	1,494.1	1,835.4	1,864.0	...
Malagasy francs per French franc	236.2	251.3	274.4	325.3	352.1	...

1/ Including use of Fund credit.