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July 21, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Madagascar - Staff Report for the 1988 Article IV Consultation
and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with Madagascar and its request for a stand-by arrangement equivalent to SDR 13.3 million, which will be brought to the agenda for discussion on a date to be announced. Draft decisions appear on page 33.

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)

INTERNATIONAL MONETARY FUND

MADAGASCAR

Staff Report for the 1988 Article IV Consultation
and Request for Stand-By Arrangement

Prepared by the African Department

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

Approved by A.D. Ouattara and H.B. Junz

July 20, 1988

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I. Introduction

A staff mission ^{1/} visited Antananarivo during June 5-15, 1988 to complete the 1988 Article IV consultation discussions and to finalize the negotiations initiated in April on an adjustment program. In support of the program, the Government of Madagascar requests, in the attached letter dated July 20, 1988, a 10-month stand-by arrangement in an amount equivalent to SDR 13.3 million, or 20 percent of quota (Appendices I and II).

As of June 30, 1988, the Fund's holdings of Madagascar's currency, the Malagasy franc (FMG), subject to repurchases totaled the equivalent of SDR 134.03 million (201.8 percent of quota), of which the equivalent of SDR 110.7 million (166.7 percent of quota) was under tranche policies, and the equivalent of SDR 23.3 million (35.1 percent of quota) under the compensatory financing facility. Outstanding purchases under *tranche policies include emergency assistance for the equivalent of* SDR 16.6 million, or 25.0 percent of quota, approved following the cyclone that struck Madagascar in March 1986 (EBS/86/104). Additionally, SDR 13.3 million was outstanding under the Structural Adjustment Facility. The expected purchases and scheduled repurchases during the period of the requested stand-by arrangement are shown in Table 1. On the assumption that the full amount of the proposed stand-by arrangement is purchased, and all scheduled repurchases are made, Madagascar's credit outstanding would decline to 194.4 percent of quota at end-June 1989, of which 150.2 percent of quota would be under tranche policies and 20.0 percent of quota under the first-year disbursement under the SAF on September 30, 1987 (EBS/87/160). A waiver of the limitation in Article V, Section 3(b)(iii), is required and is being proposed. The staff report for the 1986 Article IV consultation with Madagascar (EBS/87/21) was considered by the Executive Board on March 9, 1987. Article IV consultations with Madagascar are currently held on the standard 12-month cycle. Madagascar continues to avail itself of the transitional arrangements of Article XIV. The authorities hoped that the arrangements under the SAF would be replaced by arrangements under the extended structural adjustment facility (ESAF) in early 1989. They requested that the proposed stand-by arrangement be considered a bridge toward possible arrangements under the ESAF. Madagascar's relations with the Fund are summarized in Appendix III.

^{1/} The representatives of Madagascar included Mr. Pascal Rakotomavo, Minister at the Presidency in Charge of Finance and Economy; Mr. Georges Solofoson, Minister of Commerce; Mr. Jean Robiarivony, Director at the Presidency in Charge of Plan, Mr. Richard Randriamaholy, Governor of the Central Bank of Madagascar; and other senior officials responsible for economic and financial affairs. The staff representatives were Messrs. Carstens (head-AFR), Duran-Downing (ETR), Clément, Ms. Le Gall, Mr. Miranda (EP) (all AFR), and Mrs. le Jeune (secretary-ADM).

Table 1. Madagascar: Projected Fund Transactions and
Position During Period July 1, 1988-June 30, 1989

	Outstanding as of June 30, 1988	1988		1989	
		July 1- Sept. 30	Oct. 1- Dec. 31	Jan. 1- March 31	April 1- June 30
<u>(In millions of SDRs)</u>					
Transactions under tranche policies (net)		-2.2	-2.5	-2.7	-3.6
Purchases		2.8	3.5	3.5	3.5
Ordinary resources		2.8	3.5	3.5	3.5
Enlarged access resources		--	--	--	--
Repurchases		-5.0	-6.0	-6.2	-7.1
Ordinary resources		-2.7	-3.1	-3.5	-3.7
Enlarged access resources		-2.3	-3.0	-2.7	-3.4
Transactions under compensatory financing facility (net)		-1.8	-1.8	-1.8	-1.8
Purchases		--	--	--	--
Repurchases		-1.8	-1.8	-1.8	-1.8
Structural adjustment facility loans		--	--	--	--
Total Fund credit outstanding (end of period)	147.3	143.3	139.0	134.5	129.1
Under tranche policies	110.7	108.5	106.0	103.3	99.7
Of which: emergency assistance	(16.6)	(16.6)	(16.6)	(16.6)	(16.6)
Under compensatory financing facility	23.3	21.5	19.7	17.9	16.1
Under structural adjustment facility	13.3	13.3	13.3	13.3	13.3
<u>(In percent of quota)</u>					
Total Fund credit outstanding (end of period)	221.8	215.8	209.3	202.6	194.4
Under tranche policies	166.7	163.4	159.6	155.6	150.2
Of which: emergency assistance	(25.0)	(25.0)	(25.0)	(25.0)	(25.0)
Under compensatory financing facility	35.1	32.4	29.7	27.0	24.2
Under structural adjustment facility	20.0	20.0	20.0	20.0	20.0

Source: International Monetary Fund.

The World Bank group is active in Madagascar, essentially through IDA and the Special Facility for Africa. As of end-April 1988, total World Bank group lending amounted to US\$769 million, of which US\$561 million has been disbursed. On June 30, 1987, the Executive Board of the World Bank approved a program to be supported by a US\$100 million Industry and Trade Policy Adjustment Credit (ITPAC). In addition, on June 29, 1988, the Executive Board of the World Bank approved a program to be supported by a US\$125 million public sector adjustment credit (PSAC). The Fund staff has been extensively involved in the elaboration of these programs. Madagascar's relations with the World Bank group are summarized in Appendix IV.

Appendix V contains a review of statistical issues, and basic data and social and demographic indicators for Madagascar are provided in Appendices VI and VII, respectively.

II. Report on Discussions: Recent Developments and Performance Under the Last Program

1. Introduction

The discussions took into account the views expressed at the Fund's most recent Executive Board discussions on Madagascar. ^{1/} At these discussions, Executive Directors commended the authorities for implementing the adjustment programs supported by six stand-by arrangements with the Fund, notwithstanding adverse exogenous developments, and welcomed the continued progress in the reduction of fiscal imbalances. However, Directors noted that economic growth continued to be sluggish and the balance of payments situation remained difficult. It was suggested that careful attention would have to be paid to the evolving relationship between the roles of the private sector and the state in Madagascar. Directors also expressed concern at the slow progress in reducing the size and improving the efficiency of the public enterprise sector. Directors indicated that the focus of future policies should be to accelerate progress in the restructuring of the economy and to diversify the export base--in particular by encouraging nontraditional exports. They also stressed the importance of continuing to pursue policies aimed at containing aggregate demand and ensuring external competitiveness.

^{1/} The staff report for the 1986 Article IV consultation and first review of the last stand-by arrangement (EBS/87/21) and the report on recent economic developments (SM/87/36) were considered by the Executive Board on March 9, 1987. The staff report for the second review of the last program and the request for arrangements under the Structural Adjustment Facility (EBS/87/160) and the Policy Framework Paper, 1987-90 (EBS/87/161) were considered by the Board on August 31, 1987. The staff report for the third review of the last program (EBS/87/271) was considered by the Board on January 20, 1988.

Since the early 1980s, Madagascar's adjustment efforts have largely succeeded in reducing its financial imbalances. The external current account deficit was reduced from 14.6 percent of GDP in 1981 to 11.7 percent in 1987, ^{1/} and gross international reserves increased to about four months of the following year's imports (c.i.f.) at end-1987. The improvement in the external situation stemmed mainly from a reduction in the overall fiscal deficit from 15 percent of GDP to 4.4 percent over the period, the pursuit of a tight monetary policy, and a reduction of distortions in relative prices between traded and nontraded goods. Meanwhile, the sharp decline in real GDP in 1981-82 of about 11 percent was followed by modest growth averaging 1.5 percent during 1983-87, or less than the population growth rate of 2.9 percent. The rate of increase in the consumer price index for low-income households which averaged over 30 percent in 1981-82, declined to 15.5 percent in 1987.

Under the program supported by the previous stand-by arrangement (September 17, 1986-March 16, 1988) and the first annual arrangement under the structural adjustment facility (July 1, 1987-June 30, 1988), the Government took several measures aimed at reducing the structural and pricing rigidities that have hampered production and exports, and at transforming the Malagasy economy into a more market-oriented one. These measures included changes in the relative prices through substantial adjustments in the exchange rate of the Malagasy franc, introduction of a liberalized import regime (LIR) designed to eliminate the discretionary element in the allocation of import licenses and foreign exchange authorizations, increases in the producer prices of major agricultural crops, the virtual abolition of price controls, and progressive elimination of the quantitative restrictions on imports. Parallel with these measures, the Government continued to pursue a prudent demand-management policy, and all performance criteria were observed.

Nevertheless, the outturn for 1987 deviated from the program targets, ^{2/} partly on account of exogenous factors but also because of expenditure overruns, delays in the reform of public enterprises, and continued administrative controls on internal and external trade (Table 2). Real GDP is estimated to have increased by 1.4 percent in 1987, compared with 1.3 percent in 1986. The terms of trade are estimated to have deteriorated by 22.2 percent in 1987, as coffee prices fell sharply, and export receipts dropped by an estimated 14.6 percent from 1986 to an all-time low. Meanwhile, owing partly to administrative constraints and the effect of the large exchange rate depreciation, imports are estimated to be some 12.1 percent below 1986, also an all-time low. The decrease in imports more than offset the export

^{1/} The external current account deficit, as a percentage of adjusted GDP, was reduced from 15.4 percent to 6.3 percent over the period. GDP in SDR terms is adjusted by means of a purchasing power parity approach that neutralizes the effect of exchange rate fluctuations.

^{2/} Program targets throughout the staff report refer to the revised program targets (EBS/87/271, 12/23/87).

Table 2. Madagascar: Selected Economic and Financial Indicators, 1983-88

	1983	1984	1985	1986	1987		1988
					Prog. (EBS/87/271)	Actual	Prog.
(Annual percent changes)							
National income and prices							
GDP at constant prices	0.9	1.7	2.3	1.3	1.7	1.4	2.0
GDP deflator	21.5	10.3	10.9	15.4	18.2	20.0	12.7
Consumer prices ^{1/}	19.6	9.9	10.5	14.5	15.0	15.5	...
External sector (on the basis of SDRs)							
Exports, f.o.b.	-2.3	12.3	-15.6	2.3	-12.3	-14.6	2.2
Imports, c.i.f.	-18.2	-3.3	-2.3	-13.1	-6.0	-12.1	8.2
Non-oil imports, c.i.f.	-16.3	-5.8	1.2	-5.5	-5.0	-11.7	6.6
Export volume ^{2/}	...	...	-4.4	3.4	6.4	6.3	5.0
Import volume (nonfood) ^{2/}	...	...	0.4	1.9	-9.6	-14.4	12.5
Terms of trade (deterioration -)	...	...	-9.9	17.9	...	-22.2	-4.3
Nominal effective exchange rate (depreciation -)	-6.0	-12.6	-4.5	-10.9	-48.4	-34.4	...
Real effective exchange rate (depreciation -)	0.8	-14.3	-5.0	-5.6	-33.6	-31.9	...
Central government financial operations							
Total revenue and grants	22.3	31.1	3.4	11.5	53.6	50.0	21.8
Total expenditure	8.0	18.0	7.0	9.6	42.7	43.8	14.3
Money and credit							
Domestic credit	17.8	18.1	11.5	10.2	11.5	7.9	1.8
Government	14.2	10.3	5.6	5.5	-2.8	-3.1	-14.9
Private sector	22.3	27.2	17.5	14.5	23.5	17.2	13.3
Broad money (M ₂)	-1.5	18.3	12.6	24.0	23.5	17.6	12.5
Income velocity of broad money (M ₂)	4.5	4.3	4.3	4.1	3.9	4.2	4.3
(In percent of GDP)							
Overall fiscal deficit (-)	-6.7	-4.8	-4.7	-4.0	-4.4	-4.4	-3.7
Of which: domestic bank financing	(3.0)	(2.3)	(1.3)	(1.0)	(-0.5)	(-0.5)	(-1.5)
foreign financing (net)	(3.8)	(2.7)	(3.1)	(2.8)	(4.7)	(4.5)	(5.1)
Gross domestic investment	13.2	13.6	14.0	13.8	14.3	13.8	15.2
Gross domestic savings	6.4	8.6	6.9	8.8	6.1	7.2	5.5
Current account deficit (-)	-10.9	-10.4	-10.9	-9.2	-14.8	-11.7	-16.8
Current account deficit (adjusted) ^{3/}	-11.5	-9.1	-9.2	-7.4	-7.6	-6.3	-7.3
External debt (including the Fund)	71.5	90.1	96.3	105.7	158.2	155.4	196.0
Of which: arrears	(3.6)	(3.5)	(3.4)	(3.0)	(3.9)	(3.6)	(3.6)
Nominal GDP in billions of FMG	1,221.0	1,369.1	1,553.4	1,817.1	2,184.2	2,209.7	2,541.2
Conversion rate FMG/SDR	459.9	590.8	672.6	798.6	1,430.5	1,382.6	1,899.3
(In percent of exports of goods and services)							
Total debt service payments ^{4/}	31.4	33.4	49.2	45.2	53.4	50.2	61.3
Total gross reserves ^{5/}	...	...	7.1	16.9	...	22.1	18.9

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

^{1/} Low-income consumer price index for Antananarivo.

