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EBS/89/204

CONFIDENTIAL

October 25, 1989

To: Members of the Executive Board

From: The Acting Secretary

Subject: Madagascar - Staff Report for the 1989 Article IV Consultation and Midterm Review of the First Annual Arrangement Under the Enhanced Structural Adjustment Facility

Attached for consideration by the Executive Directors is the staff report for the 1989 Article IV consultation with Madagascar and the midterm review of the first annual arrangement under the enhanced structural adjustment facility for Madagascar. Draft decisions appear on pages 20 and 21. This subject is tentatively scheduled for discussion on Wednesday, November 22, 1989.

Mr. Carstens (ext. 8388) or Mr. Clément (ext. 6942) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

DEMOCRATIC REPUBLIC OF MADAGASCAR

Staff Report for the 1989 Article IV Consultation and Midterm Review of the First Annual Arrangement Under the Enhanced Structural Adjustment Facility

Prepared by the African Department

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

Approved by Mamoudou Touré and Anupam Basu

October 24, 1989

I. Introduction

On May 15, 1989 the Fund approved for Madagascar a three-year arrangement under the enhanced structural adjustment facility (ESAF), in support of an economic and financial program covering the period 1989-91, and the first annual arrangement thereunder, in support of the program for 1989 (EBS/89/80, 4/20/89). Total access under the ESAF arrangement, which replaced Madagascar's arrangements under the structural adjustment facility (SAF), amounts to the equivalent of SDR 76.9 million, or 115.8 percent of quota, with annual access equivalent to SDR 25.6 million, or 38.6 percent of quota, under each of the three annual arrangements. The first semiannual disbursement equivalent to SDR 12.8 million was effected on May 31, 1989, and the second semiannual disbursement of SDR 12.8 million will be available subject to compliance with end-June 1989 performance criteria and completion of the midterm review.

The discussions that formed the basis for the Article IV consultation and the midterm review of the first annual arrangement under the ESAF were held in Antananarivo between August 24 and September 10 with the newly appointed Government. 1/ As of end-September 1989,

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1/ The Malagasy representatives included Mr. Victor Rahamatra, Prime Minister; Mr. Léon Rajaobelina, Minister of Finance and Budget; Mr. Jean Robiarivony, Minister of Economy and Planning; Mr. Georges Solofoson, Minister of Commerce; Mr. Georges Ruphin, Minister of the Civil Service, Labor, and Social Conditions; Mr. Jean-Jacques Seraphin, Minister of Health; Mr. Lucien Zasy, Minister of Transport; Mr. Maxime Zafera, Minister of Animal Production; Mr. Vincent Radanielson, Minister of Industry, Energy, and Mines; Mr. Jean-Emile Tsaranazy, Minister of Public Works; Mr. José Andrianoelson, Minister of Agricultural Production; Mr. Badrhoudine, Minister of Population, Social Conditions, and Youth; Mr. Blandin Razafimanjato, Governor of the Central Bank; and

Madagascar's outstanding use of Fund resources was 181.8 percent of quota (Table 1). Upon expiration of the ESAF arrangements at end-December 1991, and assuming that all purchases and payments are made on schedule, Madagascar's outstanding use of resources would be 172.2 percent of quota, or 36.3 percent, excluding the SAF and ESAF.

Madagascar's program of structural and financial reforms is also being supported by the World Bank and other creditors and donors. Apart from project lending operations in the areas of agriculture, transportation, infrastructure, industry, and energy, the World Bank strategy in Madagascar is to support the Government's effort to rehabilitate and restructure the economy by providing financial and technical assistance for appropriate policy programs (Appendix II). A public sector adjustment credit (PSAC) for an amount equivalent to SDR 90.5 million, in support of reforms in public expenditure programming and in the public enterprise and financial sectors, as well as in support of continued market deregulation and export promotion, was declared effective on December 16, 1988. In addition, an Economic Management and Social Action Project (EMSAP) for an amount equivalent to SDR 17.1 million was declared effective by the World Bank on March 15, 1989. 1/ The objectives of the EMSAP are to initiate a program of emergency action for disadvantaged and vulnerable groups, reinforce the capacity of the Government to monitor social conditions, design social policies and programs, and facilitate the implementation of the adjustment program by strengthening key institutions. The Fund and the World Bank staffs have continued to collaborate closely on various aspects of Madagascar's structural adjustment efforts and financing requirements.

Madagascar is on the standard 12-month consultation cycle. The 1988 Article IV consultation with Madagascar was concluded on September 2, 1988. 2/ At that time, Directors pointed out the need for the authorities to take steps that would fully convince the private sector that the Malagasy economy was being changed from an administratively controlled to a market-oriented one. They observed that the opening of the banking system to the private and foreign sectors, the reform of the public sector, the liberalization of internal and external trade, the formulation of a three-year rolling investment program, the continuation of tax reform, and the pursuit of restrained demand management as well as of a flexible exchange rate policy were crucial elements

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1/ (Cont'd from p.1) other senior officials concerned with economic and financial matters. The staff team comprised Mr. Carstens (head), Mr. Clément, Ms. Le Gall, Mr. MacArthur (EP) (all AFR), Mr. Miranda (FAD), Mr. Delbecque (ETR), and Mrs. le Jeune (secretary-ADM). Mr. Schiller, the Fund's first resident representative in Madagascar, assisted the mission.

1/ The PSAC and the EMSAP are accompanied by cofinancing and coordinated financing by other multilateral and bilateral donors.

2/ The staff report for the 1988 Article IV consultation and request for stand-by arrangement (EBS/88/145) was considered by the Board on September 2, 1988.

Table 1. Madagascar: Fund Position During Period of ESAF Arrangement, 1989-91

	Outstanding on Sept. 30, 1989	1989	1990				1991			
		QIV	QI	QII	QIII	QIV	QI	QII	QIII	QIV
					(In millions of SDRs)					
Transactions under tranche policies (net)		-8.7	-6.3	-7.6	-6.2	-6.5	-6.0	-6.6	-4.1	-4.3
Purchases		--	--	--	--	--	--	--	--	--
Ordinary resources		--	--	--	--	--	--	--	--	--
Enlarged access resources		--	--	--	--	--	--	--	--	--
Repurchases		8.7	6.3	7.6	6.2	6.5	6.0	6.6	4.1	4.3
Ordinary resources		5.2	4.6	4.4	4.0	3.6	3.2	3.0	0.7	1.0
Enlarged access resources		3.6	1.7	3.2	2.2	2.9	2.7	3.5	3.4	3.3
Transactions under compensatory financing facilities (net)		-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	--	--
Purchases		--	--	--	--	--	--	--	--	--
Repurchases		2.0	2.0	2.0	2.0	2.0	2.0	2.0	--	--
Structural adjustment facility loans		--	--	--	--	--	--	--	--	--
Enhanced structural adjustment facility loans		12.8	12.8	--	--	12.8	12.8	--	--	12.8
Total Fund credit outstanding (end of period)	120.7	122.8	127.3	117.6	109.4	113.7	118.5	109.9	105.8	114.3
Under tranche policies	80.5	71.8	65.5	57.8	51.7	45.1	39.1	32.6	28.5	24.1
Of which: emergency assistance		(12.5)	(10.4)	(8.3)	(6.2)	(4.2)	(2.1)	(--)	(--)	(--)
Under compensatory financing facility	14.1	12.1	10.1	8.1	6.0	4.0	2.0	--	--	--
Under structural adjustment facility	13.3	13.3	13.3	13.3	13.3	13.3	13.3	13.3	13.3	13.3
Under enhanced structural adjustment facility	12.8	25.6	38.5	38.5	38.5	51.3	64.1	64.1	64.1	76.9
					(In percent of quota)					
Total Fund credit outstanding (end of period)	181.8	184.9	191.7	177.2	164.8	171.2	178.5	165.6	159.4	172.2
Under tranche policies	121.3	108.1	98.6	87.1	77.8	68.0	58.9	49.1	42.9	36.3
Of which: emergency assistance		(18.8)	(15.7)	(12.5)	(9.3)	(6.3)	(3.2)	(--)	(--)	(--)
Under compensatory financing facility	21.2	18.2	15.2	12.1	9.1	6.1	3.0	--	--	--
Under structural adjustment facility	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
Under enhanced structural adjustment facility	19.3	38.6	57.9	57.9	57.9	77.2	96.5	96.5	96.5	115.8
Memorandum items:										
Trust Fund loans outstanding (end of period)										
In millions of SDRs	3.0	3.0	1.6	1.6	0.1	0.1	--	--	--	--
In percent of quota	4.6	4.6	2.4	2.4	0.2	0.2	--	--	--	--

Source: IMF, Treasurer's Department.

of a medium-term adjustment strategy. These should enhance competitiveness of the economy and thus stimulate the resumption of adequate growth. These concerns have been addressed in the current ESAF program. Madagascar continues to avail itself of the transitional arrangements under Article XIV.

For the purposes of this report, the following appendices are attached: Madagascar's relations with the Fund (Appendix I), Madagascar's relations with the World Bank Group (Appendix II), statistical issues (Appendix III), basic data (Appendix IV), social indicators (Appendix V), and the letter of intent (Appendix VI).

II. Background and Medium-Term Policy Framework (1989-91)

1. Background

Recent economic and financial developments in Madagascar were summarized in the request for arrangements under the ESAF (EBS/89/80). In 1988, the Malagasy authorities implemented an adjustment program that moved Madagascar toward an open and market-oriented economy. This program, which was supported by a ten-month stand-by arrangement, 1/ represented a bridge between the first annual arrangement under the SAF and the current arrangement under the ESAF. It included far-reaching structural reforms in internal and external trade, the financial and public enterprise sectors, and public expenditure programming, and involved the continued implementation of a prudent demand management policy. The profound institutional and structural changes experienced by the Malagasy economy in the recent past are described in detail in the background paper on recent economic developments.

The comprehensive package of measures helped improve the structure of Madagascar's balance of payments in 1988, as illustrated by a greater diversity of both exports and imports. There were notable surges in nontraditional exports, tourism receipts, and imports of capital goods, raw materials, and spare parts. Despite these encouraging signs, real economic growth remained below 2 percent in 1988, reflecting the effects of a drought on agricultural production in late 1987 and early 1988, as well as a slowdown in industrial growth resulting in part from the initial impact of the ongoing restructuring of this sector (Table 2). The low growth in 1988 also reflected a further deterioration in the terms of trade by 8.0 percent after a fall of 22.4 percent in 1987. These decreases stemmed largely from the low world demand for Madagascar's traditional exports, particularly coffee, cloves, and vanilla. The inflation rate as measured by the GDP deflator reached 19.9 percent, compared with 20.3 percent in 1987. However, as measured by the price index of traditional consumer goods, the end-year 12-month inflation rate fell from 34.6 percent in 1987 to 9.6 percent in 1988.

1/ EBS/88/145.