^{2/} Calculation based on Paasche volume indices.

^{3/} GDP in SDR terms is adjusted by means of a purchasing power parity approach that neutralizes the effect of exchange rate fluctuations.

^{4/} After debt rescheduling, and 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.

shortfall, resulting in a smaller-than-anticipated current account deficit, equivalent to 11.7 percent of GDP, ^{1/} compared with 9.2 percent in 1986. In addition, net foreign assets of the banking system turned positive. The lower volume of international trade contributed to a shortfall in fiscal revenue, and with expenditure higher than programmed, the overall fiscal cash deficit widened to 4.4 percent of GDP, compared with 4.0 percent in 1986. Despite this increase, the Government was able to reduce its net indebtedness to the domestic banking system, but it accumulated domestic payments arrears. Reflecting an increase in the net foreign assets of the banking system following a restrictive credit policy, money supply broadly defined increased by 17.6 percent in 1987. The consumer price index for low-income households is estimated to have risen in 1987 by 15.5 percent, compared with 14.5 percent in 1986.

2. Production and prices

In 1987, real GDP rose by only 1.4 percent, which is about the rate posted in 1986, but below the target of 1.7 percent and the population growth rate of 2.9 percent. Agriculture, reflecting in good part a boost in producer prices and marketing reforms, contributed about two thirds of the economic growth, including a record paddy harvest and a renewed increase in the production of coffee. Industry, which accounted for one fourth of GDP growth, benefited from the reopening of the petroleum refinery that had been shut down following cyclone damage in 1986. Otherwise, performance in the industrial sector was constrained by shortages of imported raw materials and spare parts, attributable to initial problems in the operation of the LIR, and by low world demand, which affected certain mining products.

Domestic demand in real terms rose by 2.7 percent compared with a target of 4.8 percent. Consumption growth, sustained mostly by private consumption, was slightly ahead of population growth, while investment fell, reflecting mainly the continued difficulties in the public enterprise sector.

The 15.5 percent increase in the consumer price index for low-income households, one percentage point more than that of 1986, was in line with the program. The increase was modest in the first half of the year, mostly as a result of a sharp drop in the retail price of rice, but accelerated to 30 percent in the second semester with the pass-through of the exchange rate adjustment of June. ^{2/}

In 1987, the Government instituted far-reaching reforms in the areas of pricing and domestic trade. Decontrol of ex-factory prices was

^{1/} In percent of adjusted GDP, the external current account was equivalent to 6.3 percent in 1987, compared with 7.4 percent in 1986.

^{2/} From May 1987 to April 1988, the rate of increase of this index was 36.7 percent.

extended, and only five products, which represent less than 4 percent of value added in the industrial sector, remained under control. Early in the year, controls on the profit margins, both at the retail and whole-sale levels, were abolished on all but 16 product categories, including the 5 products mentioned above. Effective January 1, 1988, all economic agents have been allowed to engage freely in the various stages of domestic marketing of all agricultural products, including those remaining under the control of the Stabilization Fund. No operating licenses, cards, or prior authorizations are required.

3. Public enterprises

Many of the 167 public enterprises in Madagascar have incurred substantial losses financed by the banking system, government transfers, and the accumulation of payments arrears. Recourse to the banking system for the financing of investments and operating losses has limited credit availability to other sectors and has accounted in large measure for the nonperforming loans in the portfolios of the commercial banks. In 1987, the Government initiated a series of measures designed to redress the financial imbalances and pursued a rehabilitation program for selected enterprises. Action plans were drawn up for 16 enterprises accounting for more than one third of the banking system's outstanding credit to public enterprises, and studies were initiated on another 10 manufacturing enterprises.

4. Public finance

The 1987 target for the fiscal deficit was met. However, there was an accumulation of domestic payments arrears, including administrative payments delays on investment projects beyond the complementary period. The staff emphasized to the authorities that such delays illustrated the weakness in monitoring and control of budgetary operations. The overall deficit on a cash basis was FMG 97 billion, or 4.4 percent of GDP (Table 3). Broad fiscal developments thus showed a deterioration compared with 1986, when a deficit of 4.0 percent of GDP was registered.

Revenue and grants fell short of the program target by FMG 10 billion, owing mainly to a sharp drop in exports (attributable in part to the decline in coffee prices), which resulted in unexpectedly low revenue from export transactions. By contrast, revenue from import duties was slightly above the program level since the significant drop in imports was compensated by a tightening of procedures. Total expenditures exceeded the target by about FMG 4 billion, on account of higher transfers and subsidies and interest payments. The Government settled as programmed the outstanding balance of cross-debts between the local administrations and public enterprises.

The overall deficit on a cash basis was financed mainly by net foreign drawings. With foreign financing FMG 2 billion lower than the level in the program, the additional financing came from domestic

Table 3. Madagascar: Government Financial Operations, 1983-88

(In billions of Malagasy francs)

	1983	1984	1985	1986	1987		1988
					Prog. (EBS/87/271)	Actual	Prog.
Total revenue and grants	185.5	243.2	251.5	280.4	430.7	420.7	512.3
Budgetary revenue	141.0	168.3	195.0	211.0	314.7	308.5	380.1
Tax revenue	135.6	160.4	190.2	205.4	307.7	300.7	371.9
Nontax revenue	5.4	7.9	4.8	5.6	7.0	7.8	8.2
Extrabudgetary <u>1/</u>	36.3	62.6	49.3	54.5	96.0	93.6	108.0
Grants	8.2	12.3	7.2	14.9	20.0	18.6	24.2
Total expenditure <u>2/</u>	258.0	304.4	325.6	356.9	509.3	513.1	586.3
Current	159.9	188.1	210.9	228.6	290.9	298.6	341.6
Budgetary	145.8	172.7	196.3	215.8	273.9	281.3	326.6
Personnel	88.1	98.6	109.0	116.6	142.0	141.3	166.5
Other goods and services	26.2	28.4	39.8	35.7	49.5	46.0	44.7
Interest	14.9	25.4	27.5	34.4	55.2	56.5	74.3
Foreign <u>3/</u>	11.6	21.8	22.1	26.5	46.9	46.8	63.2
Domestic	3.3	3.6	5.4	7.9	8.3	9.7	11.1
Transfers and subsidies <u>4/</u>	16.6	20.3	20.0	29.1	27.2	37.5	41.1
Extrabudgetary <u>1/</u>	14.1	15.4	14.6	12.8	17.0	17.3	15.0
Capital	87.6	110.5	114.7	122.4	196.3	192.4	234.7
Budgetary	49.3	56.1	64.7	67.6	112.8	118.3	131.0
Foreign financed	20.5	27.2	25.8	32.0	70.0	69.2	83.0
Domestic financed	28.8	28.9	38.9	35.6	42.8	49.1	48.0
Extrabudgetary <u>5/</u>	9.2	19.8	19.0	19.5	27.5	22.6	35.7
On-lending <u>6/</u>	29.1	34.6	31.0	35.3	56.0	51.5	68.0
Additional expenditure <u>7/</u>	10.5	5.8	--	5.9	22.1	22.1	10.0
Deficit on a commitment basis <u>8/</u>	-72.5	-61.2	-74.1	-76.5	-78.6	-92.4	-74.0
Commitments for which payment orders not received	...	...	...	2.7	--	3.4	--
Deficit on a payment-order basis	-72.5	-61.2	-74.1	-73.8	-78.6	-89.0	-74.0
Payment delays (net) <u>9/</u>	11.9	3.9	-1.7	-1.4	10.3	--	13.7
Arrears (net accumulation -) <u>9/</u>	-2.8	1.1	--	-0.2	7.8	7.8	6.2
Deficit on a cash basis	-81.6	-66.2	-72.4	-72.2	-96.7	-96.8	-93.9
Financing	81.6	66.2	72.4	72.2	96.7	96.8	93.9
Foreign (net)	46.3	36.6	48.1	51.3	102.0	100.0	130.7
Drawings	67.1	76.2	92.9	101.4	182.0	180.5	242.4
Amortization (-)	-20.8	-39.6	-44.8	-50.1	-80.0	-80.5	-111.7
Domestic (net)	35.3	29.6	24.3	20.9	-5.3	-3.2	-36.8
Banking system	36.5	32.0	20.9	17.8	-9.9	-10.7	-39.1
Nonbank	-1.2	-2.4	3.4	3.1	4.6	7.5	2.3

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

1/ Mainly FNUP. Also includes the net position of other treasury operations and that of rice imported by the BCRH.

2/ On a payments-order basis through 1985 and on a commitment basis as of 1986. Capital expenditure is reported on a cash basis except the domestic financed component, which is available on a payments-order basis. Extrabudgetary expenditure is reported on a cash basis.

3/ On a contractual basis.

4/ Scholarships and grants to public entities.

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

6/ Financed through external loans.

7/ 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, and severance pay and wages due to employees in affected enterprises.

8/ Estimated since capital expenditure is only reported on a cash and payments-order basis. See footnote 2.

9/ The payment delays refer to the settlement during the complementary period of payment orders issued in the previous fiscal year. Any payments beyond this period are considered in the 1988 program as arrears.

nonbank sources, including treasury bills. As a result, the Government made a net repayment to the domestic banking system of FMC 11 billion, or roughly 10 percent more than programmed.

5. Monetary and credit policies

During 1987, the Government pursued more restrictive monetary and credit policies than envisaged in the program. Domestic credit, which was programmed to increase by 11.5 percent, grew by 7.9 percent on account of a lower level of credit to the private sector (including public enterprises) and higher repayments by the Government to the banking system. This credit policy resulted in a greater increase in net official reserves than programmed, and in turn an increase in broad money of 17.6 percent, compared with the 23.5 percent programmed. Velocity of money rose slightly from 4.1 to 4.2.

The authorities explained that the restrictive policy stance was aimed primarily at achieving an adequate level of reserves while the import liberalization was being implemented. They noted that credit demand might have been repressed during the first half of the program by high real interest rates. They explained that the large number of doubtful and litigious loans in the portfolios of the three commercial banks had resulted in relatively high lending interest rates. Since January 1987, the levels of interest rates have remained unchanged. The Central Bank's discount rate has been kept at 15 percent and the minimum rate on 6- to 12-month deposits with commercial banks at 16 percent; and the interest rate on credit has ranged from 12.75 percent for prime customers to 25 percent for high-risk customers. The authorities also stated that gross credit to public enterprises was much lower than programmed as a result of the ongoing implementation of the public enterprise sector reform (Table 4).

The staff representatives noted that the higher repayments by the Government to the banking system had been achieved in part by the accumulation of domestic payments arrears. In addition, the staff noted that recourse by the private sector to import credit had been severely restrained, explaining in part the all-time low level of imports in 1987. The staff representatives stressed that an adequate level of reserves could also be reached by an appropriate mix of budgetary, monetary, and exchange rate policies. They noted that giving undue weight to monetary policy could stifle economic growth through high positive real interest rates. Finally, they concurred that the restructuring of the commercial banks' portfolios was urgently needed.

The monetary authorities introduced two new monetary instruments during 1987: a reserve requirement system in March and the issuance of treasury bills in July.