Table 2. Madagascar: Selected Economic and Financial Indicators, 1985–92

	1985	1986	1987	1988	1989		1990	1991	1992
				Prov.	Prog. (EBS/89/80)	Est.	ESAF Projections (EBS/89/80)		
					(Annual percent changes)				
National income and prices									
GDP at constant prices	2.1	1.4	1.7	1.6	4.5	4.0	4.5	4.6	4.7
GDP deflator	11.1	15.3	20.3	19.9	12.0	11.5	11.0	10.0	9.0
External sector (on the basis of SDRs)									
Exports, f.o.b.	-15.6	2.3	-14.6	-11.7	13.1	7.9	14.6	14.7	12.5
Imports, c.i.f.	5.1	-13.1	-12.1	-2.7	15.0	4.9	24.8	3.9	8.2
Non-oil imports, c.i.f.	10.1	-5.5	-11.7	-6.7	17.9	9.0	26.7	3.1	8.2
Export volume 1/	-5.9	4.0	6.6	-3.6	15.2	23.2	13.8	13.5	11.1
Import volume (nonfood) 1/	9.3	1.9	-14.4	5.8	12.1	-0.2	23.9	0.3	4.5
Terms of trade (deterioration -)	-8.5	17.2	-22.4	-8.0	-4.2	-15.7	-3.0	-2.6	-2.2
Nominal effective exchange rate (depreciation -) 2/	-4.5	-10.9	-34.4	-23.5	2.2	...	...	...	...
Real effective exchange rate (depreciation -) 2/	-5.0	-5.6	-31.9	-13.2	-1.1	...	...	...	...
Central government financial operations 3/									
Total revenue and grants 3/	3.4	11.4	50.0	12.6	51.4	38.5	18.4	3.8	5.1
Total expenditure 3/	9.0	9.7	43.6	14.6	49.1	31.6	26.0	-1.4	-1.3
Money and credit									
Domestic credit	11.5	10.2	7.9	-0.3	6.3	6.3	...	...	...
Government	5.6	5.5	-3.1	-6.1	-7.6	-7.6	...	...	...
Nongovernment	17.5	14.5	17.2	3.8	15.0	15.0	...	...	...
Broad money (M_2)	12.6	24.0	17.6	20.2	15.2	14.5	16.0	15.1	14.1
Income velocity of broad money (M_2)	4.3	4.1	4.2	4.3	4.2	4.3	4.3	4.3	4.3
					(In percent of GDP)				
Overall fiscal deficit (-)	-4.6	-4.0	-4.4	-4.4	-4.9	-4.0	-6.8	-4.8	-2.9
Of which: domestic bank financing	(1.3)	(1.0)	(-0.5)	(-0.8)	(-0.8)	(-0.8)	(-0.3)	(-1.1)	(-1.6)
foreign financing (net)	(3.1)	(2.8)	(4.5)	(5.0)	(5.5)	(4.6)	(6.9)	(5.6)	(4.4)
Current fiscal surplus (+)	2.5	2.3	4.5	4.5	5.3	4.2	5.7	5.8	5.4
Capital fiscal deficit (-) 3/	...	...	...	...	-9.7	-8.0	-12.0	-10.2	-8.0
Gross domestic investment	14.0	13.8	14.9	16.2	17.4	16.8	20.3	17.3	15.4
Gross domestic savings	7.0	8.8	8.4	7.6	8.0	9.2	8.2	8.3	8.3
Current account deficit (-)	-10.9	-9.1	-12.4	-14.2	-15.7	-14.3	-16.9	-13.3	-10.4
Current account deficit (-) after official transfers	-8.3	-5.0	-7.5	-7.1	-8.7	-8.0	-9.2	-7.1	-5.0
External debt outstanding (including the Fund)	96.2	105.7	154.3	172.5	174.8	168.7	163.9	154.0	143.3
Of which: arrears	(3.4)	(3.0)	(3.6)	(3.0)	(1.4)	(1.4)	(—)	(—)	(—)
Nominal GDP in billions of FMG	1,553.4	1,817.1	2,225.1	2,709.1	3,101.7	3,142.6	3,597.8	4,139.6	4,724.3
Conversion rate FMG/SDR	672.7	793.4	1,382.6	1,891.0	...	...	...	...	...
					(In percent of exports of goods and services)				
Total debt service payments 4/	92.4	89.4	100.8	104.4	109.2	116.9	98.5	81.0	68.9
Total debt service payments after rescheduling	47.4	51.2	54.4	56.0	62.6	66.8	...	...	...
Total gross reserves 5/	7.1	16.9	24.5	28.8	24.5	23.0	23.6	21.8	19.8

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

1/ Calculation based on Paasche volume indices.
2/ Year average percentage changes. For 1989, the average percentage changes are from July 1988 to July 1989.
3/ Beginning in 1989, a new consolidation of the budget has been used, creating a discontinuity in total revenues, total expenditure and grants, and capital expenditures.
4/ Including the Fund and the net cash reduction in arrears.
5/ Central bank gross reserves in weeks of imports (c.i.f.) of the following year.

The real trade-weighted effective exchange rate, which depreciated by 31.9 percent in 1987, depreciated further by 13.2 percent in 1988, more than reversing the past appreciation (Chart 1). In nominal terms, it depreciated by 34.4 percent in 1987 and by 23.5 percent in 1988.

In view of the structural reforms undertaken, official creditors granted Madagascar a sixth rescheduling of its debt service due in 1988 and in 1989 under the auspices of the Paris Club. 1/ As one of the least developed countries, Madagascar has benefited from the Toronto initiative. Before debt rescheduling, Madagascar's debt service ratio reached 104.4 percent in 1988, but after debt rescheduling it was 56.0 percent. Taking account of the debt rescheduling, the overall balance of payments showed a surplus of SDR 64.3 million; and with the repayment of SDR 12.7 million of arrears, gross international reserves rose to the equivalent of about seven months' imports.

2. Medium-term policy framework for 1989-91

The authorities, in close consultation with the Fund and the World Bank staffs, have formulated a comprehensive three-year structural adjustment program covering the period January 1989-December 1991. 2/ The program aims at achieving an annual rate of economic growth higher than the population growth of 3.1 percent, while maintaining the substantial progress in financial stabilization made to date. Despite a continued deterioration in the terms of trade, the liberalization of imports and the implementation of a three-year rolling public investment program (PIP), Madagascar's external current account deficit, including official transfers, is expected initially to increase as a ratio to GDP in 1989-90 and decline substantially during 1991-92. The external financing gap--including the proposed use of ESAF resources, the maintenance of an adequate level of international reserves, and the elimination of all remaining external payments arrears by end-1990--will decline sharply (Table 3). The debt service ratio before debt relief will remain at high levels, but will decrease steadily from 1989 onward. Through a combination of revenue and expenditure measures, the overall fiscal deficit on a cash basis will be contained at a level consistent with the financing needs and domestic resource requirements of an expanding private sector; this will be achieved without the accumulation of domestic payments arrears. A prudent monetary policy will be pursued to attain these objectives while reducing the inflation rate, as measured by the GDP deflator, to less than 10 percent.

1/ See "Madagascar--Report on External Debt Renegotiation," (SM/88/278) and Paris Club extension of the consolidation period through end-December 1989.

2/ This program is described in detail in the policy framework paper (PFP), 1989-91 (EBD/89/113), for which a summary and a time frame can be found in Appendix II.

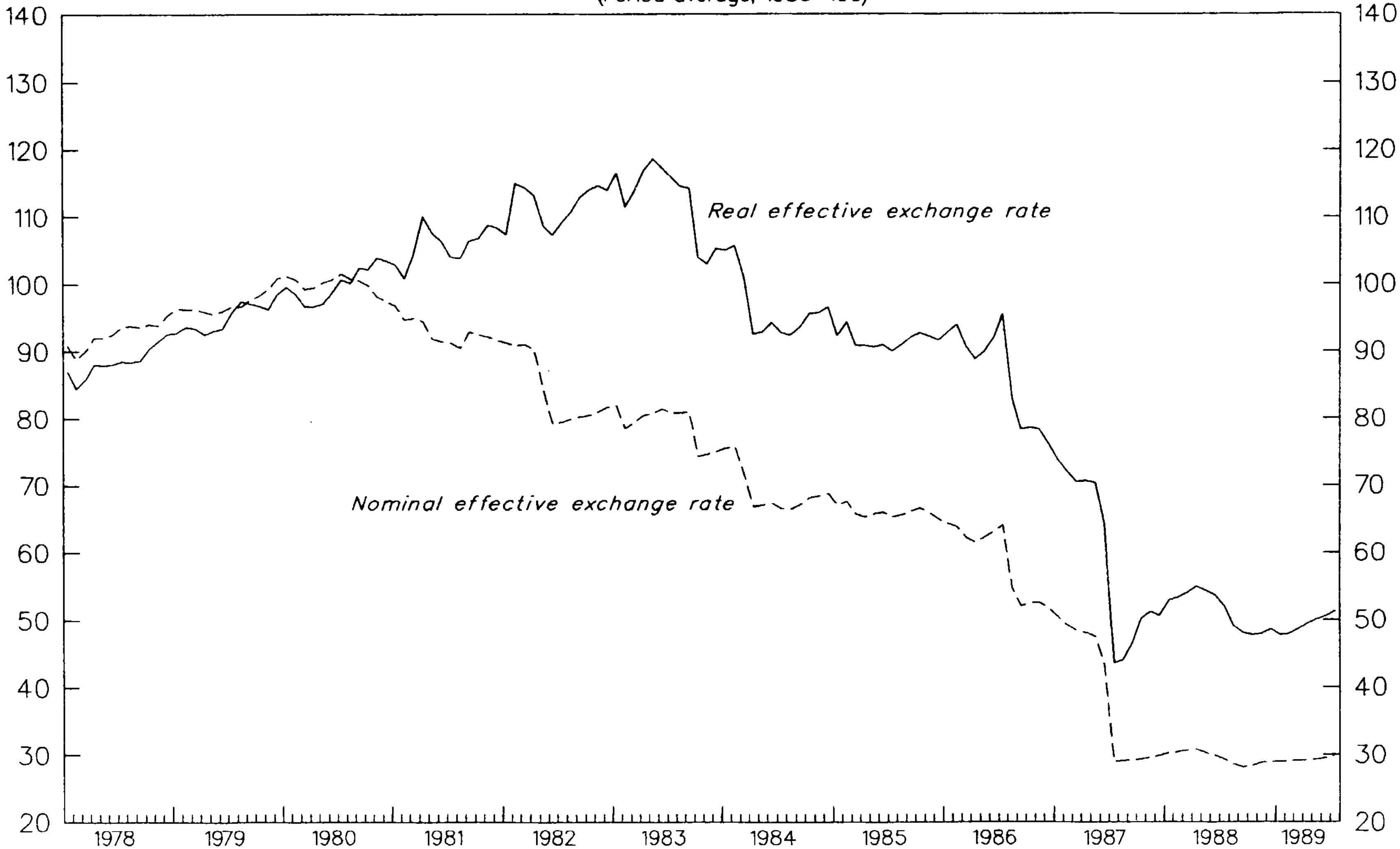
CHART 1

MADAGASCAR

NOMINAL AND REAL TRADE-WEIGHTED EFFECTIVE EXCHANGE RATES [1]

JANUARY 1978-JULY 1989

(Period average; 1980=100)



Sources: Data provided by the Malagasy authorities; and Information Notice System.

[1] A decline in the indices reflects a depreciation.