Table 4. Madagascar: Monetary Survey, 1983-88 ^{1/}
(In billions of Malagasy francs; end of period)

	1983	1984	1985	1986	1987		1988
					Dec. Prog. EBS/87/271	Dec. Act.	Dec. Prog.
Total domestic credit ^{2/}	569.1	672.2	749.6	825.9	920.8	891.2	907.1
Credit to Government, net ^{3/}	306.6	338.3	357.3	376.8	366.2	365.0	310.7
Central Bank	305.7	345.1	370.7	394.1	...	400.8	...
National banks	-15.9	-23.3	-28.1	-33.8	...	-51.0	...
Treasury	16.8	16.4	14.7	16.5	...	15.2	...
Credit to the private sector and state enterprises ^{2/}	262.5	333.9	392.3	449.1	554.6	526.2	596.4
Central Bank	26.9	35.9	32.4	29.7	...	32.7	...
National banks	232.9	295.4	355.3	415.9	...	487.6	...
Treasury	2.7	2.7	4.6	3.5	...	5.9	...
Broad money	271.5	321.1	361.5	448.2	553.6	527.4	593.3
Money supply	210.9	253.6	252.6	304.1	...	386.6	...
Currency	75.8	89.9	96.2	113.2	...	140.3	...
Demand deposits	135.1	163.7	156.4	190.8	...	246.3	...
National banks	121.2	149.7	142.3	176.3	...	231.5	...
Post Office and Treasury	13.9	14.0	14.2	14.5	...	14.8	...
Quasi-money	60.6	67.5	108.9	144.2	...	140.8	...
National banks	50.3	57.0	96.2	129.9	...	121.7	...
National Savings Fund	5.5	5.2	5.1	5.5	...	6.2	...
Other	4.8	5.3	7.6	8.9	...	12.8	...
External position	405.6	562.4	645.7	824.6	1,555.9	1,478.9	1,569.8
Net foreign liabilities	121.4	174.4	117.7	83.9	-28.8	-15.9	-61.6
Central Bank, net	130.8	193.5	137.9	105.6	...	37.8	...
National banks, net	-9.4	-19.1	-20.2	-21.7	...	-53.7	...
Long-term foreign liabilities	284.2	388.0	528.0	740.7	1,584.7	1,494.8	1,631.4
Central Bank	269.2	376.3	520.0	735.0	...	1,487.5	...
Of which:							
rescheduling agreements	(193.1)	(301.4)	(471.4)	(706.4)	(...)	(1,443.8)	(...)
National banks							
Long-term borrowing	15.0	11.7	8.1	5.7	...	7.3	...
Other items, net	-108.0	-211.4	-257.6	-447.0	-1,188.7	-1,115.1	-1,256.1
Of which:							
valuation adjustment	(-108.6)	(-200.7)	(-220.1)	(-405.6)	(...)	(-1,058.7)	(...)

Sources: Central Bank of Madagascar; and staff estimates.

^{1/} Totals may not add up because of rounding errors.

^{2/} The series on "Credit to the private sector and state enterprises" have been revised to show gross credit outstanding, including provisions for loan losses. Previously, the national banks had been reporting "Credit to the private sector and state enterprises" net of provisions for loan losses. For 1988, figures reflect the write-off of doubtful and litigious loans effected in April 1988.

^{3/} 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.

6. External policies

In the framework of the last program with the Fund in 1987 and early 1988, the authorities embarked on substantial adjustment of the exchange rate and a major trade liberalization effort.

Concerning the exchange rate, the authorities recalled that the Malagasy franc had been devalued in steps in the first half of 1987 by a cumulative 52.3 percent in foreign currency terms with respect to a basket of currencies. As a result, the real effective exchange rate of the Malagasy franc depreciated 43 percent through July 1987 in addition to the 17 percent already realized in 1986 (Chart 1). However, with the acceleration in inflation--partly due to the pass-through effect of the depreciation--the Malagasy franc appreciated significantly by about 23 percent in real effective terms during the second part of 1987 and the first quarter of 1988.

The authorities recognized that the competitiveness of the Malagasy economy had been eroded recently and that there was a need to continue following a flexible exchange rate policy. However, they indicated that caution should be exercised in the pursuit of exchange rate policy in order to avoid undesirable effects of exchange rate depreciations on prices, the level of imports, and the purchasing power of the population.

In the area of external trade, the authorities described the recent measures. Since January 1988, state trading companies no longer have a monopoly on the export of pepper and cloves. Also, on April 28, 1988 the authorities published a guide containing simplified export procedures. These include the elimination of exporters' cards and the introduction of a reporting system that requires only an a posteriori declaration. In addition, the maximum delay for the repatriation of foreign exchange has been lengthened from 30 days to 90 days from the date of embarkation of goods. Moreover, domestic trade in export crops has been liberalized. The authorities noted that some of these measures had been reflected in an increase in the number of registered exporters and a pickup in the rate of increase in nontraditional exports. They feared, however, that a sudden increase in the supply of certain traditional exports for which Madagascar is a major world supplier would result in a decline of prices on world markets.

With respect to imports, the authorities indicated that the liberalization of the system had been accelerated with the introduction of the Système de license automatique (an open general license system--OGL) on February 1, 1988. This system covered imports of raw materials and spare parts in its first stage; and gradually replaced the previous LIR. Under the new system, no import license, any other prior approval, or authorization is required for the decontrolled categories. Foreign exchange is available for these imports at the prevailing exchange rate. All procedures, including the collection of statistical data, are

handled by commercial banks. Furthermore, the authorities have reduced the number of prohibited imports and imports for which quantitative restrictions are applied to 95 custom nomenclature categories.

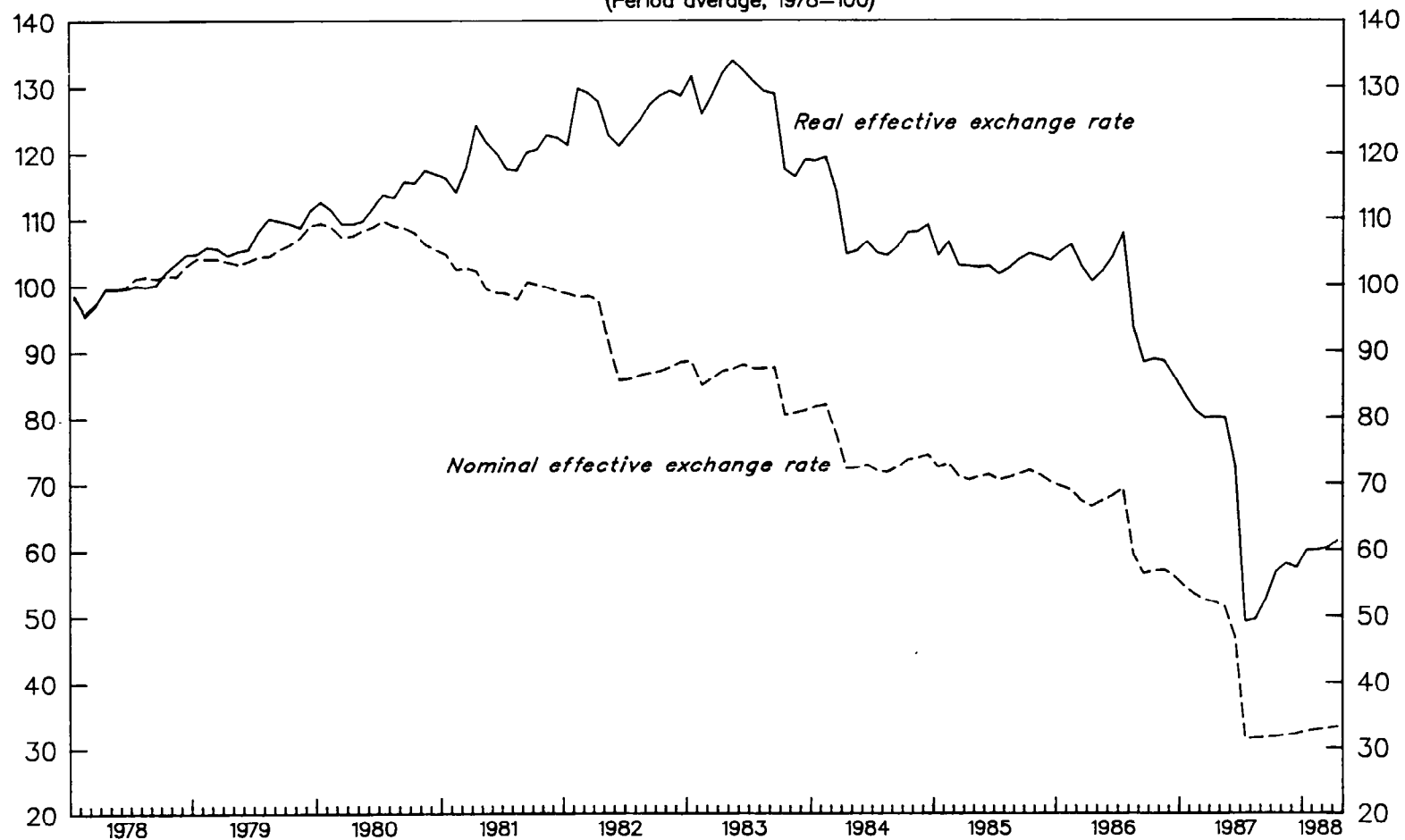
In introducing the new system, the authorities, concerned about the possibility of a substantial increase in import demand, introduced a 100 percent local counterpart deposit scheme for the opening of letters of credit. However, in the period February-May 1988, authorizations under the OGL amounted to less than SDR 6 million and the prior import deposit scheme was abolished on May 1, 1988. Thus, currently no restrictions of any kind apply to the opening of letters of credit by the banking system. Each commercial bank is free to decide on the desirability of requiring such a provision, which in no case may exceed 20 percent of the c.i.f. value of the imports. Importers may now use their own resources, borrow from the banking system, or obtain external loans to finance their imports. The authorities noted that during May there had been an acceleration in the use of foreign exchange under the OGL, which was expected to continue for the rest of the year.

In order to minimize the number of changes in the import regime during a relatively short period, the authorities postponed the extension of the OGL system to imports of equipment goods from the targeted date of April 1, 1988 to July 1, 1988. Despite the postponement, the system became fully operative--covering all imports--as of July 1, 1988. Between February 1 and July 1, the LIR continued to be applied on a transitional basis for products that were not yet covered by the OGL. The monthly allocation consisted of SDR 5 million in that period.

In spite of the measures taken, the performance of the external sector in 1987 was disappointing and reflected in part the deterioration of the terms of trade by more than 22 percent. The external current account deficit is estimated at SDR 186.7 million or the equivalent of 11.7 percent of GDP, compared with 14.8 percent that was envisaged in the program (Table 5). However, this better-than-programmed deficit hides the weak underlying base of the external sector. Exports registered an all-time low of SDR 239.6 million--a decrease of 14.6 percent with respect to the previous year. Exports of coffee plummeted as a result of the sharp fall in world prices. Exports of cloves also suffered a setback as volumes were cut to almost one fourth of the levels reached in the previous two years because of lower demand from Indonesia, the principal market. In contrast, exports of vanilla and pepper registered increases both in prices and in volumes. Exports other than the four main products generally posted strong gains, with a growth rate of more than 16 percent.

Imports declined by 12.1 percent to a record low of SDR 295.4 million (c.i.f. value) as a result of administrative constraints and the effect of the large exchange rate depreciation. All import categories suffered a decline, but the fall was especially pronounced in food, raw materials, and equipment goods. Imports of rice declined from 162.2 thousand tons in 1986 to 93.8 thousand tons in 1987, and imports of raw

CHART 1
MADAGASCAR
NOMINAL AND REAL TRADE-WEIGHTED EFFECTIVE EXCHANGE RATES¹
JANUARY 1978–APRIL 1988
(Period average; 1978=100)



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

¹ A decline in the indices reflects a depreciation.



Table 5. Madagascar: Balance of Payments, 1983-88

(In millions of SDRs)