Table 3. Madagascar: Balance of Payments, 1985-92

(In millions of SDRs)

	1985	1986	1987	1988	1989		1990	1991	1992
				Prov.	Prog. (EBS/89/80)	Est.	ESAF Projections 1/ (EBS/89/80)		
Exports, f.o.b.	274.5	280.7	239.6	211.7	239.4	228.4	274.4	314.9	354.2
Of which: traditional exports 2/	(179.1)	(199.7)	(145.5)	(101.6)	(108.3)	(107.7)	(116.9)	(130.4)	(130.4)
Imports, f.o.b.	-329.6	-282.2	-243.7	-237.1	-272.7	-248.8	-340.2	-353.3	-382.5
Trade balance	-55.1	-1.5	-4.1	-25.4	-33.3	-20.4	-65.8	-38.5	-28.2
Service receipts	62.0	68.5	81.4	98.0	105.6	97.8	120.6	135.0	161.9
Service payments	-296.0	-311.7	-317.4	-320.3	-356.3	-343.7	-392.1	-403.8	-413.7
Freight and insurance	(-46.1)	(-46.9)	(-45.1)	(-44.0)	(-50.4)	(-46.0)	(-62.9)	(-65.4)	(-70.7)
Transport and travel	(-68.9)	(-72.6)	(-67.3)	(-69.7)	(-71.4)	(-62.4)	(-78.1)	(-82.0)	(-86.0)
Investment income	(-131.2)	(-136.3)	(-142.1)	(-134.0)	(-152.7)	(-161.8)	(-148.3)	(-152.3)	(-146.2)
Other	(-49.8)	(-55.9)	(-62.9)	(-72.6)	(-81.7)	(-73.5)	(-102.7)	(-104.1)	(-110.7)
Services (net)	-234.0	-243.2	-236.0	-222.3	-250.7	-245.8	-271.5	-268.7	-251.8
Of which: interest payments 3/	(-129.7)	(-135.1)	(-141.4)	(-133.5)	(-152.0)	(-161.3)	(-147.9)	(-157.7)	(-145.4)
Private unrequited transfers (net)	37.4	36.1	40.4	44.6	47.9	48.9	52.7	58.0	63.8
Current account balance, excluding net official transfers	-251.7	-208.7	-199.7	-203.1	-236.1	-217.4	-284.6	-249.2	-216.2
Public unrequited transfers (net)	59.4	93.6	78.8	101.1	106.0	95.3	130.0	116.6	111.9
Current account balance, including net official transfers	-192.3	-115.1	-120.9	-102.0	-130.1	-122.1	-154.6	-132.6	-104.3
Nonmonetary capital (net)	163.5	181.1	192.3	141.2	185.9	148.8	36.7	43.5	40.6
Drawings	143.4	163.9	173.6	147.5	202.6	165.1	222.5	232.0	240.0
Amortization 4/	-147.0	-132.9	-157.4	-149.6	-166.0	-168.3	-185.8	-188.5	-199.4
Debt relief already obtained	151.7	159.5	171.4	157.5	160.8	163.5	—	—	—
Official creditors 5/	(137.9)	(159.5)	(165.6)	(157.5)	(160.8)	(163.5)	(—)	(—)	(—)
Of which: cancellation	(—)	(—)	(—)	(15.2)	(18.9)	(19.1)	(—)	(—)	(—)
Commercial banks 6/	(13.8)	(—)	(5.9)	(—)	(—)	(—)	(—)	(—)	(—)
Petroleum financing	15.4	-9.4	4.7	-14.2	-11.5	-11.5	—	—	—
Drawing	(37.9)	(23.2)	(26.5)	(11.5)	(—)	(—)	(—)	(—)	(—)
Amortization	(-22.5)	(-32.6)	(-21.8)	(-25.7)	(-11.5)	(-11.5)	(—)	(—)	(—)
National banks (net)	1.0	5.9	-7.1	-0.8	—	—	—	—	—
Direct investment	—	—	—	—	5.0	5.0	10.0	15.0	20.0
Other 7/	20.0	-6.9	-0.7	25.9	—	—	—	—	—
Overall balance	-7.8	65.0	63.6	64.3	60.9	31.7	-107.9	-74.1	-43.7
Financing	7.8	-65.0	-63.6	-64.3	-60.9	-31.7	107.9	74.1	43.7
IMF (net)	-3.4	3.4	6.8	-21.7	-12.7	-12.7	-9.1	0.6	-11.5
Purchases	(29.0)	(44.2)	(20.0)	(7.8)	(—)	(—)	(—)	(—)	(—)
Repurchases	(-32.4)	(-40.8)	(-26.5)	(-29.5)	(-38.3)	(-38.3)	(-34.7)	(-25.0)	(-11.5)
SAF and ESAF loans (net)	(—)	(—)	(13.3)	(—)	(25.6)	(25.6)	(25.6)	(25.6)	(—)
Net cash change in arrears (decrease -)	-8.3	-8.7	-10.4	-12.7	-21.0	-21.0	-21.5	—	—
Net central bank reserves; excluding IMF (increase -)	19.5	-59.8	-60.0	-29.9	-27.2	2.0	—	—	—
Financing gap	—	—	—	—	—	—	138.5	73.5	55.2
Memorandum items:									
Current account deficit (excluding public transfers)/GDP 8/									
Before debt relief	-10.9	-9.1	-12.4	-14.2	-15.7	-14.3	-16.9	-13.3	-10.4
After debt relief 9/	-8.3	-6.7	-9.9	-10.5	-12.3	-10.7	...	...	...
Current account deficit (including public transfers)/GDP 8/									
Before debt relief	-8.3	-5.0	-7.5	-7.1	-8.7	-8.0	-9.2	-7.1	-5.0
After debt relief 9/	-5.7	-2.6	-5.0	-3.4	-5.2	-4.5	...	...	...
Outstanding arrears	77.4	68.7	57.8	42.5	21.5	21.5	—	—	—

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

1/ Baseline scenario.
2/ Coffee, vanilla, and cloves.
3/ Including moratorium interest rate.
4/ Before the current year's debt rescheduling.
5/ Includes rescheduling through 1989 with Paris Club and other official creditors.
6/ Includes small amount of debt relief from private creditors other than commercial banks. In December 1985 commercial banks rephased amortization payments on rescheduled debt through 1992. In June 1987, these amortization payments were again rephased through 1996.
7/ Includes valuation adjustment; short-term capital other than petroleum financing; and errors and omissions.
8/ The high current account/GDP ratio in some years reflects, in part, the impact of the depreciation of the exchange rate of the Malagasy franc on GDP expressed in SDRs in those years.
9/ Includes impact of reschedulings through the current year.

The program builds upon the substantial progress already achieved in decontrolling the economy while emphasizing the continuation of a flexible exchange rate policy, and prudent demand management and external debt policies. Profound reforms are being put in place in the public enterprise and financial sectors. In formulating policy, social and environmental issues are being addressed. The program also includes the publication of a new liberalized investment code and free trade zone

III. Report on Discussions

The discussions covered overall economic and financial developments over the six-month period ended June 1989 and prospects for the remainder of 1989. Although the focus was primarily on the likely impact of the downward revisions of coffee export prices and of PIP-related capital expenditure, considerable attention was also devoted to the implementation of structural policies.

1. Overview

A detailed statement of the outcome of the discussions is contained in the appended letter from the Malagasy authorities (Appendix VI). In brief, during the first half of 1989, additional progress was made in transforming the economy into an open, market-oriented one, while strict demand management was maintained. All benchmarks at end-March 1989 and all performance criteria at end-June 1989 were met (Table 4). The structural benchmarks at end-June 1989 and for the midterm review were met, with the exception of delays in the full implementation of the second phase of the three-year program for the reform of public enterprises and in the completion of the census of central government personnel. By contrast, a new investment code and the legislation setting up free zones will be published before the end of the year, and the drafting of the new mining code is well under way.

In the context of the medium-term macroeconomic framework for 1989-91, the main objectives for 1989 are an acceleration of economic growth from 1.6 percent in 1988 to 4.5 percent in 1989, and a slowdown in the rate of inflation, as measured by the GDP deflator, from 19.9 percent to 12.0 percent (Table 2). With the substantial progress made since 1988 in structural adjustment, Madagascar is expected for the first time since the early 1970s to register positive per capita real growth, despite a sharp deterioration in its terms of trade for the third consecutive year. The Malagasy authorities reported that a decisive change in the economic environment was noticeable, with the number of exporters and tourists increasing. They also cited the creation of new enterprises as another important indicator of the upturn; newly registered enterprises, which averaged 5 in 1985-86, increased sharply to 53 in 1988, and by another 30 during the first eight months of 1989. The Malagasy authorities expected that their number would increase further with the enactment of a new investment code and free trade zone legislation. The liberalization of internal and external trade, a good agricultural crop, and the pursuit of a

Table 4. Madagascar: Performance Criteria and Benchmarks for the First Annual Arrangement Under the Enhanced Structural Adjustment Facility

	Dec. 1988 Actual	From Jan. 1 to March 31, 1989 1/ Prog.	Act.	From Jan. 1 to June 30, 1989 2/ Prog.	Act.	From Jan. 1 to Sept. 30, 1989 1/ Prog.	From Jan. 1 to Dec. 31, 1989 1/ Prog.
Quantitative performance criteria and benchmarks		(In millions of Malagasy francs)					
Total domestic credit 3/	888.9	17.0	6.7	42.6	21.9	68.7	55.9
Net credit to Government 3/	328.1	2.0	1.2	10.4	10.1	-6.3	-25.9
Credit to public enterprises	215.3	4.7	0.3	16.7	-12.0	22.7	24.7
Credit to class "D" public enterprises	--	--	--	--	--		
		(In millions of SDRs)					
External payments arrears	42.5	-3.0	-3.8	-9.0	-11.1	-13.0	-21.0
External debt maturity between 1-5 years 4/		5.0	--	5.0	--	5.0	5.0
External debt maturity between 5-15 years 4/		15.0	--	15.0	--	15.0	15.0
Short-term external debt 5/		55.0	20.0	55.0	21.0	55.0	55.0

Structural performance criterion	Target date	Status
Complete clearing of the BTM and BFV portfolios with private sector agreement to 25 percent participation in the equity capital of at least one of the two banks	End-June 1989	Observed
Structural benchmarks	**Target date**	**Status**
Elimination of all controls on profit margins	End-March 1989	Observed
Implementation of the second stage of the three-year public enterprise reform program	End-June 1989	Being implemented
Drafting of a list of at least 20 enterprises for liquidation, privatization, or reorganization	Midterm review	Being implemented
Reduction of the number of prohibited customs nomenclatures	End-June 1989	Observed
Completion of census of central government personnel	Midterm review	Being implemented
Privatization of the BNI	End-December 1989	
Abolition of the FNUP	End-December 1989	

Source: Memorandum on economic and financial policies of the Government of Madagascar for the period from January 1 to December 31, 1989, attached to the letter of request from the Malagasy authorities of March 3, 1989.

1/ Quantitative benchmarks.
2/ Performance criterion.
3/ If the amount of financial assistance and grants received exceeds the FMG 31 billion programmed through end-March 1989, the FMG 63 billion programmed through end-June 1989, the FMG 95.1 billion programmed through end-September 1989, and the FMG 131.5 billion programmed through end-December 1989, the ceilings for total domestic credit and net credit to Government will be adjusted downward by as much. These ceilings will also be adjusted if the net amount of treasury bills (LOVA included) subscribed by the nonbanking system exceeds the FMG 1.6 billion programmed through end-March 1989, the FMG 3.5 billion programmed through end-June 1989, the FMG 5.5 billion programmed through end-September 1989, and the FMG 7.5 billion programmed through end-December 1989.
4/ Accumulated annual amount of external debts contracted, guaranteed, or authorized by the Government and/or the Central Bank on nonconcessional terms.
5/ Outstanding short-term external debt.

prudent demand management policy should result in the lowest inflation rate recorded in the 1980s. The inflation rate, as measured by the GDP deflator, is now estimated at 11.5 percent; the traditional consumer price index rose by 6.9 percent in the first half of 1989 compared with the corresponding period of 1988, which should result in an inflation rate of 8.7 percent in 1989, compared with the 9.5 percent programmed and 26.3 percent rate recorded in 1988. This lower rate of inflation, together with a continued depreciation in foreign currency terms, succeeded in keeping the real effective exchange rate at levels that at least maintained the gains in competitiveness of the Malagasy economy, which resulted from the sharp accumulated depreciation in the last two years.

2. Financial policies

Concerning budgetary developments during the first six months of 1989, current revenues and grants were FMG 13.6 billion below the programmed level at end-June 1989, but this shortfall was substantially compensated by lower-than-programmed current and capital expenditures. The Malagasy authorities emphasized that unexpectedly low trade-related taxes accounted for most of the revenue shortfall, with the shortfall in taxes on imports amounting to nearly FMG 11.7 billion. They added that current expenditures were FMG 9.8 billion below target, reflecting in part the introduction of a new procurement system in early 1989. Capital expenditures were also below programmed levels, with PIP-related expenditures amounting to FMG 176.7 billion against the targeted FMG 209.0 billion. At end-June 1989, the overall cash deficit reached FMG 89.4 billion compared with FMG 92.1 billion programmed, while net credit to the Government reached FMG 9.0 billion, instead of the targeted FMG 10.4 billion.

For the year as a whole, total budgetary revenues are expected to be lower than programmed (Table 5). However, since capital expenditure is also expected to be lower, the overall budget deficit on a cash basis is now projected at FMG 126.3 billion (4.0 percent of GDP) compared with FMG 152.0 billion programmed (4.9 percent of GDP). Taking into account foreign financing, the Government is expected to achieve the programmed net repayment to the banking system of FMG 25.9 billion.

The downward revision in revenues is explained primarily by a FMG 28.0 billion shortfall in export taxes, 1/ reflecting lower unit prices for traditional exports--especially for coffee, following the collapse of the International Coffee Organization (ICO) agreement in July 1989. Moreover, import tax receipts are estimated to be FMG 17.6 billion lower than programmed. The Malagasy authorities emphasized that this shortfall reflected a shift in the composition of imports toward goods with relatively lower duty rates; a lower level of imports as a result of lower PIP implementation; and underinvoicing of

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1/ Including those collected under the Stabilization Fund (FNUP).

Table 5. Madagascar: Government Financial Operations, 1985-92

	1985	1986	1987	1988	1989 Prog. (EBS/89/80)	1989 Est.	1990 ESAF Projections 1/ (EBS/89/80)	1991	1992
	(In billions of Malagasy francs)								
Current revenue and current grants	251.7	280.4	420.7	473.5	548.8	516.0	635.7	714.2	776.2
Budgetary revenue	194.9	210.9	308.5	369.1	442.4	426.0	522.1	588.3	648.8
Tax revenue	190.1	205.3	300.7	360.5	425.5	393.8	510.5	574.9	633.6
Nontax revenue	4.8	5.6	7.8	8.6	16.9	32.2	11.6	13.4	15.3
Extrabudgetary 2/	49.6	54.5	93.6	79.9	74.9	58.5	86.4	97.8	98.3
Current grants	7.2	15.0	18.6	24.6	31.5	31.5	27.2	28.2	29.1
Current expenditure 3/	212.6	237.7	321.5	350.8	385.3	383.6	432.1	475.5	520.1
Budgetary	196.3	215.9	281.3	325.5	371.1	364.1	411.6	454.4	498.5
Personnel	109.0	116.6	141.3	165.9	182.2	179.7	198.8	215.0	230.3
Other goods and services	39.8	35.7	46.0	47.9	55.3	53.0	64.5	75.2	86.8
Interest	27.5	34.5	56.5	71.9	81.4	81.4	90.4	100.5	111.8
Foreign 4/	22.1	26.5	46.8	60.9	67.9	67.9	75.7	84.4	94.1
Domestic	5.4	8.0	9.7	11.0	13.5	13.5	14.7	16.1	17.7
Transfers and subsidies 5/	20.0	29.1	37.5	39.8	52.2	50.0	57.9	63.7	69.5
Extrabudgetary	16.3	16.5	18.1	20.4	14.2	19.5	20.5	21.1	21.6
FNUP 6/	13.0	12.8	15.7	14.6	10.7	15.0	15.1	16.5	17.4
Other 7/	3.3	3.7	2.4	5.8	3.5	4.5	5.4	4.6	4.2
Additional expenditure 8/	—	5.3	22.1	5.0	—	--	--	--	—
Balance--current	39.1	42.7	99.2	122.7	163.5	132.4	203.5	238.7	256.1
Capital receipts	...	...	...	...	168.4	139.8	213.6	167.4	150.7
Receipts of capital grants	...	...	...	...	139.7	112.0	182.9	145.4	130.9
Self-finance and other 9/	...	...	...	...	28.7	27.8	30.7	22.0	19.8
Capital expenditure 3/	112.9	119.5	191.6	237.3	470.7	390.2	646.7	588.5	529.7
Budgetary	64.7	67.6	118.3	141.1	167.5	136.0	249.1	229.8	206.8
Foreign-financed	25.8	32.0	69.2	81.6	95.1	75.0	148.2	126.7	114.0
Domestic-financed	38.9	35.6	49.1	59.5	72.4	61.0	100.9	103.1	92.8
Extrabudgetary	17.2	16.6	21.8	27.5	40.6	33.4	62.9	57.8	52.0
FNUP	1.1	2.9	2.8	2.2	3.0	3.0	4.6	8.1	7.3
Other 10/	16.1	13.7	19.0	25.3	37.6	30.4	58.3	49.7	44.7
Capital grants	...	...	...	...	139.7	112.0	182.9	145.4	130.9
Self-finance 8/	...	...	...	...	28.4	24.0	30.2	21.2	19.1
On-lending 11/	31.0	35.3	51.5	68.7	90.6	81.0	115.8	123.9	111.5
Other 12/	...	...	...	...	3.9	3.8	5.8	10.4	9.4
Balance--capital	-112.9	-119.5	-191.6	-237.3	-302.3	-250.4	-433.1	-421.1	-379.0
Deficit on commitment basis	-73.8	-76.8	-92.4	-114.6	-138.8	-118.0	-229.6	-182.4	-122.9
Commitments w/o payment orders	--	2.7	3.4	—	--	--	--	--	--
Deficit on payment order basis	-73.8	-74.1	-89.0	-114.6	-138.8	-118.0	-229.6	-182.4	-122.9
Payment delays (net) 13/	-1.7	-1.4	--	-0.4	13.2	8.3	16.6	16.4	16.2
Arrears (net accumulation -)	--	—	7.8	6.3	--	--	--	--	--
Deficit on cash basis	-72.1	-72.7	-96.8	-120.5	-152.0	-126.3	-246.2	-198.8	-139.1
Financing	72.1	72.7	96.8	120.5	152.0	126.3	246.2	198.8	139.1
Foreign (net)	48.0	51.4	100.0	134.6	170.4	144.7	247.0	232.4	205.6
Drawings	92.8	101.4	180.5	245.3	285.7	256.0	367.1	357.5	335.9
Of which: program loans	(36.0)	(34.1)	(59.8)	(95.0)	(100.0)	(100.0)	(103.1)	(106.9)	(110.4)
Amortization	-44.8	-50.0	-80.5	-110.7	-115.3	-111.3	-120.1	-125.1	-130.3
Domestic	24.1	21.3	-3.2	-14.1	-18.4	-18.4	-0.8	-33.7	-66.5
Banking system	20.9	17.8	-10.7	-21.7	-25.9	-25.9	-9.5	-43.7	-77.9
Nonbank	3.2	3.5	7.5	7.6	7.5	7.5	8.7	10.0	11.4
Memorandum items:	(As percent of GDP)								
Total expenditure 14/	21.0	19.7	23.1	21.7	27.6	24.6	30.0	25.7	22.2
Total revenue	16.2	15.4	18.9	17.5	23.1	20.9	23.6	21.3	19.6
Cash deficit	-4.6	-4.0	-4.4	-4.4	-4.9	-4.0	-6.8	-4.8	-2.9
Current account surplus	2.5	2.3	4.5	4.5	5.3	4.2	5.7	5.8	5.4
Capital account deficit	-7.3	-6.6	-8.6	-8.8	-9.7	-8.0	-12.0	-10.2	-8.0

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

1/ Baseline scenario.

2/ Mainly Stabilization Fund (FNUP). Also includes the net position of other treasury operations and that of the rice import account held at the Central Bank, when positive.

3/ On a payment order basis, except for 1986 and 1987, which are reported on a commitment basis. Capital expenditure is reported on a cash basis except for the domestic-financed component, which is available on a payment order basis. Extrabudgetary expenditures, both current and capital, are reported on a cash basis.

4/ On a contractual basis.

5/ Scholarships, grants to public entities, and revenue-sharing with local governments.

6/ While FNUP receipts will be consolidated as export taxes starting with the 1990 budget, they are shown separately in this table for comparison purposes.

7/ Includes net position of other treasury operations and that of the rice import account held at the Central Bank, when negative. Beginning in 1989, with the consolidation of the PIP, also includes a small amount of counterpart funds used for current extrabudgetary expenditures.

8/ Expenditure for repairing cyclone damage and/or rehabilitating public enterprises. In 1988, it includes the partial write-off of doubtful and litigious loans of the commercial banks to public enterprises, expenditures associated with the rehabilitation of certain public enterprises, and severance pay and wages due to employees in affected enterprises.

9/ Beginning in 1989, includes the component of the PIP self-financed by public enterprises.

10/ Financed through proceeds of foreign assistance-in-kind and financial aid.

11/ Financed through external loans.

12/ Locally financed capital expenditure under the PIP.

13/ Payment delays refer to the settlement during the complementary period of payments orders issued in the previous fiscal year. Payments made beyond this period are considered as arrears.

14/ Excluding payment delays and arrears settlement.

imports, notably garments. However, the Malagasy authorities noted that in response to this situation and to strengthen customs administration, a Fund technical assistance mission was to visit Antananarivo in October 1989 at their request. Furthermore, they indicated that several recommendations of recent technical missions in the area of tax reforms would be implemented in the 1990 budget, and in particular, all FNUP receipts would be included in the budget as a single tax on coffee and cloves.

On the expenditure side and as envisaged in the last letter of intent of March 1989, the PIP-related expenditures for 1989 have been revised downward on the basis of the end-June 1989 actual data, from FMG 470.7 billion to FMG 390.2 billion. The authorities noted that a World Bank mission was to visit Antananarivo in October 1989 to help them improve the monitoring of the PIP and to refine the estimates of the PIP-related expenditure for the period 1989-92. In addition, the Malagasy authorities expressed their intention to monitor current expenditures strictly; as regards the census of central government personnel, a methodology had been defined and it was expected that the final results would be ready before end-March 1990. Moreover, in accordance with the recommendations of a Fund technical assistance mission, the authorities stated their intention to present the financial operations of the Central Government on a commitment, payment-order, and cash basis beginning in 1990, thus preventing the emergence of domestic arrears at a time when spending priorities were being reordered. On the basis of the inventory carried out at end-March 1989, it was reported that the stock of domestic arrears recorded had been cleared. The authorities were undertaking the verification of the completeness of this inventory before end-November 1989.

On the external side, despite the sharp deterioration of the terms of trade for the third year in a row (16 percent in 1989, compared with an envisaged deterioration of 4 percent), it is expected that the external program targets will be achieved (Table 3). Thus, despite the sharp decrease in the unit prices of traditional exports, the value of total exports is expected to increase by 8 percent (13.1 percent programmed) on account of a sharp increase in volume of traditional exports and a good performance of nontraditional exports. Imports are expected to be lower than programmed, reflecting primarily a lower implementation of the PIP and the improved management of stocks by enterprises, which is attributable to the full liberalization of the external sector. Furthermore, a sharp increase in tourism receipts is expected. Reflecting these developments, the external current account deficit, excluding official grants, is now estimated to reach 14.3 percent of GDP compared with 15.7 percent programmed. However, with lower grants and capital inflows as a result of lower PIP expenditures, the overall balance of payments is now estimated to show a surplus of SDR 31.7 million instead of the original target of SDR 60.9 million. Taking into account the envisaged repayment of arrears of SDR 21.0 million and the net repayments to the Fund of SDR 12.7 million, net international reserves are expected to decline by SDR 2.0 million compared with a programmed increase of SDR 27.2 million. Total gross reserves are estimated to reach the equivalent of 23 weeks of imports, against the targeted 24.5 weeks.