	1983	1984	1985	1986	1987		1988
					Prog. (EBS/87/271)	Actual	Prog.
Exports, f.o.b.	289.7	325.2	274.5	280.7	246.2	239.6	244.8
Imports, f.o.b.	-353.8	-343.5	-330.7	-282.2	-265.9	-243.7	-263.5
Trade balance	-64.1	-18.3	-56.2	-1.5	-19.7	-4.1	-18.7
Service receipts	45.0	56.9	62.0	68.5	76.3	82.5	87.7
Service payments	-268.0	-289.2	-296.0	-311.7	-319.0	-306.1	-334.3
Freight	(-49.6)	(-48.1)	(-46.1)	(-46.9)	(-43.8)	(-45.1)	(-48.9)
Transport and travel	(-54.6)	(-61.8)	(-68.9)	(-72.6)	(-67.3)	(-67.7)	(-68.3)
Investment income	(-106.6)	(-134.9)	(-131.2)	(-136.3)	(-144.8)	(-129.6)	(-144.6)
Other	(-57.2)	(-44.4)	(-49.8)	(-55.9)	(-63.0)	(-63.7)	(-72.5)
Services, net	-223.0	-232.3	-234.0	-243.2	-242.7	-223.6	-246.6
Of which: interest (including moratorium interest on rescheduled debt)	(-104.4)	(-133.2)	(-129.7)	(-135.1)	(-143.8)	(-129.1)	(-144.0)
Private unrequited transfers	-1.1	9.3	37.4	36.1	36.9	41.0	40.0
Current account	-288.2	-241.3	-252.8	-208.6	-225.5	-186.7	-225.3
Public unrequited transfers	56.9	66.1	59.4	93.6	81.9	82.9	84.5
Nonmonetary capital (net)	184.1	179.5	163.5	181.1	192.3	182.6	61.0
Drawings	181.1	117.9	143.4	163.9	181.6	173.6	206.8
Amortization 1/	-183.1	-127.0	-147.0	-132.9	-159.5	-159.6	-154.0
Debt relief (net of down payments)	186.1	164.9	151.7	159.5	167.6	163.9	27.7
Official creditors	(125.1)	(141.1)	(137.9)	(159.5)	(161.7)	(158.0)	(27.7)
Commercial banks 2/	(61.0)	(23.8)	(13.8)	(--)	(5.9)	(5.9)	(--)
Petroleum financing	...	23.7	15.4	-9.4	2.6	4.7	-19.5
Drawing	(...)	(23.7)	(37.9)	(23.2)	(23.5)	(26.5)	(4.6)
Amortization	(...)	(--)	(22.5)	(-32.6)	(-20.9)	(-21.8)	(-24.1)
National banks (net)	-0.3	-12.2	1.0	5.9	--	-7.1	--
Other 3/	-41.7	23.6	21.1	-6.9	--	-8.0	--
Overall balance	-89.2	15.7	-7.8	65.1	48.7	63.6	-79.8
Financing	89.2	-15.7	7.8	-65.1	-48.7	-63.6	79.8
IMF (net)	6.5	17.9	-3.4	3.4	6.8	6.8	-18.2
Purchases	(10.2)	(41.4)	(29.0)	(44.2)	(33.3)	(33.3)	(11.3)
Repurchases	(-3.7)	(-23.5)	(-32.4)	(-40.8)	(-26.5)	(-26.5)	(-29.5)
Net cash change in arrears (decrease -)	69.6	-9.0	-8.3	-8.7	-10.0	-10.4	-10.0
Net central bank reserves; excluding IMF and arrears (increase -)	13.1	-24.6	19.5	-59.8	-45.5	-60.0	2.0
Financing gap	--	--	--	--	--	--	106.1
Memorandum items:							
Current account deficit as percent of GDP 4/	-10.9	-10.4	-10.9	-9.1	-14.8	-11.7	-16.8
Current account deficit as percent of adjusted GDP 5/	-11.9	-9.1	-9.2	-7.4	-7.6	-6.3	-7.3
Outstanding arrears	95.5	81.4	77.4	68.7	58.7	57.8	47.8
Total gross reserves (Central Bank)	33.8	71.8	45.7	95.9	41.0	135.7	...
Debt service ratio before rescheduling 6/	87.0	75.6	94.3	90.9	105.4	101.1	101.5
Debt service ratio after rescheduling 7/	31.4	33.4	49.2	45.2	53.4	50.2	61.3
GDP in SDRs	2,653.2	2,315.5	2,308.2	2,290.0	1,526.8	1,598.2	1,337.9
FMG/SDR exchange rate	460.2	591.1	672.6	793.5	1,430.5	1,382.6	...

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

1/ Before current year's debt rescheduling.

2/ Includes small amount of debt relief from private creditors other than commercial banks. In December 1985 commercial banks repaid amortization payments on previously rescheduled debt through 1992. In June 1987, these amortization payments were again repaid through 1996.

3/ Includes valuation adjustment; short-term capital other than petroleum financing; errors and omissions; and SDR 3.5 million in SDR allocations in 1981.

4/ 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 terms of SDRs in those years.

5/ Using an adjusted series for GDP in SDR terms, based on a purchasing power parity approach that eliminates the impact of exchange rate fluctuations.

6/ Includes impact of previous years' reschedulings, but excludes that of the current year.

7/ Includes impact of reschedulings through the current year.

materials and capital goods dropped by about 14 percent. The decline in imports more than compensated the decline in exports, and the trade account improved in relation to programmed levels. The current account also reflected a stronger-than-anticipated balance of services and more private transfers, partly owing to the exchange rate adjustment that took place in midyear.

With respect to the capital account, net capital inflows are calculated to be somewhat below program, reflecting lower-than-anticipated drawings on medium- and long-term loans and some outflow of monetary capital. The debt relief obtained from official creditors is estimated at SDR 158 million for the calendar year 1987 and SDR 27.7 million for the first quarter of 1988. The Government has already negotiated and implemented most of the bilateral agreements with official creditors participating in the Paris Club and is striving to finalize all remaining agreements. The Government is also completing the rescheduling negotiations with other official creditors on terms comparable to those of the Paris Club rescheduling. In June 1987, commercial banks rephased amortization payments on previously rescheduled debt through 1996, providing debt relief equivalent to about SDR 6 million in 1987. The debt service ratio before debt rescheduling is estimated at 101 percent, and after rescheduling, at 50 percent; both ratios have increased since 1986 because of the deterioration in export receipts and somewhat higher levels of debt service due.

As a result of the changes described above, the overall surplus of the balance of payments was larger than programmed. After net repayments to the Fund and payment of external arrears of SDR 10.4 million, the larger surplus was reflected in larger-than-programmed increases in net international reserves of the central bank. Net reserves--excluding the Fund and payments arrears--increased by about SDR 60 million for the second consecutive year and reached the equivalent of 22 weeks of the projected level of imports for 1988. The authorities explained that to monitor the appropriateness of the exchange rate, they had previously referred to the concept of "freely disposable reserves," which takes into account the foreign exchange obligations incurred in the framework of the LIR. However, with the full operation of the OGL system, they would focus henceforth on the concept of total reserves for that purpose.

III. The 1988/89 Economic and Financial Program

1. Introduction

To enhance growth prospects in the context of broad financial stability, the Government took major structural adjustment initiatives in the context of the third review of the last stand-by arrangement with the Fund, and the policy framework paper of the SAF. Hence, the proposed program will build upon the major policy initiatives recently

taken, particularly in the areas of internal and external trade, financial sector reform, and public enterprises. The restrained demand management policy stance will be continued and supplemented by an improvement in the efficiency of public expenditure and the pursuit of a flexible exchange rate policy. The proposed program represents the consolidation of a major shift in the macroeconomic policy stance in Madagascar, continuing the transformation of the economy into an open and market-oriented one. The authorities would like to view the program as the basis for launching an ESAF program as early as 1989.

In the context of a comprehensive medium-term macroeconomic framework for 1988-92, the key targets for 1988 include an increase in economic growth from 1.4 percent in 1987 to 2.0 percent in 1988, and a decrease in the rate of inflation, as measured by the GDP deflator, from 20.0 percent to 12.7 percent. Notwithstanding the deterioration of 4.3 percent in the terms of trade in 1988 and the implementation of the OGL system, the external current account deficit is programmed at 16.8 percent of GDP in 1988 compared with 11.7 percent in 1987. ^{1/} To reach these targets, the overall fiscal deficit on a cash basis will be reduced from 4.4 percent of GDP in 1987 to 3.7 percent in 1988. This will be achieved through revenue enhancement and expenditure cuts, and will permit a net repayment to the banking system. A restrained monetary policy will also be pursued, aiming at a 12.5 percent increase in broad money in 1988 compared with 17.6 percent in 1987. The financing gap for 1988 is estimated at SDR 106 million and is expected to be covered by rescheduling of maturities falling due to official creditors. ^{2/}

Performance criteria under the proposed stand-by arrangement have been set for end-September and end-December 1988 (Table 6). The performance criteria for end-March 1989 will be set during the midterm review of the program in October 1988. The authorities have requested technical assistance from the Fund in the area of tax reform and budget monitoring. Recommendations by the technical assistance mission will serve as a basis for reaching understandings on the 1989 budget during the midterm review. The implementation of the public enterprise and financial sector reforms as well as the liberalization of domestic and external trade will also be reviewed at that time.

2. Structural policies

a. Public enterprises

A major goal of the authorities is to reduce the size of the public enterprise sector and to raise the efficiency of the enterprises that

^{1/} In percent of adjusted GDP, the external current account deficit is programmed at 7.3 percent in 1988 compared with 6.3 percent in 1987.

^{2/} The absence of comprehensive data on GDP by revenue sources rendered difficult the analysis of the impact of the financial policies on macroeconomic variables such as private savings.

Table 6. Madagascar: Performance Criteria for 1988

	Dec. 1987 Actual stocks at end-period	Jan. 1, 1988 to Sept. 30, 1988	Jan. 1, 1988 to Dec. 31, 1988
(In billions of Malagasy francs)			
Domestic credit	891.2	9.2 <u>1/</u>	15.9 <u>1/</u>
Net credit to Government	349.8	-20.4 <u>1/</u>	-39.1 <u>1/</u>
Gross credit to public enterprises	228.4	1.6	1.6
(In millions of SDRs)			
External payment arrears	57.8	-8.0	-10.0
External debt <u>2/</u>			
1-5 years maturity	2.3	5.0	5.0
5-15 years maturity	21.5	25.0	25.0
Short-term debt	39.6 <u>3/</u>	60.0 <u>4/</u>	60.0 <u>5/</u>

1/ To the extent that the amount of program loans received in the budget is higher than the FMG 79.0 billion programmed through end-September 1988 and the FMG 91.4 billion programmed through end-December 1988, the ceilings on total domestic credit and net credit to Government will be adjusted downward accordingly. Similarly, these ceilings will be adjusted if the net amount of treasury bills subscribed by the nonbanking system is higher than the FMG 2.0 billion programmed through end-September 1988 and the FMG 2.3 billion programmed through end-December 1988. The corresponding gross amount of treasury bills subscribed is programmed at FMG 7 billion through end-September 1988 and FMG 9.9 billion through end-December 1988.

2/ Annual cumulative contracting of nonconcessional external debt.

3/ External short-term debt outstanding at end-December 1987.

4/ Stock during the period January 1, 1988 to September 30, 1988.

5/ Stock during the period October 1, 1988 to December 31, 1988.

will remain in the public sector. Thus, the Government has decided to accelerate the reform of public enterprises and implement a comprehensive plan of action that will entail government divestiture, liquidation, and restructuring of all public enterprises. Given the comprehensive nature of this task and the large number of public enterprises involved, the program will be implemented in stages and will be completed by June 1991. Most of the 167 public enterprises have been reviewed, and the Government has already officially dissolved 19 public enterprises and initiated liquidation of their assets. The Government has also initiated the divestiture process for seven major public enterprises in the industrial sector, including large users of bank credit, with the objective of completing this process by December 1988. Furthermore, beginning in 1989, the Government will liquidate an additional ten public enterprises and initiate the divestiture process for another ten. This action program will have a significant impact on the parastatal sector as it will encompass at least 40 percent of industrial value added, 77 percent of employment in the state-controlled industrial sector, and all major enterprises whose bank credits are classified as high risk ("D"). Prior to end-1989, the Government will liquidate, disengage itself from, or restructure other public enterprises. The cost of the public enterprise reform, other than wage related costs and the size of the doubtful and litigious loans, is yet to be determined.

In support of its structural policies, the Government will continue to implement measures that contain the activities of existing public enterprises. During the parastatal reform program, no new public enterprises will be created, with the exception of those agreed upon in the reform of the sector or in the framework of the review of public expenditure programs. In addition, no increase will be permitted in budgetary transfers beyond the 1987 level to the group of public enterprises whose loans are classified as high risk. Finally, the expansion in gross bank credit to any of these enterprises beyond their commitments at end-1987 will be prohibited.

b. Public finance

The authorities have decided to renew efforts to improve the management of public finance in Madagascar and to strengthen budgetary performance.

On the revenue side, the objective is to rationalize the tax structure and broaden the tax base. The authorities have already taken steps in this direction, following the recommendations of a FAD technical assistance mission to Antananarivo in 1987. On January 1, 1988, the authorities replaced quantitative import restrictions with a simplified eight-bracket tariff structure with a maximum tariff of 80 percent and a minimum rate of 5 percent as well as a temporary surcharge of 30 percent to ease the transition period. All imports--except those exempted in accordance with international treaties--are now subject to the minimum 5 percent tariff. With the 1989 budget, the authorities plan to take additional revenue measures. Proposals under consideration include

replacement of the confiscatory taxation of incomes and profits with a marginal tax structure having low rates and limited exemptions; adoption of a single, lower rate for corporate taxes; and elimination of taxes levied for historical reasons, which have limited yield. The authorities also explained that starting in 1989, they would undertake to reduce the effective rate of taxation of traditional exports, and correspondingly, to raise additional revenue from domestic sources. In a move to facilitate the formulation of the necessary reforms within the specified time period, the Government has requested technical assistance from the Fund.