The authorities have continued to pursue a prudent external public debt management policy and all the ceilings established for end-June 1989 were amply respected. Moreover, the authorities have concluded three debt swap operations in 1989: (a) in June 1989, a "debt-for-health" swap with three different associations 1/ for an amount of about US$681,000; the proceeds from which will, among other things, help finance priority programs; (b) in July 1989, a debt-equity swap with the Banque Nationale de Paris Internationale (BNPI) and the Société Financière d'Outre-Mer (SFOI) for an amount of US$620,000, the proceeds from which have been used to finance the capital of the Banque Malgache de l'Océan Indien (BMOI); and (c) in August 1989, the first "debt-for-nature" swap in Africa with the World Wildlife Fund (WWF) for an amount of US$3 million, the proceeds from which will be used to finance conservation programs. Finally, the authorities will make their best efforts to conclude as quickly as possible the bilateral agreements with official creditors pursuant to Paris Club agreements, for which the deadline was August 30, 1989. The Malagasy authorities will resume discussions with the London Club with a view to obtaining further alleviation of Madagascar's debt to the banks. 2/

Monetary policy remained prudent in the first half of 1989 and growth of total domestic credit was FMG 20.9 billion, against FMG 42.6 billion programmed for end-June 1989. The Malagasy authorities noted that these developments were mainly explained by lower-than-programmed credit to the public enterprises that were being restructured and by the cautious approach of the commercial banks with regard to extending credit at a time when their portfolios were being restructured. The June 1989 subceilings on net credit to the Government, gross credit to the public enterprises, and new credits to high-risk ("D") enterprises were also observed. Taking into account the downward revision of the overall surplus of balance of payments, the money supply is now estimated to increase by 14.5 percent, compared with the 15.2 percent programmed and an increase in nominal GDP of 16.0 percent (Table 6). The authorities observed that by continuing to pursue a stringent budget management policy during the second half of the year, they expected to reach the credit objectives for the entire year.

1/ Médecins sans frontières, Comité catholique contre la faim, and Comité catholique pour le développement. These operations are of an ad hoc nature and are not governed by general regulations on debt conversion operations.

2/ The possible rescheduling of debt service falling due in 1990 will be addressed in the context of the second annual arrangement under the ESAF.

Table 6. Madagascar: Monetary Survey, 1985-89 1/

	1985	1986	1987	1988	1989 Prog. (EBS/89/80)	1989 Est.
	(In billions of Malagasy francs; end of period)					
Total domestic credit	749.6	825.9	891.2	888.9	944.8	944.8
Credit to Government, net 2/	357.3	376.8	365.0	342.7	316.8	316.8
Central Bank	370.7	394.1	400.8	375.5		
National banks	-28.1	-33.8	-51.0	-47.4		
Treasury	14.7	16.5	15.2	14.5		
Credit to the private sector and state enterprises	392.3	449.1	526.2	546.2	628.0	628.0
Central Bank	32.4	29.7	32.7	26.7		
National banks	355.3	415.9	487.6	512.7		
Treasury	4.6	3.5	5.9	6.8		
Of which: credit to state enterprises	(...)	(215.0)	(228.4)	(215.1)	(239.8)	(239.8)
Broad money	361.6	448.3	527.4	633.9	730.0	725.7
Money supply	252.7	304.1	386.6	469.6		
Currency	96.2	113.2	140.3	171.2		
Demand deposits	156.5	190.8	246.3	298.4		
National banks	142.3	176.3	231.5	283.7		
Post Office and Treasury	14.2	14.5	14.8	14.7		
Quasi-money	108.9	144.2	140.8	164.3		
National banks	96.2	129.9	121.7	141.6		
National Savings Fund	5.1	5.5	6.2	6.7		
Other	7.6	8.9	12.8	16.1		
External position 3/	645.7	824.3	1,478.9	1,685.6	1,737.1	1,835.4
Net foreign liabilities	74.4	27.9	-137.6	-297.2	-423.0	-324.7
Central Bank, net	94.6	49.6	-83.9	-232.9		
National banks, net	-20.2	-21.7	-53.7	-64.3		
Long-term foreign liabilities	571.3	796.4	1,616.6	1,982.8	2,160.1	2,160.1
Central Bank	563.2	790.7	1,609.3	1,978.9		
Of which: rescheduling agreements	(511.6)	(762.1)	(1,550.0)	(1,920.1)		
National banks Long-term borrowing	8.1	5.7	7.3	4.9		
Other items, net	-257.6	-446.8	-1,115.2	-1,430.8	-1,522.3	-1,616.3
Of which: valuation adjustment	(-220.1)	(-405.6)	(-1,058.7)	(-1,286.3)		
Memorandum items:	(Twelve-month rate of change, in percent)					
Total domestic credit	11.5	10.2	7.9	-0.3	6.3	6.3
Credit to Government, net	5.6	5.5	-3.1	-6.1	-7.5	-7.5
Credit to the private sector and state enterprises	17.5	14.5	17.2	3.8	15.0	15.0
Credit to state enterprises	...	...	6.2	-5.8	11.5	11.5
Broad money	12.6	24.0	17.7	20.2	15.2	14.5
	(In percent of broad money)					
Money	69.9	67.8	73.3	74.1		
Currency	26.6	25.3	26.6	27.0		
Demand deposits	43.3	42.6	46.7	47.1		
National banks	(39.3)	(39.3)	(43.9)	(44.8)		
Post Office and Treasury	(3.9)	(3.2)	(2.8)	(2.3)		
Quasi-money	30.1	32.2	26.7	25.9		
National banks	26.6	29.0	23.1	22.3		
National Savings Fund	1.4	1.2	1.2	1.1		
Other	2.1	2.0	2.4	2.5		

Sources: Central Bank of Madagascar; and staff estimates.

1/ Totals may not add up because of rounding errors.
2/ Differs from the definition of net credit to Government for performance criteria purposes, as the latter excludes deposits at the Treasury by the National Savings Bank and the postal checking system.
3/ The breakdown of the series "external position" has been revised from 1985 onward. The revision comprises a reclassification of the Central Bank's foreign liabilities from short-term to long-term.

3. Structural policies

As envisaged in the program, the portfolios of the National Bank for Rural Development (BTM) and of the National Bank for Commerce (BFV) have been restructured, and the BFV has signed a protocol of agreement with a foreign bank, whereby the foreign bank would acquire a 25 percent participation in the capital of the BFV. A plan for restructuring the National Bank for Industry (BNI) has been outlined with assistance from a foreign consultancy firm and will be implemented before end-1989. Finally, the Banque Malgache de l'Océan Indien (BMOI), a wholly owned private subsidiary of a European group, opened for business in August 1989.

The staff noted that some delay had occurred in the completion of the second phase of the reform program for public enterprises. The Malagasy authorities responded that the delay was mainly due to technical problems and to the fact that 1989 is an election year. However, to compensate for the delay, the authorities intended to take a series of actions (described in detail in the appended letter of intent--Appendix VI, paragraph 6) in order to complete the second phase before end-1989.

The authorities reported that in accordance with the program, price controls and the control of profit margins in the wholesale and retail sectors had been eliminated. In addition, they emphasized that the Stabilization Funds for Coffee and for Cloves, and the Stabilization Fund (FNUP) would be dissolved before end-1989, leaving only the Stabilization Fund for Vanilla as of 1990. The authorities indicated that the Coffee Fund would be replaced by a professional organization of producers and exporters, which would promote coffee growing and monitor the management of commitments undertaken in the context of the ICO. Regarding rice, the authorities noted that Madagascar was close to being self-sufficient in food, and would become a net exporter in 1990. As a result, and subject to normal weather conditions, they intended to discontinue rice imports except as necessary, but to a limited extent Madagascar would still import rice under intervention programs that targeted disadvantaged groups; in so doing, the authorities would take care not to disturb the functioning of the domestic rice market, so as to avoid discouraging domestic production. Moreover, the authorities noted that buffer stocks of rice would be replaced by security stocks before end-1989. Finally, a population policy and an environmental charter were to be presented to the National Assembly in October 1989. It was also reported that a national health policy was being prepared. Within the context of the EMSAP and since mid-1988, the authorities had undertaken a comprehensive campaign against malaria, which had already resulted in a significant reduction in the infant mortality rate.

4. Medium-term outlook

Madagascar remains vulnerable to changes in the external environment, particularly to world market prices for its major exports. In 1989, the average export price of coffee is expected to fall by 28 percent, contributing to a 16 percent decline in the terms of trade. On the basis of this decline and the downward revision in PIP-related expenditures, a sensitivity analysis of the baseline scenario (EBS/89/80) was prepared (Table 7). The projections remain preliminary and will be refined during the preparation of the second-year ESAF program. They assume no resumption of the ICO agreement. As compared with the baseline scenario, the sensitivity analysis shows that the effect of the spreading of the original PIP-related expenditures over a longer time span and the impact of the collapse of the ICO agreement on GDP growth are expected to be compensated by an unexpectedly strong response of the private sector to the liberalization and the opening of the economy. This upward renewal of private sector activity is based on the stronger than originally anticipated showing of new exporters and enterprises. The new investment code and trade legislation should reinforce this trend. The sensitivity analysis shows that the overall fiscal deficit will increase as compared to the baseline scenario owing to a shortfall in trade-related taxes and a smoothing over time of the PIP. However, the new incentive structure will provide an impetus for stronger export growth and higher investment with lower import content because of more efficient stock management. Finally, a higher rate of private sector savings is now anticipated, following the reform of the financial sector. The external current account, as a percent of GDP, will thus be lower than in the baseline scenario, while the overall external gap, after increasing temporarily in 1990, will decrease more rapidly thereafter. Thus, the repayment capacity of the Malagasy economy will not be affected over time.

The authorities are aware that the financial prospects for the coming years will be affected by the decrease in coffee export prices. Consequently, they intend to continue implementing the adjustment program vigorously. They are aware of the importance of introducing structural reforms on a timely basis, not only in the public enterprise sector, but also in a number of government institutions to strengthen administrative capacity. A key element in this strategy remains the continued pursuit of a flexible exchange rate policy and a prudent demand policy.

IV. Staff Appraisal

The Government of Madagascar has successfully embarked on a comprehensive three-year program (1989-91) with continued political commitment and social sensitivity. The program includes policies and reforms consistent with a macroeconomic and structural framework that effectively redefines the role of the private and government sectors, amplifies the

Table 7. Madagascar: Medium-Term Outlook and Sensitivity Analysis, 1989-92

(In percent, unless otherwise specified)

	1989	1990	1991	1992
		Program (EBS/89/80)		
External current account/GDP 1/	-8.7	-9.2	-7.1	-5.0
External financing gap/GDP	--	8.2	3.9	2.7
Fiscal deficit (-)/GDP	-4.9	-6.8	-4.8	-2.9
Current fiscal surplus (+)/GDP	(5.3)	(5.7)	(5.8)	(5.4)
Capital fiscal deficit (-)/GDP	(-9.7)	(-12.0)	(-10.2)	(-8.0)
Real GDP growth rate	4.5	4.5	4.6	4.7
Resource gap/GDP 2/	9.5	12.1	9.0	7.2
		Sensitivity Analysis 3/		
External current account/GDP 1/	-8.0	-8.9	-7.1	-4.1
External financing gap/GDP	--	9.2	3.9	1.6
Fiscal deficit (-)/GDP	-4.0	-5.5	-5.2	-3.9
Current fiscal surplus (+)/GDP	(4.2)	(4.3)	(4.7)	(4.5)
Capital fiscal deficit (-)/GDP	(-8.0)	(-10.0)	(-10.0)	(-8.3)
Real GDP growth rate	4.0	4.5	4.6	4.7
Resource gap/GDP 2/	7.6	10.5	8.6	6.0

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

1/ Current account, including net official transfers.
2/ Resource gap is defined as gross investment less domestic savings, or imports of goods and nonfactor services less exports of goods and nonfactor services.
3/ Assumptions: no resumption of ICO agreements, and spreading originally programmed PIP-related expenditure over a longer time span.

use of price signals as a resource allocation mechanism, and hence furthered the transformation of Madagascar into an open and market-oriented economy.