On the expenditure side, structural policies aim at strengthening the monitoring and control of the financial operations of the Central Government, and at improving the structure of public spending. To prevent the emergence of domestic payments arrears, the Government will present the budget on a commitment basis and on a payment-order basis as well as on a cash basis, beginning with the 1989 budget. To this end, the Government has requested technical assistance from the Fund. The Government will also take steps to reorder public spending priorities and monitor the progress of capital expenditures. It will draw up a three-year rolling public expenditure program (PEP) and a public investment program (PIP) that will initially cover the period 1989-91. Both the PEP and PIP will be finalized before presentation of the 1989 budget to the National Assembly. As part of its efforts to improve the structure of public expenditure, the Government will undertake a review of personnel outlays. Initial results of an audit intended to make the Government's official payroll consistent with staff actually holding positions and to eliminate incorrect payments will be available by October 1988, and will be incorporated into the 1989 budget. In addition, a comprehensive census of permanent staff will be completed before April 1989, and of nonpermanent staff before October 1989. More generally, the Government will take steps to orient public spending in favor of such items as recurrent and maintenance expenditure linked to capital projects, and nonpersonnel goods and services. The authorities will seek to improve the provision of basic education and health care in order to mitigate the impact of adjustment on the poor.

c. Financial sector

The Government has decided to accelerate the liberalization of the financial sector by opening it to the Malagasy private sector and foreign financial institutions; to this end, new banking legislation was adopted and published on May 5, 1988. A prior condition for the approval of the requested stand-by arrangement is the publication of all decrees and instructions referred to in this legislation that would allow existing banks to continue their activities and new banks and institutions to conduct business.

The Government will restructure the portfolios of the existing commercial banks while actively seeking the participation of the private and foreign sectors. In the first phase of the reform, doubtful and

litigious debts (classified "D" ^{1/}) of public enterprises and the private sector in the portfolios of the three commercial banks--estimated at FMG 142.9 billion at end-December 1987, or about 30 percent of total loans to the nongovernment sector--have been partially written off in the amount of FMG 74.1 billion through end-April 1988 against earmarked provisions and accumulated interest charged on these debts. In the second phase of the reform, a distinction is to be made between the three banks. A detailed plan for the writing off of "D" debts and all or part of "C" debts will be prepared on the basis of the audits for 1987, which will be available before end-September 1988. Pending these audits, the amounts from the 1987 OGT (opérations générales du Trésor) allocated to write off part of the "D" debts of the BTM and BFV will not be used, nor will any issue of financial instruments be envisaged until consultations on action plans, including significant private participation, take place with the Fund, the World Bank, and potential private partners before end-1988.

As for the BNI, the writing off of the remaining "D" debt and of all or part of the "C" debt existing at end-1987 will take place in the context of the overall restructuring and privatization of the bank. In the meantime, the amount from the 1987 OGT allocated for this purpose will be frozen. The Government will make contact as quickly as possible with one or more private banks with a view to reaching a participation agreement, which would include the possibility of setting up a private commercial bank before end-1988. Until end-1988, special attention will be given by the monetary authorities and by the management of the BNI to the functioning of the bank, both with respect to the setting of the bank's credit ceilings and to the nature of its activities, so as to avoid any significant changes from its balance sheet structure of end-1987.

The implementation of the restructuring of the three banks' portfolios, the agreement of the private sector to participate in the capital of two of the three banks, and the establishment of one or more independently operating foreign commercial bank(s) are conditions for completion of the midterm review.

d. External sector

To strengthen the short-term external position and improve the profile of Madagascar's balance of payments over the medium term, the Government has taken and intends to take a series of measures in exchange rate management and trade policy.

The authorities have decided to reverse the appreciation in real terms of the Malagasy franc, excluding the pass-through effects of the

^{1/} All loans are now classified into one of four categories according to the risk associated with the loan--"A," minimum risk; "B," to be watched; "C," probable risk; and "D," certain risk.

last devaluation. In addition, they will continue adjusting the exchange rate as frequently as needed to reflect changes in the exchange rates and differentials in inflation between Madagascar and its main trading partners with the aim of ensuring export competitiveness and supporting trade liberalization. The authorities will also evaluate the appropriateness of the exchange rate in light of quarterly benchmarks for net international reserves, developments in the main components of the balance of payments, and other policy objectives. In the event that the reserve targets are not met, there will be consultations with the Fund staff. The authorities will also consult with the Fund staff in the event that imports do not recover as envisaged in the program, in order to examine the factors behind the behavior of imports, to discuss appropriate measures to correct the situation, and to ensure the success of the liberalization of the trade system.

In June 1988, the Government took additional measures to liberalize exports. For the period May 1988 to May 1989, all parties may freely negotiate and execute export contracts on coffee. During this transitional period, a reference price will serve as a basis for calculating taxes on exports and for determining the foreign exchange to be repatriated. A committee of experts will construct, in collaboration with the World Bank, the reference price on the basis of international market data and will update it weekly. The Stabilization Fund will continue to distribute automatically coffee export stamps from the International Coffee Organization (ICO) to applicants having an export contract. Following this transitional period, the Government will introduce additional liberalization measures with the aim of implementing a reform of the Stabilization Fund before the beginning of the 1989 crop year.

The Government will carry forward the liberalization of exports of cloves. On April 16, 1988, the Government signed a contract with Indonesia providing for the exports of 10,000 tons of cloves at a fixed price of US\$2.60 per kilogram f.o.b. for 1988. Notwithstanding this contract, to date private traders and state trading companies are authorized to export to any market any quantity of cloves at a price exceeding that negotiated with Indonesia. If exporters have incurred storage costs with respect to the contract with Indonesia, the Government will reimburse these costs as the contract is executed. Before completion of the midterm review, private operators and state trading companies will be authorized to export to any market at a price freely determined by exporters and importers.

The requirement of quality control or certification of exportable goods by the Government has been abolished for a number of products and is now limited to only four: vanilla, coffee, shellfish, and meat. Exports of cloves will also need a certificate of quality but only for

the remainder of 1988. ^{1/} Quality control will be limited to a quality or sanitary inspection certificate from a government agency or a specialized private company of international standing, at the option of the exporter. For vanilla, coffee, and cloves, the control will be effected at the level of stocks and not at the time of embarkation. For shellfish and meat, control will be exercised at the time of embarkation only in the absence of a mechanism directly agreed upon by the importer and exporter in conformity with international agreements.

Concerning imports, the full implementation of the open general license system was completed as scheduled on July 1, 1988. Moreover, the Government has undertaken not to impose restrictions of any kind on the opening of letters of credit or other means of financing imports. In addition, the Government will continue to review the list of imports subject to administrative control with the objective of reducing it further and will continue to streamline the tariff structure with a view to progressively reducing effective protection. To this end, the temporary 30 percent surcharge will be re-examined during the midterm review of the program.

The liberalization of external trade will be supplemented with the reduction in restrictions on certain imports of services. From July 1, 1988, the allocation of foreign exchange for business travel was increased from the equivalent of US\$54 per day to US\$100 per day. To facilitate the marketing and promotion of Malagasy products abroad, the Government intends to ease the administrative procedures covering business travel.

To ensure the smooth functioning of the liberalized external trade system, the Government has decided to set up an independent committee to examine grievances and receive suggestions and proposals from exporters and/or importers with respect to the operation of the system.

3. Financial programming

a. Public finance

Under the fiscal program for 1988, the overall deficit on a cash basis will be limited to FMG 93.9 billion, or 3.7 percent of GDP, compared with 4.4 percent of GDP in 1987, and the Government will substantially reduce its indebtedness to the domestic banking system.

Revenue and grants are expected to rise by 22 percent, an increase that the authorities attributed to a number of recent measures. First, all imports, except those exempted by international treaty, are subject to the 5 percent minimum tariff as of April 1, 1988, which is expected to improve the elasticity of import taxes and yield an additional

^{1/} Mining products are covered by a special arrangement under the Mining Law, which is now being discussed with the World Bank.

FMG 2.5 billion. Second, the prices have been raised for the three monopoly products (tobacco at end-1987, and flour and matches in March 1988), which will bring in new revenues estimated at FMG 8.3 billion. Third, controls on profit margins have been lifted on all but a limited number of goods, contributing to higher revenue from the value-added tax and taxes on income and profits. Finally, in January 1988, tax collection procedures were tightened, with decentralized committees now closely monitoring the collection of indirect taxes.

Total expenditure is projected to increase in 1988 by 14 percent. Current expenditure will be allowed to grow by 14.4 percent, representing an increase of about 2 percent in real terms. In this respect, the authorities noted that in January 1988 they had ordered cuts in budgetary allocations, other than those for personnel and interest payments, totaling FMG 16.5 billion. This restraint in current expenditure will permit a 22 percent increase in capital expenditure in keeping with the PIP for 1988, most of which will be financed from foreign concessional sources. The expenditure projections include FMG 10 billion for the partial write-off of doubtful and litigious loans of the commercial banks to public enterprises as well as for the rehabilitation of public enterprises and severance pay and wages due to employees in affected enterprises. The compensation to these employees, which falls within the scope of the Economic Management and Social Action Project (EMSAP) envisaged with the World Bank, is designed to cushion the social impact of public enterprise reform. If the FMG 10 billion is not fully used, the deficit target will be revised downward and repayment of the Government to the banking system increased accordingly. Another FMG 6.2 billion has been earmarked for the settlement of domestic payments arrears. During the program, the Government will not accumulate new domestic payments arrears excluding payments for expenditure committed in 1988, which will be honored during the complementary period, if the supporting documents have been received within that time.

To strengthen control over fiscal developments and ensure that timely corrective actions are taken, quarterly targets have been established for total revenue and total expenditure. If a shortfall in revenue appears likely or if expenditure exceeds the targets established in the program, the Government will consult with Fund staff on the appropriate measures to take so as to meet the fiscal targets.

b. External sector

The program's objective is to limit the external current account deficit to SDR 225 million for 1988 (16.8 percent of GDP), compared with

SDR 187 million (11.7 percent of GDP) recorded in 1987. ^{1/} The widening of the current account deficit in 1988 reflects the continued deterioration in the terms of trade--which are projected to decline by 4.3 percent--and the recovery of imports in the second half of the year following the implementation of the OGL system and other liberalization measures; it also reflects the increase in payment of services associated with higher imports and higher interest payments due on external debt.

Exports of goods are projected to increase by 2.2 percent with respect to 1987. Exports of coffee and vanilla are expected to decrease because of lower volume and unit value, but these decreases will be more than compensated by increases in exports of cloves, pepper, and nontraditional exports. Notwithstanding a sharp decrease in rice imports, total imports f.o.b. are projected at about SDR 264 million, an increase of more than 8 percent compared with 1987. Nonfood imports are expected to register strong gains as the OGL system is put in place. Most of the increases are likely to take place in the second half of 1988.

In the capital account, net drawings on medium- and long-term loans are projected at SDR 206.8 million. Of this total, about one half corresponds to disbursement on loans from the World Bank and takes into account the outcome of the Consultative Group meeting held in January 1988 and the March 1988 donors' meeting in the context of the World Bank's special program of assistance. Amortization payments are estimated at SDR 154 million, along with some SDR 19.5 million of net repayments anticipated for petroleum financing. Considering the debt relief already obtained from the Paris Club for the first quarter of 1988, repayments of SDR 10 million of external arrears, the use of SDR 2 million of gross official reserves, and net repurchases to the Fund, the remaining financing gap is estimated at SDR 106 million. To cover this gap, the Government intends to request a rescheduling of maturities falling due to official creditors beginning on April 1, 1988, including those in arrears since April 1, 1988.

The service of external debt continues to be a severe burden for the Malagasy economy. Debt service payments before rescheduling are projected at 101 1/2 percent of exports of goods and services in 1988 or at about the same level of 1987. The debt service ratio, after debt relief, is projected to increase to 61.3 percent in 1988 from 50.2 percent in 1987. Accordingly, the Government will continue to pursue prudent debt management policies and will seek to improve the profile of

^{1/} To a certain extent, the increase in the external current account deficit with respect to GDP reflects the changes in the exchange rate of the Malagasy franc with respect to the SDR in 1987 and 1988. In percent of adjusted GDP, the external current account deficit is programmed at 7.3 percent in 1988 compared with 6.3 percent in 1987.

its external debt. To this end, ceilings have been placed on the contracting and guaranteeing of nonconcessional loans by the public sector for maturities between 1 and 5 years and between 5 and 15 years. Also, the outstanding stock of short-term debt, which reached about SDR 52 million by end-April 1988, will not be allowed to exceed SDR 60 million at any time during 1988.

c. Monetary and credit policies

The Government will pursue prudent monetary and credit policies consistent with the objectives of the program. Given the balance of payments and inflation targets, the expected impact of the financial sector reforms, and the need to provide adequate resources to finance economic activity especially for the private sector, money supply broadly defined is projected to increase by 12.5 percent in 1988, compared with a 15 percent increase in nominal GDP. Net credit to the Government is programmed to decrease by 14.9 percent while credit to the private sector (including credit to public enterprises) is expected to increase by 13.3 percent. Gross credit to public enterprises is programmed to increase by about 1 percent, reflecting the effect of the implementation of the ongoing public enterprise reform program and a zero increase to public enterprises classified as high risk ("D").

Consistent with the lower projected rate of inflation of 12.7 percent in 1988, the Central Bank decreased its discount rate from 15 percent to 12 percent in June 1988. The authorities will review the evolution of domestic prices closely in order to keep interest rates on deposits and credit positive in real terms during the entire program period.

As a performance criterion, total domestic credit, which amounted to FMG 891.2 billion as of December 31, 1987 and which is estimated at FMG 835.8 billion as of end-April 1988, will not be allowed to increase by more than FMG 9.2 billion during the period January 1 to September 30, 1988, or by more than FMG 15.9 billion during the period January 1 to December 31, 1988. Within these ceilings, three subceilings have been established, also as performance criteria. First, credit to Government, which amounted to FMG 349.8 billion as of December 31, 1987, and which is estimated at FMG 357.3 billion at end-April 1988, will decrease by at least FMG 20.4 billion from January 1 to September 30, 1988, and by at least FMG 39.1 billion from January 1 to December 31, 1988. To the extent that the amount of program loans (financial aid) is higher than the FMG 91.4 billion projected, the ceilings on total domestic credit and net credit to the Government will be adjusted downward accordingly. In addition, the ceilings on total domestic credit and on net credit to Government will be adjusted downward in the event that the net amount of treasury bills subscribed by the nonbanking system is higher than the FMG 2.3 billion programmed. The same will apply to the extent that the amount for writing off doubtful and litigious loans of the banking system to public enterprises as well as for

financing the rehabilitation program for public enterprises and the payment of lay-off compensation and wages due is less than the FMG 10 billion programmed.

Second, gross credit to public enterprises, as reported by the credit information office (Centrale des Risques), which amounted to FMG 228.4 billion as of December 31, 1987 and which is estimated at FMG 240.8 billion at end-March 1988, will not be allowed to increase by more than FMG 1.6 billion during the period January 1 to September 30, 1988 or by more than FMG 1.6 billion during the period January 1 to December 31, 1988. Third, no new credit will be extended to public enterprises classified as high risk ("D"). Moreover, all the necessary steps will be taken to define the credit ceilings to public enterprises on a net basis; this change in definition will be adopted for the March 1989 credit ceilings that will be set during the midterm review.

d. Performance criteria, midterm review, and phasing and purchases

In the proposed program, performance criteria have been set for end-September and end-December 1988, and include (1) a ceiling on the increase in total domestic credit by the banking system; (2) a subceiling on the increase in net credit to Government by the banking system; (3) a subceiling on the increase in gross credit from the banking system to public enterprises; (4) a subceiling on new credit to public enterprises classified as high risk; (5) limits on the stock of outstanding external debt with an initial maturity of a year or less of the Government and the Central Bank and authorized or guaranteed by them; (6) limits on the contracting of external nonconcessional debt with an initial maturity between 1 to 5 years, and between more than 5 years to 15 years by the Government and the Central Bank and authorized and guaranteed by them; and (7) a program for the reduction of external payments arrears. The program has a midterm review in October 1988. At that time, understandings will be reached on the 1989 budget on the basis of the recommendations of the FAD mission requested by the authorities. The implementation of the public enterprise and financial sector reforms will also be reviewed, as well as the liberalization of domestic and external trade. In light of these reforms and new developments, including the outcome of external debt rescheduling, performance criteria for March 1989 will be set. During the review, the Government will reach understandings with the Fund on the adoption of all additional measures that may be deemed necessary to attain the targets of the program.

The amount of access under the proposed stand-by arrangement, at 20 percent of quota, is consistent with access criteria, taking into account the adjustment envisaged under the program and the prospect of Fund involvement in Madagascar in the near future. There will be four purchases under the proposed stand-by arrangement: the initial one (SDR 2.8 million) that would be available upon the Fund's approval of the stand-by arrangement, and three subsequent ones, each for SDR 3.5

million. The second purchase would be subject to observance of end-September 1988 criteria, the third purchase would be subject to observance of end-December 1988 performance criteria and completion of the midterm review, and the fourth purchase would be subject to observance of end-March 1989 performance criteria.

IV. Medium-Term Scenario

Madagascar's medium-term outlook remains difficult, reflecting the continued seriousness of the country's debt situation, especially its high debt service ratio and its weak export base. Thus, the Government has sought both to preserve the progress made to date in financial stabilization, and to undertake further structural adjustment measures aimed at liberalizing the economy, while achieving a rate of growth higher than the population growth in the near future.

The medium-term scenario has been constructed on the basis of the main assumptions of the most recent World Economic Outlook concerning the external environment and on present macroeconomic policies (Table 7). The projections show continued reliance, albeit at a declining rate, on exceptional financing and rescheduling through 1992. The magnitude of the financing gaps--especially in the outer years--will depend crucially on the response of the economy to the comprehensive set of structural and liberalization measures undertaken by the Government in 1988-89, on the vigor with which the Government implements them, and on the profile of world prices for the traditional exports. The scenario assumes that the terms of trade continue to deteriorate slightly because of slow growth in the prices of Madagascar's main export items. The Malagasy authorities expect overall real GDP growth to rise steadily from 2.0 percent in 1988 to 4.2 percent by 1992. The rate of domestic inflation--measured by the GDP deflator--is projected to decline gradually from 20 percent in 1987 to 9 percent in 1989 and to 6 percent thereafter.

The scenario also envisages a gradual reduction in the size of the fiscal deficit, which is targeted to decline from 3.7 percent of GDP in 1988 to 2.3 percent of GDP in 1992 through a combination of revenue and expenditure measures. The structure of revenue is expected to undergo substantial changes, leading to an increase in the share of domestic sources of revenue in contrast to sources linked to external trade. Moreover, expenditures are expected to be rationalized, with greater importance being attached to the level and quality of investment expenditure.

As the private sector is expected to accelerate its rate of investment in response to the various structural measures, total gross investment with respect to GDP is projected to rise steadily and reach 16.0 percent by 1992--compared with 13 2/3 percent on average in the period 1983-87. The rate of domestic savings is projected to increase

Table 7. Madagascar: Selected Medium-Term Indicators, 1988-92

	<u>1988</u> Prog.	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>
		Projections			
	(Annual percentage changes)				
Real GDP	2.0	3.0	3.5	3.9	4.2
Inflation <u>1/</u>	12.7	9.0	6.0	6.0	6.0
Total government revenue and grants	21.8	14.2	8.8	7.6	8.2
Total government expenditure	14.3	16.3	7.1	6.0	7.0
Broad money	12.5	11.8	9.7	10.1	10.5
Export volume	5.0	16.8	9.3	9.3	9.2
Nonfood import volume	12.5	13.7	8.0	3.9	3.4
Terms of trade (- deterioration)	-4.3	-2.2	-0.2	-0.7	0.4
	(In percent of GDP, unless otherwise indicated)				
Gross investment	15.2	15.4	15.5	15.7	16.0
Domestic savings	5.5	6.1	6.8	8.3	10.3
Resource gap	9.7	9.2	8.7	7.4	5.6
Total government revenue and grants	20.2	20.5	20.3	19.9	19.4
Total government expenditure	23.1	23.9	23.3	22.5	21.7
Overall fiscal deficit	-3.7	-3.4	-3.0	-2.6	-2.3
Current account	-16.8	-16.6	-15.3	-13.5	-10.8
Current account (adjusted) <u>2/</u>	-7.3	-7.1	-6.6	-5.8	-4.7
Debt service ratio before rescheduling <u>3/</u>	101.5	100.4	91.5	77.5	70.0
Debt service ratio after rescheduling <u>4/</u>	61.3	69.0	66.7	59.4	60.1

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

1/ As measured by the GDP deflator.

2/ An adjusted series of GDP expressed in SDR terms is used, based on a purchasing power parity approach that neutralizes the impact of exchange rate fluctuations.

3/ Total debt service, excluding net reductions in short-term debt, including the reduction in arrears, and interest on the financing gap, as a ratio of exports of goods and services.

4/ Assuming that further possible rescheduling is limited to the same terms of Paris Club V (1986).

gradually from 5 1/2 percent in 1988 to about 10 percent over the projection period, reflecting the reform of public enterprises and the financial sector, renewed confidence in economic prospects, and the maintenance of positive real interest rates.

Consistent with the macroeconomic framework, the medium-term projections for the balance of payments show a decline in the current account deficit from 16.8 percent of GDP in 1988 to 10.8 percent of GDP in 1992. Part of this decline will be achieved through a reduction in the overall deficit of the Central Government. However, the brunt of the adjustment will be absorbed by the reduction in losses of the public sector enterprises and commercial banks, which will release resources for expansion of the private sector.

Exports are projected to increase by an average of about 14 percent in value terms, and by about 11 percent per year in volume terms in 1988-92, as the impact of export reform and liberalization takes hold (Table 8). The authorities are projecting a moderate rate of increase in the volumes of the main traditional items. In addition, exports of pepper are expected to double in volume terms. The resumption of exports of meat to the European Communities, the initiation of exports of rice, and the rapid expansion of other nontraditional products will account for a major portion of export volume growth over the period. In particular, the share of nontraditional exports in total exports is expected to rise from about 41 percent in 1988 to nearly 56 percent in 1992.

Import demand is expected to grow rapidly as a result of the liberalization of domestic and external trade. Imports are expected to increase by an average of about 9 percent a year in value terms in the period 1988-92, with substantial increases in imports of equipment goods, raw materials, and spare parts. Excluding food items, imports will increase by 6.4 percent a year in volume terms over the period. The general profile of imports shows a quantum adjustment of their levels in 1989-90, reflecting the accommodation of the economy to the liberalization measures. After 1990, the pattern of import demand will reflect more closely the current growth of domestic investment, consumption, and overall growth of the economy.

With respect to the capital account, it is expected that concessional capital flows will increase over time approximately in line with the growth of imports. Debt service will remain very high over the projection period but will stabilize at about SDR 375 million a year in 1990-92. The debt service ratio (in terms of exports of goods and services), which averaged 95 percent in 1985-87, is expected to peak at 101-102 percent in 1988-89 before declining gradually to 70 percent by the end of the projection period. The stock of external debt will increase over the projection period, but will decline in terms of GDP from a peak of 196 percent in 1988 to 180 percent in 1992. Reflecting the net repurchases to the Fund, the debt service ratio on Fund obligations will decline sharply from 13 1/2 percent in 1988 to only 3 1/2

Table 8. Madagascar: Medium-Term Balance of Payments Scenario, 1985-92

(In millions of SDRs)

	1985	1986	1987	1988 Prog.	1989	1990	1991 Proj.	1992
Exports, f.o.b.	274.5	280.7	239.6	244.8	291.8	330.8	373.2	421.5
Of which: Coffee	101.4	126.5	75.8	71.5	76.7	84.6	90.0	97.2
Imports	-330.7	-282.2	-243.7	-263.5	-303.7	-336.1	-361.8	-384.3
Trade balance	-56.2	-1.5	-4.1	-18.7	-11.9	-5.4	11.4	37.1
Services (net, excl. interest)	-104.3	-108.1	-94.6	-102.6	-109.6	-115.9	-121.0	-125.2
Private transfers	37.4	36.1	41.0	40.0	43.2	46.7	50.4	54.4
Public transfers	59.4	93.6	82.9	84.5	85.7	88.3	91.0	93.7
Direct investment	...	...	...	--	5.0	7.0	9.0	11.0
Drawings on loans	143.4	163.9	173.6	206.8	226.2	240.7	250.1	256.3
Balance available for debt servicing	79.7	184.1	198.8	210.0	238.6	261.4	290.9	327.3
Total debt service	-309.1	-308.8	-315.2	-327.5	-360.5	-376.0	-373.2	-375.4
Amortization	-179.4	-173.7	-186.1	-183.5	-204.1	-220.4	-214.8	-222.0
IMF repurchases and repayments	(-34.5)	(-45.9)	(-31.6)	(-34.1)	(-41.2)	(-37.6)	(-25.1)	(-15.5)
Interest	-129.7	-135.1	-129.1	-144.0	-156.4	-155.6	-158.5	-153.4
Interest on existing debt	...	...	...	-138.6	-136.6	-120.7	-109.4	-92.7
Interest on new loans	...	...	...	-1.2	-8.2	-14.8	-22.1	-29.6
Interest on financing of the gap	...	...	...	-3.9	-10.7	-19.1	-25.9	-30.2
Of which: IMF charges	(-13.7)	(-13.0)	(-11.6)	(-10.9)	(-9.5)	(-7.2)	(-5.0)	(-3.5)
Rescheduling already obtained ^{1/}	151.7	159.5	163.9	27.7	--	--	--	--
Short-term capital	16.4	-3.5	-2.4	-19.5	--	--	--	--
Errors and omissions	21.1	-7.0	-8.0	--	--	--	--	--
Balance after debt servicing	-40.2	24.3	37.1	-109.4	-121.9	-114.6	-82.4	-48.1
IMF purchases and SAF	29.0	44.2	33.3	11.3	7.0	--	--	--
Of which: SBA	29.0	44.2	20.0	11.3	7.0	--	--	--
SAF	--	--	13.3	--	--	--	--	--
Change in arrears (-decline)	-8.3	-8.7	-10.4	-10.0	-28.3	-20.0	--	--
Change in foreign reserves of the Central Bank (-increase)	19.5	-59.8	-60.0	2.0	--	-5.0	-5.0	-5.0
Financing gap	--	--	--	-106.1	-143.2	-139.6	-87.4	-53.1
Possible further rescheduling ^{2/}				106.0	121.5	107.6	87.4	68.1
Remaining necessary financing				0.1	21.7	32.0	--	-15.0
Memorandum Items:								
Current account deficit ^{3/}	-252.8	-208.6	-186.7	-225.3	-234.7	-230.2	-217.7	-187.0
Cumulative financing gap	--	--	--	106.1	249.2	388.8	476.2	529.2
Stock of outstanding debt ^{4/}	2223.1	2419.6	2484.0	2622.8	2766.8	2906.7	3029.5	3116.8
Debt service ratio								
without rescheduling ^{5/}	94.3	90.9	101.1	101.5	100.4	91.5	77.5	70.0
Debt service ratio after rescheduling ^{6/}	49.2	45.2	50.2	61.3	69.0	66.7	59.4	60.1
Debt service ratio on Fund obligations ^{7/}	14.3	16.9	13.4	13.5	13.1	10.4	6.3	3.5
Gross reserves, Central Bank ^{8/}	7.1	16.9	22.1	18.9	17.1	16.4	16.0	...
Interest service ratio	38.5	38.7	40.1	43.3	40.4	36.0	32.9	28.6
Debt/GDP ratio	96.3	105.7	155.4	196.0	195.2	192.6	187.7	180.1
Debt/adjusted GDP ratio ^{9/}	80.8	85.5	84.3	84.7	84.3	83.0	80.9	77.7

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

^{1/} Includes rescheduling through 1987 with the Paris Club and other official creditors. Amortization payments reflect the rephasing of service to commercial banks.