With the implementation of structural reforms since 1988, Madagascar is expected for the first time since the early 1970s to register positive per capita real growth in 1989, which will be achieved despite a sharp deterioration in its terms of trade for the third consecutive year. A decisive change has taken place in the economic environment, as evidenced by the noticeable expansion in the number of exporters and tourists. Another important indicator of this upturn is the creation of new enterprises, the number of which is expected to increase further with the enactment of a new investment code and legislation on a free trade zone. The liberalization of external and internal trade, a good agricultural crop, and the pursuit of a prudent demand management policy should result in the lowest inflation rate recorded in the 1980s as measured by the traditional CPI.

Despite the collapse of the ICO agreement, which resulted in a sharp drop of coffee export prices in the second semester of 1989, the program is expected to remain on track. All performance criteria and benchmarks at end-June 1989 were met, with the exception of some delays in the completion of the second stage of public enterprise reform and in the completion of the census of civil servants. These delays are partly due to the fact that presidential, parliamentary, and local elections took place during the first nine months of 1989. Recognizing these delays, the authorities have decided to accelerate the implementation of the second stage of public enterprise reform to complete it before end-1989, and they are committed to finalizing the central government personnel census by end-March 1990. Further progress has been made in the restructuring of the banking system; a new liberalized investment code and legislation on free trade zones will be presented to Parliament before end-1989. Moreover, price controls and the control of profit margins in the wholesale and retail sectors have been eliminated. In addition to strengthening the reorientation of marketing policy, the authorities have decided to abolish the Stabilization Fund (FNUP), as well as the Coffee Stabilization Fund and the Cloves Stabilization Fund, before the end of 1989. Concerning rice, buffer stocks will be replaced by security stocks. Initial steps have been taken to reverse the serious degradation of the environment, including the first agreement in Africa of a debt-for-nature swap. Finally, the authorities have undertaken a comprehensive campaign against malaria within the context of the EMSAP, which has already resulted in a significant reduction in the infant mortality rate.

With the resurgence of economic activity, a number of bottlenecks are appearing, notably in transportation, owing to the deterioration of roads and the remaining monopolies in maritime and air transport. These bottlenecks will have to be addressed rapidly to turn the still fragile recovery into a more sustained and permanent growth. The staff is of the view that more attention should be devoted to project implementation, including maintenance, and that a strengthening of the administrative capacity of monitoring the PIP, as well as the reform of public enterprises, is urgently required. Moreover, as the medium-term sensitivity analysis shows, Madagascar is still vulnerable to external shocks. On the assumption that export quotas under the ICO will not be re-established, the financial prospects for the coming years will already be affected by the sharp decline in the export unit prices of coffee. Consequently, the staff encourages the authorities to implement the program rigorously and on a timely basis in order to increase the ongoing diversification of export receipts and to broaden the basis for sustained and positive per capita growth. At this juncture, any relaxation in the pursuit of a prudent demand management policy could jeopardize the resumption of private sector confidence and the progress achieved thus far in stabilizing the economy.

The staff views the current level of the exchange rate as adequate but encourages the authorities to implement a prudent monetary policy to maintain the gains in competitiveness of the Malagasy economy, which resulted from the recent cumulated depreciation of the Malagasy franc. In view of the heavy debt burden, the staff encouraged the authorities to continue to pursue a prudent debt management policy, and to make their best efforts to conclude as quickly as possible the bilateral agreements with official creditors pursuant to Paris Club agreements.

In conclusion, the staff holds the view that the program is well under way, and that 1989 should be a turning point for economic performance. However, the base remains very fragile and sustained diligence is still required.

Madagascar maintains exchange restrictions, consisting of allocations of foreign exchange for business and tourism travel purposes requiring Fund approval under Article VIII, Section 2(a) of the Articles of Agreement. Since submitting Madagascar's request for arrangements under the ESAF, the authorities have introduced no additional restrictions in the exchange and trade system. At the time of Board approval of Madagascar's request on May 15, 1989, the Executive Directors approved the retention of these restrictions by Madagascar until December 31, 1989, or the completion of the midterm review of the first annual arrangement, whichever is earlier. In view of the progress made so far in the liberalization of external current transactions, and the authorities' commitment to endeavor to eliminate these restrictions as soon as possible, the staff recommends the approval of the retention by Madagascar of these restrictions until March 31, 1990, or the approval of the request of the second annual arrangement, whichever is earlier.

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

V. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1989 Consultation

1. The Fund takes this decision relating to Madagascar's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1989 Article XIV consultation with Madagascar, in the light of the 1989 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 EBS/89/204 and SM/89/ , in accordance with Article XIV, Section 2, except that the limits on the availability of foreign exchange for certain invisible payments are subject to Fund approval under Article VIII, Section 2(a). The Fund approves the retention of these restrictions by Madagascar until March 31, 1990, or the consideration of the request for the second-year annual arrangement under the ESAF, whichever is earlier.

Review Under the First Annual Arrangement Under the Enhanced Structural Adjustment Facility

1. The Fund determines that the midterm review specified in paragraph 2(c) of the three-year and first annual arrangements under the enhanced structural adjustment facility (EBS/89/80, Sup. 1) has been completed.

2. The letter of the Minister of Finance and Budget, dated October 14, 1989, shall be attached to the ESAF arrangement for Madagascar and the letter dated March 3, 1989, attached to that arrangement shall be read as supplemented and modified by the letter dated October 14, 1989.

MADAGASCAR - Relations with the Fund
(As of September 30, 1989, unless otherwise indicated)

I. Membership Status

a. Date of membership: September 23, 1963
b. Status: Article XIV

A. Financial Relations

II. General Department

a. Quota: SDR 66.4 million

b. Total Fund holdings of Malagasy francs: SDR 94.6 million, or 142.5 percent of quota

		Amount (SDR millions)	Percent of quota
c.	Total Fund credit outstanding	117.86	177.50
	General Resources Account		
	Compensatory financing	14.09	21.21
	Credit tranche	33.07	49.80
	Enlarged access resources	47.47	71.48
	Special Disbursement Accounts		
	SAF arrangement	13.28	20.00
	ESAF arrangement	9.96	15.00
d.	Reserve tranche position:	--	--

III. Stand-By Arrangements and Special Facilities

a. Stand-by arrangements during the last ten years:

i. 1988-89

Duration: September 2, 1988 through July 1, 1989; canceled upon approval of first annual arrangement under the enhanced structural adjustment facility, May 15, 1989.

Amount: SDR 13.3 million, or 20.0 percent of quota

Utilization: SDR 2.8 million (on September 8, 1988)

Undrawn balance: SDR 10.5 million

ii. 1986-88:

Duration: September 17, 1986 through March 16, 1988

MADAGASCAR--Relations with the Fund (continued)

Amount: SDR 30.0 million, or 45.2 percent of quota

Utilization: SDR 30.0 million

Undrawn balance: None

iii. 1985-86

Duration: April 23, 1985 through April 22, 1986

Amount: SDR 29.5 million, or 44.4 percent of quota

Utilization: SDR 29.5 million

Undrawn balance: None

iv. 1984-85

Duration: April 10, 1984 through March 31, 1985

Amount: SDR 33.0 million, or 49.7 percent of quota

Utilization: SDR 33.0 million

Undrawn balance: None

v. 1982-83

Duration: July 9, 1982 through July 8, 1983

Amount: SDR 51.0 million, or 100 percent of quota

Utilization: SDR 40.8 million

Undrawn balance: SDR 10.2 million

vi. 1981-82

Duration: April 13, 1981 through June 26, 1982

Amount: SDR 109.0 million, or 213.7 percent of quota

Utilization: SDR 39.0 million

Undrawn balance: SDR 70.0 million

MADAGASCAR--Relations with the Fund (continued)

vii. 1980-82

Duration: Initially requested to cover the period from June 27, 1980 to June 26, 1982; canceled in April 1981 by the Malagasy authorities.
Amount: SDR 64.45 million, or 189.6 percent of quota

Utilization: SDR 10.0 million

Undrawn balance: SDR 54.45 million

b. Special facilities:

i. Compensatory financing of SDR 16.1 million was approved May 28, 1986 in respect of the 1985 export shortfall. Previously, Madagascar had made three purchases under the CFF, in 1980, 1982, and 1984.

ii. Emergency assistance of SDR 16.6 million was approved May 28, 1986 under policies of the Fund relating to natural disasters, following a cyclone that struck Madagascar in March 1986.

c. Structural adjustment facility:

Duration: August 31, 1987 to August 30, 1990; canceled upon approval of first annual arrangement under the enhanced structural adjustment facility, May 15, 1989
Amount: SDR 46.48 million
Undrawn balance: SDR 33.20 million

d. Enhanced structural adjustment facility:

Duration: May 15, 1989 through May 14, 1992
Amount: SDR 76.90 million
Undrawn balance: SDR 64.08 million

IV. SDR Department

a. Net cumulative allocation: SDR 19.3 million

b. Holdings: SDR 0.12 million, or 0.6 percent of the cumulative allocation

c. Current designation plan: None

V. Administered Accounts

a. Trust Fund loans

MADAGASCAR--Relations with the Fund (continued)

i. Disbursed - SDR 25.41 million

ii. Outstanding - SDR 3.00 million

b. SFF Subsidy Account payments: SDR 3.3 million

c. ESAF Trust Loans: SDR 2.9 million

VI. Financial Obligations Due to the Fund

	Overdue financial obligations (9/30/89)	Principal and interest due			
		1989 QIV	1990	1991	1992
		(In millions of SDRs)			
Principal	--	10.7	37.6	25.1	11.5
Repurchases	--	10.7	34.7	25.0	11.5
Trust Fund repayments	--	--	2.9	0.1	--
Charges and interest (including Trust Fund, SAF, and SDR)	--	1.6	8.2	5.3	3.7
Total	--	12.3	45.8	30.4	15.2

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

FMG 1,644.7 per U.S. dollar on August 31, 1989. 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.

VIII. Exchange Restrictions

Madagascar continues to maintain specific limits for certain invisible payments and external payments arrears. Nonetheless, there has been some liberalization in the context of the adjustment programs supported by Fund stand-by arrangements. The Fund granted approval for the retention of these restrictions until end-December 1989, or the completion of the midterm review of the first annual arrangement under the enhanced structural adjustment facility, whichever is earlier.

MADAGASCAR--Relations with the Fund (concluded)

IX. Technical Assistance

A CBD mission visited Madagascar in January 1984 to review the financial system. In addition, the CBD provided consultants to the Central Bank of Madagascar for various periods in 1983 and 1984 to review the accounting of external assets and liabilities, monetary statistics, data processing requirements, and the establishment of a new bank data reporting system. A FAD tax review mission visited Madagascar in November 1981; its recommendations have been partially implemented. Also, a 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, a 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, a FAD mission visited Antananarivo to examine export taxation and make recommendations regarding the reform of export taxes. As for government expenditure, a FAD mission visited Madagascar in November 1988; the mission's main recommendation was the introduction of an improved expenditure monitoring and control system, which will enable the authorities to compile expenditure data on a commitment, payment-order, and cash basis, beginning in January 1990. A government finance mission from the Bureau of Statistics visited Antananarivo in March 1988 for the purpose of training government officials in the GFS methodology. A CBD mission visited Antananarivo in August-September 1989 to examine with the authorities the adoption of monetary policy to a more open and budget-oriented economy.