^{2/} Estimate; assumed to be on the same terms as Paris Club V (1986).

^{3/} Including the cost of rescheduling and of financing the remaining gap.

^{4/} Assuming that the remaining gaps will be financed by new debt.

^{5/} Total debt service, excluding net reductions in short-term debt, including the reduction in arrears, and interest on the financing gap, as a ratio of exports of goods and services.

^{6/} Assuming that further possible rescheduling is limited to the same terms of Paris Club V (1986).

^{7/} Repurchases and charges, including Trust Fund repayments, as a ratio of exports of goods and services.

^{8/} In weeks of the following year's imports of goods (c.i.f.).

^{9/} Using an adjusted series for GDP in SDR terms based on a purchasing power parity approach that neutralizes the impact of exchange rate fluctuations.

percent in 1992. Madagascar has serviced its debt to the Fund in a timely fashion, and no arrears have arisen toward the Fund. Its record of punctual repayment to the Fund, as well as the expected improvement in its balance of payments and the comfortable level of foreign exchange, should indicate that Madagascar will remain current with the Fund.

The stock of outstanding payments arrears at the end of 1988 is estimated at SDR 47.8 million. The medium-term scenario assumes the elimination of these arrears through cash payments in the period 1989-90. Furthermore, the projections assume accumulation of gross reserves consistent with the maintenance of a level of 4 months on imports of the following year.

Despite the Government's efforts, the balance of payments projections show financing gaps persisting over the medium term. However, the financing gaps will decline substantially over the period--from SDR 143 million in 1989 to SDR 53 million in 1992. Financing gaps for 1989-91 are expected to be covered with possible use of Fund resources under the ESAF and with a combination of additional debt relief from official creditors and donor support. 1/

V. Staff Appraisal

Since the early 1980s, Madagascar's adjustment efforts have focused on reducing its financial imbalances. In the first stages, these efforts concentrated mainly on budgetary restraint, monetary policy, and correction of the overvalued exchange rate.

Under the program supported by the previous stand-by arrangement and the first annual arrangement under the structural adjustment facility, the Government moved to reduce structural and pricing rigidities that hampered production and exports, thus alleviating the administrative control imposed at all levels of the economy. The measures implemented included substantial adjustments in the exchange rate of the Malagasy franc, the introduction of a liberalized import regime designed to eliminate the discretionary element in the allocation of import licenses and foreign exchange authorizations, increases in the

1/ An alternative scenario, envisaging a higher growth profile and a faster response of imports of goods and services to the liberalization measures, coupled with a somewhat slower reaction of exports to the various new incentives, was also considered. Under this scenario, the adjustment of the external current account comes with a substantial delay; the current account deficit--before interest payments on the financing gap--increases through 1990 before starting to decline in subsequent years, while averaging about 18 percent of projected GDP for the period 1988-92. Consequently, the financing gaps are also larger than under the first scenario.

producer prices of major agricultural crops, the virtual abolition of price controls, and the progressive elimination of the quantitative restrictions on imports. Parallel with these measures, the Government continued to pursue a prudent demand management policy. However, the outturn for 1987 deviated from the program targets partly on account of exogenous factors, but also because of expenditure overruns, delays in the reform of public enterprises, and continued administrative controls on internal and external trade. Nevertheless, all performance criteria were observed, showing the need to strengthen the implementation of financial as well as structural policies and in particular to improve the control and monitoring capability of the government in the area of public expenditures.

In recognition of the need to proceed with structural reforms, the authorities are moving ahead with the implementation of their structural adjustment program. The measures to be effected under the proposed program with the Fund include in particular a further liberalization of internal and external trade, and financial and public enterprise sector reforms. These are to be flanked by an appropriate demand management policy stance supplemented by an improvement in the efficiency of public expenditures and the pursuit of a flexible exchange rate policy. In the staff's view, the program represents a major shift in the macroeconomic stance in Madagascar, which, if implemented steadfastly, should enhance confidence of the private sector in the determination of the authorities to turn the Malagasy economy from an administratively controlled to a market-oriented one. However, given the slippages that have occurred in the recent past, mainly because of weaknesses in the budgetary expenditure controls, the success of the demand policy will depend crucially on the degree of rigor with which the authorities will execute their budgetary policy. The absence of data on the income side of the national accounts makes the impact of demand management policies and the correction of relative prices, especially interest rates, on consumption and savings flows difficult to gauge.

The proposed program is comprehensive and addresses the structural weaknesses in the major sectors of the economy. The envisaged measures will need to be implemented simultaneously, as delays in one sector could jeopardize the success of the overall program. The opening of the banking system to the private and foreign sector, together with the timely restructuring of the portfolios of the three existing banks, is a crucial element of the program. The difficulties encountered by the banking system, illustrated by the large accumulation of doubtful and litigious loans, were the result of excessive lending to an inefficient public enterprise sector. The relatively high lending rates, together with cumbersome administrative procedures, pushed investors to quick turnover activities with little value added and little impact on employment. Hence, the reform of the public enterprises as well as a continued restrained budgetary stance will be important in freeing domestic resources to finance the resurgence of private sector activity, particularly productive investments. These reforms, along with the liberalization of domestic and external trade, including the full

implementation of an open general license system and the pursuit of a flexible exchange rate policy, should enhance the competitiveness of the Malagasy economy. The authorities also intend to address the structure of public expenditure so as to increase its efficiency while alleviating adjustment costs falling on the poorest segments of the population. In addition, they also intend to continue the tax reform with a view to decreasing the share of taxes on international trade.

At a more microeconomic level and in collaboration with the World Bank, the formulation of a three-year rolling investment program, which would take into account recurrent costs and promote judicious choices in investment strategy, is also of paramount importance. The identification of profitable projects, in collaboration with the World Bank, e.g., nontraditional activities, could be a key element in the liberalization policy. The success of such projects could demonstrate the benefits of the new policy and thus encourage the local business community to diversify its investments. Finally, and not the least, agricultural policy should continue to aim at transforming the country into a net exporter of rice. The level of grant-financed rice imports will have to be monitored closely in the next few years to avoid the dampening of domestic production.

Madagascar maintains exchange restrictions requiring Fund approval under Article VIII, Section 2(a), of the Articles of Agreement. Since the 1986 Article IV consultation, no additional restrictions have been introduced in the exchange and trade system; an open general license system was introduced on February 1, 1988 and is, at present, covering all imports; liberalization measures have also been implemented for exports; the limit for the allocation of foreign exchange for business travel was substantially increased in dollar terms on July 1, 1988. In January 1988, during the third review of the last stand-by arrangement with the Fund, the Executive Board approved the retention of these restrictions by Madagascar until May 31, 1988. The staff recommends the approval of the retention by Madagascar of these restrictions until January 31, 1989 or completion of the midterm review of the proposed stand-by arrangement, whichever is earlier.

In the opinion of the staff, the proposed program represents a significant continuation of the policy aimed at resolving the structural rigidities of the Malagasy economy and achieving financial stability, both of which will stimulate a resumption of adequate growth. The authorities recognize the medium-term nature of their policy intentions and hope, in support thereof, to be able to replace the proposed stand-by arrangement by arrangements under the ESAF early next year. Provided that the policies are put in place on a timely basis and that objective conditions are not unduly unfavorable, external financing gaps should decrease substantially over the medium term. Decisions are proposed to the Board by management.

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

VI. Proposed Decisions

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

1988 Consultation

1. The Fund takes this decision relating to Madagascar's exchange measures subject to Article VIII, Section 2, and in concluding the 1988 Article XIV consultation with Madagascar, in the light of the 1988 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/88/145 and SM/88/ , in accordance with Article XIV, Section 2, except that the specific 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 January 31, 1989, or the completion of the mid-term review of the requested stand-by arrangement, whichever is earlier.

Stand-By Arrangement

1. The Government of Madagascar has requested a stand-by arrangement for the period from , 1988 to , 1989 in an amount of SDR 13.3 million.

2. The Fund approves the stand-by arrangement set forth in EBS/88/145.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Madagascar - Stand-By Arrangement

Attached hereto is a letter, with an annexed memorandum, dated July 20, 1988, from the Minister at the Presidency in charge of Finance and Economy of Madagascar requesting a stand-by arrangement and setting forth:

(a) the objectives and policies that the authorities of Madagascar intend to pursue for the period of this stand-by arrangement; and

(b) understandings of Madagascar with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Madagascar will pursue for the period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of ten months from _____, Madagascar will have the right to make purchases from the Fund in an amount equivalent to SDR 13.3 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. a. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 2.8 million until September 30, 1988, the equivalent of SDR 6.3 million until December 31, 1988 and the equivalent of SDR 9.8 million until March 31, 1989.

b. None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Madagascar's currency in the credit tranches beyond 25 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources.

4. Madagascar will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Madagascar's currency in the credit tranches beyond 25 percent of quota:

(a) during any period in which:

- (i) the limit on net domestic credit described in paragraph 11 of the memorandum annexed to the letter is not observed; or
- (ii) the limit on net domestic credit to the Government described in paragraph 11 of the memorandum annexed to the letter is not observed; or

- (iii) the limit on gross credit to public enterprises including credit to public enterprises classified as high risk ("D") described in paragraph 11 of the memorandum annexed to the letter is not observed; or
- (iv) the target for the reduction of external payments arrears on a net basis described in paragraph 20 of the memorandum annexed to the letter is not observed; or
- (v) there is an accumulation of new external payments arrears;
- (vi) any of the limits on contracting, or guaranteeing of nonconcessional external debt described in paragraph 20 of the memorandum annexed to the letter are not observed; or

(b) during any period after December 30, 1988 until the midterm review contemplated in paragraph 3 of the attached letter has been completed and suitable performance criteria have been established, or after such performance criteria having been established, while they are not being observed; or

(c) during the entire period of this stand-by arrangement, if Madagascar:

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

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

5. Madagascar will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a re-purchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Madagascar's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Madagascar. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Madagascar and understandings have been reached regarding the circumstances in which such purchases can be resumed.

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

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

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

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

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

11. In accordance with paragraph 21 of the memorandum annexed to the attached letter, Madagascar will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Madagascar has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Madagascar's balance of payments policies.

DEMOCRATIC REPUBLIC OF MADAGASCAR

Ministry at the Presidency in Charge of Finance and Economy

The Minister

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

Antananarivo, July 20, 1988

Dear Mr. Camdessus:

1. Since 1980, the Government of Madagascar has been pursuing an adjustment program supported by six stand-by arrangements from the Fund. Under the program supported by the most recent stand-by arrangement and the first annual arrangement under the structural adjustment facility, emphasis has been placed on eliminating the structural rigidities that have hampered growth and exports. Most of the measures envisaged in the program have been taken, and all performance criteria were observed. The economic and financial performance for 1987 was, however, disappointing, partly on account of exogenous factors, exacerbated by slippages in the fiscal program, administrative difficulties in implementing the reform of external trade, and delays in the reform of public enterprises. In order to reverse the downward trend in the economy, early in 1988 the Government embarked on major policy initiatives, notably in the areas of domestic and foreign trade, the public sector, and the financial sector; these were described in my letter of December 15, 1987.

2. The Government of Madagascar has adopted a financial program covering calendar year 1988, in support of which the Government requests the use of Fund resources through end-June 1989 under a stand-by arrangement in an amount equivalent to SDR 13.3 million.