Financial Relations with the World Bank Group

At end-August 1989, World Bank Group lending to Madagascar amounted to US$981.7 million, of which US$949.1 million was from IDA. The FY89 disbursement level (US$95.9 million) is in line with the increased annual disbursement levels that started in FY86 as a result of policy-based lending. Bank Group assistance has been concentrated on transportation (25 percent) and agriculture (25 percent), and has also included credits aimed at the industrial (16 percent), public sector adjustment (13 percent), and energy (5 percent) sectors. IFC has five investments in Madagascar, in textiles, footwear, and fisheries.

In the agricultural sector, an Agricultural Sector Adjustment Credit and a technical assistance credit supporting agricultural institutions were approved in 1986; a second agricultural credit project was approved in 1987, a forest management and protection project in 1988, and a National Agricultural Research Project in 1989. In infrastructure, a railways project (1986), a ports rehabilitation project (1987), and a seventh highway credit (1988) are now under implementation. An energy project aimed at improving the efficiency of the energy sector, and particularly of the national utility company, was approved in 1987. In industry, an Industry and Trade Policy Adjustment Credit (1987) and an Ilmenite Mining Engineering Project (1988) are under implementation. Finally, a Public Sector Adjustment Credit, in support of reforms in the public enterprise/financial sectors, and public expenditures, as well as in support of continued market deregulation and export promotion, became effective in December 1988, and an Economic Management and Social Action Program Credit became effective in March 1989.

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 setting a more favorable climate for private sector initiative and investments;

(ii) supporting sectoral strategies aimed at rehabilitating productive infrastructure 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 sectoral and, possibly, structural adjustment lending as its main vehicle of financial assistance. The Bank and Fund staffs have cooperated in developing the sectoral objectives, as well as in formulating broad macroeconomic policies.

Financial Relations with the World Bank Group (concluded)

(In millions of U.S. dollars)

Amounts outstanding on August 31, 1989	Committed 1/	Disbursed 2/	Repaid	Out-standing 3/
Completed projects (IDA)				
Agriculture and rural development	58.63	56.47	1.98	56.82
Transportation	114.28	114.28	6.36	107.92
Forestry	23.48	21.84	0.34	23.48
Education	13.72	13.72	7.03	6.69
Energy, power, and utilities	52.96	52.96	0.41	52.56
Industry	4.99	4.99	--	4.99
Urban development	13.50	13.50	--	13.50
Subtotal	281.56	277.76	16.12	265.96
Completed projects (IBRD)				
Agriculture and rural development	2.80	2.80	2.22	0.58
Transportation	18.50	18.50	5.94	12.58
Forestry	6.74	6.74	1.26	5.48
Education	4.53	4.53	2.10	2.43
Subtotal	32.57	32.57	11.52	21.07
Projects in progress (IDA)				
Agriculture and rural development	151.51	90.53	--	92.13
Transportation	113.00	58.36	--	62.40
Forestry	7.00	1.44	--	1.35
Education	21.80	11.37	--	12.78
Energy, power, and utilities	36.50	15.82	--	16.73
Industry	151.55	118.10	--	119.13
Urban development	12.80	8.43	--	8.44
Cyclone rehabilitation	25.00	27.12	--	28.74
Public Sector Adjustment	126.40	32.49	--	30.98
Economic Management and Social Action Program	22.00	1.30	--	1.26
Subtotal	667.56	364.96	--	373.94
Total	981.69	675.29	27.64	660.97
IDA	949.12	642.72	16.12	639.90
IBRD	32.57	32.57	11.52	21.07
IFC investments	28.88			

Source: World Bank.

1/ Original principal minus cancellations.

2/ Differs from amount committed owing to SDR/US$ exchange rate fluctuation.

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

MADAGASCAR--Statistical Issues

1. Outstanding statistical issues

a. Real sector

Madagascar's statistical base is very weak and the data are not current. It is understood that the statistical office (DGBDE--Direction Générale de la Banque des Données de l'Etat) is currently receiving technical assistance from France.

b. Government finance

No government finance data are published in IFS. Data published in the 1988 GFS Yearbook are neither current nor complete, owing to sporadic reporting. No detailed data other than for central government revenue have been published since 1973. A government finance statistics mission visited Antananarivo in March 1988 for the purpose of training government officials in the GFS methodology. However, no data have been received for the 1989 GFS Yearbook.

c. Monetary accounts

At the suggestion of the African Department, the authorities have requested a Bureau of Statistics mission to resolve certain problems with the monetary accounts that have arisen in the context of the current program supported by the ESAF. This mission will take place in October-November 1989.

d. Balance of payments

Madagascar has reported balance of payment data only up to 1986. Any assistance the mission could provide in obtaining more current data would be appreciated.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Madagascar in the October 1989 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Madagascar, which during the past year have been provided on an infrequent basis for monetary accounts; no real sector data have been provided for the year, and no balance of payments data have been provided since November 1988.

Status of IFS Data

		Latest Data in October 1989 IFS
Real Sector	- National Accounts:	
	GDP	1986
	Components	1984
	- Prices	Jan. 1988
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	March 1989
	- Deposit Money Banks	March 1989
	- Other Financial Institutions	n.a.
Interest Rates	- Discount Rate	March 1989
	- Bank Lending/Deposit Rates	n.a.
	- Bond Yields	n.a.
External Sector	- Merchandise Trade:	
	Values:	
	Exports	1987
	Imports	Q2 1987
	Prices: (principal commodity exports)	1985
	- Balance of Payments	1986
	- International Reserves	March 1989
	- Exchange Rates	August 1989

3. Technical assistance missions in statistics (1985-present)

Subject	Staff Member	Date
Government Finance Statistics	Vincent Marie	March 1988

Madagascar - Basic Data

Area, population, and GDP per capita

Area	587,000 square kilometers
Population: Total (1988)	11.2 million
Growth rate	3.1 percent
GDP per capita (1988)	SDR 128

	1984	1985	1986	1987	1988	1989 Est.
GDP (at current prices; in billions of Malagasy francs)	1,369	1,553	1,817	2,225	2,709	3,143
GDP (at 1984 prices)						
Total (in billions of Malagasy francs)	1,369	1,398	1,418	1,443	1,466	1,524
Agriculture (percent of total)	42	42	43	43	43	...
Secondary sector (percent of total)	16	16	16	16	16	...
Annual real rate of growth (percent)	1.7	2.1	1.4	1.7	1.6	4.0
Investment as percent of GDP	14	14	13	13	13	14
Prices (percent changes)						
GDP deflator	10	11	15	20	20	11.5
Consumer price index (annual average)	10	11	15	16	26	8.7
Central government finance	(In billions of Malagasy francs)					
Total current revenue and grants	243.5	251.7	280.4	420.7	473.5	516.0
Current expenditure	-189.7	-212.6	-232.4	-299.4	-345.8	-383.6
Current surplus/deficit (-)	53.8	39.1	42.7	99.2	122.7	132.4
Capital expenditure	-108.9	-112.9	-119.5	-191.6	-237.3	-390.2
Overall cash deficit	-65.9	-72.1	-72.7	-96.8	-120.5	-126.3
External financing (net)	36.6	48.0	51.4	100.0	134.6	144.7
Domestic bank borrowing	31.9	20.9	17.8	-10.7	-21.7	-25.9
Domestic nonbank borrowing	-2.6	3.2	3.5	7.5	7.6	7.5
Overall deficit as percent of GDP	-4.8	-4.6	-4.0	-4.4	-4.4	-4.0

Madagascar - Basic Data (concluded)

	1984	1985	1986	1987	1988	1989 Est.
Money and credit	(In percentage change)					
Domestic credit	18	11.5	10.2	7.9	-0.3	6.3
Government	10	5.6	5.5	-3.1	-6.1	-7.6
Nongovernment	27	17.5	14.5	17.2	3.8	15.0
Money and quasi-money	18	12.6	24.0	17.6	20.2	14.5
Balance of payments	(In millions of SDRs)					
Exports, f.o.b.	325	275	281	240	212	228
Imports, f.o.b.	-312	-330	-282	-244	-237	-249
Trade balance	13	-55	-2	-4	-25	-20
Services and private transfers (net)	-238	-197	-207	-196	-178	-197
Current account balance	-225	-252	-209	-200	-203	-217
Offical transfers (net)	66	59	94	79	101	95
Capital account (net) 1/	190	164	181	192	141	149
Drawings 2/	118	143	164	174	148	165
Amortization 2/	-181	-147	-133	-157	-150	-168
Rescheduled debt service	231	152	160	171	158	164
Allocation of SDRs	--	--	--	--	--	--
Other 3/	-15.0	21	-1	-7.0	25	5.0
Overall surplus or deficit (-)	16	-8	65	64	64	32
Current account deficit as percent of GDP	-9.7	-10.9	-9.1	-12.4	-14.2	-14.3
Central Bank gross reserves 4/	9.7	7.1	16.9	24.5	28.8	23.0
External public debt						
Disbursed and outstanding (end of period)	2,085	2,222	2,420	2,484	2,471	2,567
Debt service as percent of exports of goods and services						
Before rescheduling						
Including the Fund	75.6	92.4	89.4	100.8	104.4	116.9
After rescheduling	33.4	47.4	51.2	54.4	56.0	66.8

1/ Including petroleum financing.
2/ Excluding petroleum financing.
3/ Including banks, short-term capital, valuation adjustments, and errors and omissions.
4/ In weeks of the following year's imports, c.i.f.

Madagascar - Social and Demographic Indicators 1/

Area	Population	Density (1988)
587.0 thousand sq. km.	11.2 million (1988)	19.1 per sq. km.
Agricultural (percent of total): 63.1	Rate of growth (1988): 3.1 %	30.2 per sq. km. of agricultural land

Population Characteristics		Health (in thousands)	
Life expectancy at birth	53	Population by physician	10.0
Infant mortality (aged under 1, per thousand)	110	Population per nurse	1.7
Child death rate (aged 1-4, per thousand)	21	Population per hospital bed (1978)	0.51

Income Distribution (1983)		Distribution of Land (1980)	
Percent of national income		Percent area exploited by top 11 percent of farmers	...
Highest quintile	60.1	Percent area exploited by smallest 12 percent of farmers	...
Lowest quintile	5.2		

Access to Safe Water		Access to Electricity (1976)	
Percent of population		Percent of dwellings	
Total	20.0	Urban	...
Urban	73.0	Rural	...
Rural	9.0		

Nutrition		Education (1983)	
Calorie intake as percent of requirements (1983)	114.0	Adult literacy rate (percent)	53.0
Per capita protein intake (grams per day)	54.0	Primary school enrollment (percent)	100.0

Sources: World Bank, Social Indicators of Development, 1988; and staff estimates.

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

Democratic Republic of Madagascar
Ministry of Finance and Budget Antananarivo, October 14, 1989
The Minister

Dear Mr. Camdessus:

1. During the first half of 1989, with the implementation of the program supported by the first annual arrangement under the enhanced structural adjustment facility (ESAF), additional progress was made in transforming the Malagasy economy into an open, market-oriented economy, while strict demand management was maintained. Thus, despite the slump in coffee export prices, it may be expected that the main objective--a rate of economic growth higher than the rate of population growth--will be achieved as of 1989. Moreover, all the indicators at end-March 1989 and all the performance criteria at end-June 1989 were met. The structural indicators at end-June 1989 and those for the midterm review were satisfied, with the exception of delays in the full implementation of the second phase of the three-year program for the reform of public enterprises, and in the completion of the census of central government personnel. By contrast, a new investment code and the legislation setting up free zones will be submitted before the programmed deadline to the National Assembly when it next meets in October 1989, and the new mining code is shaping up well.

2. In the context of the medium-term macroeconomic framework for 1989-91, the main objectives for 1989 are an acceleration of economic growth from 1.8 percent in 1988 to 4.5 percent in 1989, and a slowdown in the rate of inflation, as measured by the GDP deflator, from 19.9 percent to 12.0 percent. On the basis of performance in the first half year, the rate of growth of GDP in real terms is now estimated at 4.0 percent compared with a 3.1 percent rate of population growth. This downward revision is largely the result of lower expenditure under the Public Investment Program (PIP) than was expected. As anticipated, however, rice production should expand considerably, and exports, at least in volume, should make a strong showing, while activity in the tourism sector is expected to increase substantially. It bears noting that imports of inputs have risen, which should benefit the agricultural and industrial sectors. Overall, the economy seems to have reached a turning point, as can be seen from the increase in the number of authorized exporters and enterprises. In contrast to the annual average of only 5 such authorizations granted in 1985-86, the number jumped sharply to 53 in 1988. Moreover, 30 new enterprises have already been approved in the first half of 1989. With the publication of the new investment code, which should help simplify administrative procedures, the number should continue to rise. Renewed growth has increased the problems confronting the land, air, and marine transport sectors, problems that the Government intends to tackle by implementing a coherent plan of action. Efforts to cap inflation are continuing as programmed. The lifting of price controls and restraints on domestic commerce, together with a prudent monetary policy, has helped achieve

this encouraging result. Thus, the traditional consumer price index rose 6.9 percent in the first half of 1989 compared with that of 1988, which should result in an annual inflation rate of 8.7 percent compared with the programmed 9.5 percent and the 26.3 percent recorded in 1988. The authorities have continued to apply a flexible exchange rate policy to maintain the competitiveness of the Malagasy economy.

3. On the basis of performance during the first six months of the year, overall budgetary policy objectives should be reached, provided strict revenue collection and budget expenditure control measures are applied. The deficit in overall treasury operations (OGT) on a cash basis is expected to reach FMG 126.3 billion, or 4.0 percent of GDP compared with the 4.9 percent programmed. The balance of current operations should show a surplus of FMG 132.4 billion, equivalent to 4.2 percent of GDP, compared with the projected 5.3 percent. The balance of capital operations, in which all of the PIP is included for the first time, should show a deficit of FMG 250.4 billion or 8.0 percent of GDP, compared with a programmed 9.7 percent. Taking into account net external financing estimated at FMG 144.7 billion and a net subscription of treasury notes (including the LOVA issue) by the non-banking system, unchanged at FMG 7.5 billion, net credit to the Government by the banking system will be reduced by FMG 25.9 billion as programmed.

4. As regards budget revenue, and in accordance with the program, the second phase of the tariff reform has been completed; the reform of domestic taxes is still under way. Total revenue should reach FMG 655.8 billion, including grants of FMG 143.5 billion (the program called for FMG 717.2 billion and FMG 171.2 billion, respectively). Duties and taxes from foreign trade, including revenue of the Stabilization Fund (FNUP), should reach FMG 277.6 billion compared with FMG 323.2 billion programmed. This shortfall is largely the result of the collapse of coffee export prices. It was exacerbated by the authorities' decision to suspend collection of the taxe conjoncturelle on coffee as of August 17, 1989 to safeguard producer incomes.

As agreed, a Fund technical assistance mission visited Antananarivo in April 1989 to evaluate the export tax system. The Government basically supports the mission's recommendations and intends to take the required steps to incorporate them in the 1990 Finance Law. In any case, the FNUP will be eliminated and its revenue consolidated in the 1990 budget in the form of a single tax on coffee and cloves. The Stabilization Fund for Vanilla will continue to perform its normal operations. Before end-1989, the authorities also plan, in accordance with the program, to review the customs nomenclature and identify measures that could enhance the organization of customs administration and customs policies, as well as customs valuation controls on imported goods. To expedite the drafting of these measures and examine the impact of the tariff reform, a Fund technical assistance mission is scheduled to visit Madagascar in October 1989.

5. Taking into account the performance in the first half of 1989 and the stringent measures adopted to limit operating expenditure, the OGT's current expenditure should be kept below FMG 383.6 billion in 1989 compared with the FMG 385.3 billion programmed. On the basis of expenditure recorded at end-June 1989, which was less than the programmed amount, capital expenditure has been revised downward as envisaged in the program: it will now be about FMG 390.2 billion, compared with the FMG 470.7 billion programmed.

An enhanced action program has been introduced to improve the collection of tax revenue, particularly that collected by tax roll, which was not brought in during previous years. The anticipated results of this action will not suffice to offset the forgone earnings resulting from lower export prices. The authorities have therefore decided to monitor carefully budget expenditure authorizations during the second half of 1989. Strict controls will be applied at all levels of government to keep expenditure at the level currently programmed. The introduction of these controls should prevent any new accumulation of arrears. On the basis of the inventory carried out at end-March 1989, the stock of domestic arrears recorded has been cleared. The authorities undertake to verify the completeness of this inventory before end-November 1989. As regards the census of central government personnel, a methodology has already been worked out and the final results should be ready before end-March 1990.

As a follow-up to the recommendations of the two Fund technical assistance missions, the Government has begun to put in place an improved system for the monitoring and control of expenditure, which will enable it to send the Fund the monthly statistical data on general budget expenditure on a commitment basis, with a maximum lag of three months, and on a payment order and cash basis, with a maximum lag of two months, beginning in January 1990.

Investment expenditure executed at end-June 1989 amounts to about FMG 176.7 billion, whereas the program had specified FMG 209 billion for this purpose. It is clear from this delay that enhanced administrative capacity and improved coordination between the ministries involved is essential for execution of the PIP.

However, as stated in the letter from the Government of March 3, 1989, the authorities considered as the wiser course a downward revision of the PIP not only in 1989 but also for the medium term, that is, FMG 540 billion in 1990 and FMG 580 billion in 1991. These preliminary estimates for 1990 and 1991 will be reassessed on the basis of the PIP review with the World Bank scheduled for October 1989 in consultation with Fund and World Bank staffs.

6. There has been some delay in the completion of the second phase of the reform program for public enterprises. The authorities therefore intend to take the following steps to complete this second phase before end-1989, with financial support from the World Bank. Before

end-November 1989, the Government will create a single structure to replace both the structure for monitoring and rehabilitating purposes originally called for in the agreements with the World Bank, and the various institutions currently responsible for implementing the program for divestiture, liquidation, and privatization. Before end-December 1989, the Government will take the following measures: (i) prepare a plan of action for reorganizing HASYMA, FIFABE, SOMALAC, FAFIMA, ROSO and SICE; (ii) divest itself of, or dissolve CIMA, HODIMA, SEVMACAM, SOABE, SOJUFA, SUMATEX and ZEMA; (iii) make satisfactory progress in the actual liquidation of the enterprises appearing on the list already agreed with the World Bank; and (iv) prepare a definitive supplementary list of 20 enterprises for liquidation, restructuring, or divestiture by the Government.

7. As set forth in the program, the portfolios of the BTM and the BFV have been restructured, and the BFV has signed a protocol of agreement with a foreign private bank, whereby the foreign bank would acquire a 25 percent participation in the capital of the BFV. A plan for restructuring the BNI has been outlined with assistance from a foreign consultancy firm and will be implemented before end-1989. Finally, the Banque Malgache de l'Océan Indien (BMOI), a wholly owned private subsidiary of a European group, opened for business on August 21, 1989.

8. Imports of rice will not exceed 73,000 tons in 1989, and Madagascar, which is close to being self-sufficient in food, will become a net rice exporter in 1990. As a result, and subject to normal weather conditions, the Government intends to discontinue rice imports except as necessary, but to a limited extent it will still import rice under intervention programs targeting disadvantaged groups; in so doing it will take care not to disturb the functioning of the market and thereby discourage domestic production. Moreover, buffer stocks will be replaced by security stocks before end-1989. In accordance with the program, the Coffee and Cloves Price Stabilization Funds will be dissolved before end-1989. The Coffee Fund will be replaced by a professional organization of producers, exporters, and public services, which will promote coffee growing (particularly through research, extension, and supervisory activities) and monitor the management of commitments undertaken in the context of the International Coffee Agreement. In the industrial sector, price controls and the control of profit margins in the wholesale and retail sectors have been eliminated. Finally, a population policy will be presented to the National Assembly in October 1989. A national health policy and a draft environmental charter are also on the drawing board.

9. Monetary policy has remained prudent in the first half of 1989: the growth of total domestic credit was FMG 20.9 billion against FMG 42.6 billion programmed for end-June 1989. The subceilings on net credit to the Government, gross credit to the public enterprises, and new credits granted to high-risk ("D") enterprises have also been observed. This policy of strict limits on domestic credit has resulted, ceteris paribus, in a net growth of external holdings of

FMG 3.1 billion. By continuing to pursue a stringent budget management policy during the second half year, the credit objectives for the entire year should be reached, despite the forgone earnings in the area of budget revenue.

10. Notwithstanding the collapse of international coffee prices, which will be reflected in an estimated 16 percent deterioration in the terms of trade in 1989 (compared with the projected 4 percent), it is expected that the program objective of holding the current external deficit at SDR 130.1 million in 1989 (8.7 percent of GDP) will be attained. This will be made possible by an import level that is lower than foreseen and by a strong export performance, particularly as regards volume. The results for the first half of 1989 confirm a continual improvement in the structure of the balance of payments. Thus, imports of capital goods, raw materials, and spare parts have increased, while nontraditional exports are expanding. Steps have been taken to speed up the administrative procedures at both the Central Bank and the commercial banks for obtaining the foreign exchange required for imports. Moreover, revenue from the tourism sector increased markedly in the first half of 1989; performance in this sector should remain strong for the entire year. In all, it is estimated that the current external deficit, including government transfers, should reach SDR 122.1 million, or 8.0 percent of GDP. Net inflows of capital should be SDR 37 million less than the amount foreseen in the program. The reason for this contraction is the reduction in public investment (PIP) expenditure and in drawings under the World Bank loan programs. Consequently, the overall balance of payments should show a surplus of SDR 31.7 million, as against the SDR 60.9 million projected in the program. Finally, net international reserves are expected to decline by SDR 2 million, compared with a programmed increase of SDR 27 million.

The Government continued to apply a prudent management policy to the external public debt: all ceilings established for the external debt were amply respected at end-June 1989. In addition, debt service monitoring was improved, particularly to introduce greater consistency in the debt data appearing in the budget and the balance of payments.

The authorities have concluded debt conversion agreements with third parties and some foreign commercial banks for about SDR 2.6 million. In particular, an agreement was signed with the World Wildlife Fund, which will provide financing for environmental protection programs. Finally, the authorities will complete as quickly as possible the bilateral agreements with official creditors pursuant to Paris Club agreements, and will resume discussions with the London Club with a view to obtaining further alleviation of the debt with banks.

11. The authorities are aware that the financial prospects for the coming years will be affected by the plunge in coffee export prices. Consequently, they intend to continue implementing the adjustment program rigorously. The authorities reaffirm their commitment to the continued transformation of the Malagasy economy into an outwardly open,

market-oriented economy. They are aware of the importance of introducing structural reforms on a timely basis, not only in the public enterprise sector, but also in a number of government institutions to strengthen administrative capacity. All these efforts should eventually result in a greater diversity of production and exports and thus improve the structure of the balance of payments. A key element in this strategy remains the continued pursuit of a flexible exchange policy and a prudent demand policy.

In view of plummeting prices for traditional exports and the scope of the measures in the program, the authorities hope that they will continue to receive sustained support from the international community.

Sincerely yours,

Léon Rajaobelina

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431