3. The Government believes that the policies and measures described in the attached memorandum are adequate to achieve the objectives of the program for 1988, but will take any further measures that may become appropriate for this purpose. In addition, the Government of Madagascar will consult with the Fund on the adoption of any measures that may become appropriate in accordance with Fund policies on such consultations. Before end-October 1988, the Government will consult with the Fund on the progress made under the program and will reach understandings with the Fund on the 1989 budget, details of tax measures, and budgetary expenditures, including enhanced monitoring of the latter to reduce administrative payment delays. The reform of public enterprises and of the financial sector will also be examined during the review, which will in addition set the performance criteria for end-March 1989.

4. The Government believes that the program described in the attached memorandum may provide the basis for a triennial adjustment program, which could be supported by use of Fund resources under the Enhanced Structural Adjustment Facility. The program contains a number of far-reaching measures, which will be implemented before end-1988 and will be pursued and strengthened if necessary under a medium-term structural adjustment program.

Very truly yours,

Pascal Rakotomavo

Memorandum on the Economic and Financial Policies
of the Democratic Republic of Madagascar for 1988

1. In recent years, Madagascar has made progress in reducing its financial imbalances. The external current account deficit was reduced from 14.6 percent of GDP in 1981 to 11.7 percent in 1987, and gross international reserves increased to the equivalent of 5.5 months of imports (c.i.f.) at end-1987. The improvement in the external situation stemmed from a reduction in the overall fiscal deficit from 15 percent of GDP in 1981 to 4.4 percent in 1987, and the pursuit of a tight monetary policy. Meanwhile, the sharp decline in real GDP in 1981-82 of about 11 percent was followed by modest growth of 1.5 percent per annum in 1983-87. Inflation, which averaged over 30 percent in 1981-82, was brought down to 15.5 percent in 1987.

2. Under the program supported by the last stand-by arrangement and the first annual arrangement under the structural adjustment facility, the Government took several measures aimed at making the economy more market oriented. These included, inter alia, changing the relative prices between traded and nontraded goods through substantial adjustments in the exchange rate, introducing a liberalized import regime (LIR) designed to eliminate the discretionary element in the allocation of foreign exchange, increasing the producer prices of major agricultural crops, virtually abolishing price controls, and progressively reducing the quantitative restrictions on imports. Parallel with these measures, the Government continued to pursue a prudent demand management policy. Most of the measures envisaged in the programs have been taken, and all performance criteria have been observed. Nevertheless, the outturn for 1987 has deviated from the program targets partly on account of exogenous factors, as well as expenditure overruns, problems encountered in reforming external trade, and delays in the reform of public enterprises. Real GDP is estimated to have increased by 1.4 percent in 1987, compared with 1.3 percent in 1986. The terms of trade deteriorated by 22.2 percent in 1987, mainly on account of a sharp fall in coffee prices. As a result, export receipts fell by 14.6 percent in 1987. Meanwhile, due partly to administrative constraints, the slow pace of utilization of foreign exchange allocations under the LIR, and the low level of economic activity, imports have declined by 12.1 percent in 1987. The decrease in exports, more than offset by the import shortfall, led to a smaller-than-programmed current account deficit in 1987, equivalent to 11.7 percent of GDP, instead of 14.8 percent. In addition, net foreign assets of the banking system turned positive. The lower volume of international trade contributed to a shortfall in fiscal revenue, and with expenditure higher than programmed, the overall fiscal deficit widened to 4.4 percent of GDP in 1987, compared with 4.0 percent in 1986. Meanwhile, the Government accumulated domestic payments arrears, including administrative delays, amounting to FMG 6.2 billion, and reduced its net indebtedness to the domestic banking system. Money supply broadly defined increased by 17.6 percent in 1987. The inflation rate, as measured by the low-income consumer price index, rose by 15.5 percent in 1987, compared with 14.5 percent in 1986.

3. To enhance growth prospects in the context of greater financial stability, as described in the letter dated December 15, 1987, the Government took measures, and envisaged others, to accelerate the adjustment process and to liberalize further the economy. These were mainly in the areas of domestic and foreign trade, financial sector reform, and public enterprise reform. The program for 1988, built on these recent policy initiatives, will ensure that they are implemented. It will also continue with a restrained demand policy supplemented by an improvement in the efficiency of public expenditure and the pursuit of a flexible exchange rate policy.

4. The main quantitative targets of the 1988 program are to limit the external current account deficit to SDR 225.3 million in 1988 (16.8 percent of GDP), to contain the rate of inflation, as measured by the GDP deflator, to 12.7 percent, and to raise the rate of real growth to 2.0 percent. To attain these objectives, the overall fiscal deficit, on a cash basis, will be reduced from 4.4 percent of GDP in 1987 to 3.7 percent in 1988. Domestic credit is programmed to increase by 1.8 percent in 1988, compared with 7.9 percent in 1987. Taking into account the balance of payments objectives, the rate of increase in the money supply broadly defined will be reduced from 17.6 percent in 1987 to 12.5 percent in 1988, remaining below the projected growth in nominal GDP.

5. Fiscal policy for 1988 aims at reducing the overall fiscal deficit on a cash basis to FMG 93.9 billion, compared with FMG 96.8 billion in 1987. To achieve the 1988 deficit target, the Government has adopted a range of measures affecting revenue and expenditure. As regards revenue, the tax administration's monitoring capacity has been strengthened. Specifically, since early in the year, decentralized revenue and expenditure committees have continuously monitored the collection of indirect taxes. The prices of the three monopoly products were raised at end-1987 for tobacco, and in March 1988 for flour and matches. It is estimated that these price adjustments will yield additional revenue of FMG 8.3 billion. Beginning on April 1, 1988, the application of the minimum tariff of 5 percent to all imports, except imports under international agreements, is expected to generate FMG 2.5 billion. Budgetary appropriations were reduced by FMG 16.5 billion in January 1988, apart from expenditure appropriations for personnel and debt service. The partial write-off of the banking system's doubtful and litigious claims on public enterprises, the Government's contribution to the public enterprise rehabilitation program, and the financing of severance pay for employees who will lose their jobs as a result of the closing or restructuring of public enterprises, and the payment of wages owed to these employees, are estimated at FMG 10 billion. Such wage and severance payments fall within the scope of the Economic Management and Social Action Project (EMSAP) envisaged with the World Bank and will be included in the Government's financial participation when the project is introduced. An amount of FMG 6.2 billion has been appropriated to liquidate domestic payment arrears (estimated at FMG 2.5 billion at end-1987) and administrative payment delays outstanding (estimated at FMG 3.7 billion at end-1987). Moreover, the Government

will not accumulate new domestic payments arrears during the program period, excluding payments for expenditure committed in 1988, which will be honored during the complementary period, if the supporting documents have been received within that time. Drawings on foreign loans are currently estimated at FMG 242.4 billion, of which FMG 91.4 billion represent counterpart funds from program loans (financial aid). On this basis, the Government will repay FMG 39.1 billion to the banking system. If the amount of program loans differs from the projected FMG 91.4 billion, repayments to the domestic banking system will be adjusted accordingly. In the event that the projected amounts for writing off the doubtful and litigious debts of public enterprises to the banking system, for the contribution to public enterprise rehabilitation, for payment of severance pay and wages due, are not fully utilized, the deficit target will be adjusted downward accordingly, and the projected repayments to the banking system will be increased by the same amount. In tandem with traditional Treasury bills, the Government will again auction bills conferring no tax advantages. Thus, as of July 1, 1987, Treasury bills with six-month and one-year maturities will be offered to the public, including the commercial banks, at a rate at least one point higher than the indicative rate for private 6- to 12-month deposits with banks. Bills with six-month and one-year maturities will be issued monthly in amounts of at least FMG 1 billion and FMG 500 million, respectively. The Central Bank will absorb the unsubscribed amounts in each issue and reduce accordingly the amount of these ordinary advances to the Treasury. In addition, the amount actually subscribed by commercial banks will be considered as a credit to the Government.

6. As part of the ongoing efforts to improve the management of public finance, the Government has decided to strengthen the monitoring and control mechanism for financial operations of the Central Government by introducing OGTs on a commitment basis, on a payment-order basis, and on a cash basis, beginning in 1989. The main objective is to prevent the emergence of domestic payments arrears at a time when spending priorities have been reordered. To facilitate this task, the Government has requested Fund technical assistance in strengthening the monitoring and control mechanism. In this context, the Government will report to the Fund, with a delay of no more than three months, quarterly statistical data on expenditure on a commitment basis and on a payment-order basis. In addition, the Government will report to the Fund, with a delay of no more than two months, monthly data on expenditure on a cash basis.

7. In order to take timely corrective action to achieve the overall fiscal deficit target in 1988, the Government has established and is monitoring targets for revenue and expenditure. Thus, total receipts, including grants, are estimated at FMG 101.4 billion at end-March 1988 and projected to reach FMG 345.3 billion at end-September 1988 and FMG 512.3 billion at end-December 1988, respectively. Similarly, expenditure, including payments of arrears, estimated at FMG 134.3 billion at end-March, are projected to reach FMG 432.0 billion at end-September and

FMG 606.2 billion at end-December. The nonobservance of quarterly revenue and expenditure targets will trigger consultations with the Fund staff regarding appropriate measures to be taken to achieve the fiscal targets.

8. In line with the objective of improving expenditure control mechanisms, the Government will reach understandings with the Fund, prior to the completion of the mid-term review of the program, on the preparation of a three-year rolling Public Expenditure Program (PEP) and Public Investment Program (PIP). Hence, the PEP and PIP for 1989-91 will be finalized prior to the presentation of the 1989 budget to the National Assembly.

9. The Government has started implementing recommendations made by the Fund fiscal mission that visited Antananarivo in 1987. A comprehensive tariff reform was introduced on January 1, 1988. Furthermore, as of April 1, 1988 rice, fertilizers, and pharmaceutical products, as well as imports under the Investment Code, became subject to the minimum tariff of 5 percent. In the context of the 1989 budget, increased reliance will be placed on domestic sources of revenue, thus reducing the relative share derived from duties and taxes on international trade. Tax measures envisaged for the 1989 budget could include: (i) the replacement of confiscatory taxation of incomes and profits with a marginal tax structure having low rates and limited exemptions; (ii) the establishment of a single, lower rate for corporate taxes; (iii) the abolition of taxes levied for historical reasons and having limited revenue-raising importance; and (iv) the reduction of the effective rate of taxation of traditional exports. As a condition for completing the mid-term review, understandings will be reached with the Fund concerning the measures to be adopted in the context of the 1989 budget. To facilitate the formulation of these reforms within the specified time frame, the Government has requested technical assistance from the Fund.

10. The lack of decisive progress in public enterprise reform has continued to hinder the adjustment process in Madagascar. There are over 150 public enterprises, many of which have incurred substantial losses financed by the banking system, by budgetary transfers, and by the accumulation of payments arrears. In cooperation with the World Bank, the Government has reviewed the performance of the public enterprise sector. The main conclusion of this review is that the measures adopted since 1983 need to be intensified and expanded to bring the sector's performance back to a satisfactory level. While the sector has received a large share of public resources, and mobilized a sizable amount of credit, its contribution to national value added has been small. Recourse to the banking system to finance public enterprise investment and operating losses has been a factor limiting the credit available to other sectors. A major reform is therefore needed to rationalize and restructure the public enterprise sector while at the same time reforming the financial sector. The main aim of public enterprise reform is to rationalize the sector through a program of government divestiture, including specific, urgent measures for a sizable number of enterprises,

in order to reduce the negative impact of the sector's poor performance on the economy in the short term while improving the efficiency of those enterprises that will remain in the public sector. These objectives will be achieved through the following measures: (i) reform of the incentive system through initiatives in each public enterprise designed to increase revenue and cut costs; and (ii) rationalization of the institutional and regulatory frameworks within which the public enterprises operate to bring them into line with the free market system, including free domestic and external competition. Taking into account the significant number of enterprises in the Central Government's portfolio and the comprehensive nature of the proposed reform, it is desirable for the specific measures for divestiture, liquidation, and restructuring to be introduced in stages, bearing in mind their economic importance and social impact as well as the Government's administrative capacity. In this context, the Government will implement a three-year sectoral reform program. While this program is being put into place, the Government has decided: (a) to create no new public enterprises, with the exception of those authorized under the sectoral reform or within the framework of public expenditure program reviews; (b) to prohibit increases in budgetary transfers beyond the 1987 level to the group of public enterprises whose debts are classified as high risk; and (c) to prohibit increases in gross bank credit to each of these enterprises beyond their commitments at end-1987. In a first stage of the reform, the Government has already liquidated some twenty enterprises and begun the process of divestiture from an additional seven. In a second stage, the Government will announce before end-1988, the liquidation of, divestiture from, or restructuring of about twenty other public enterprises. In a third stage of the reform, the Government will announce before end-1989 the liquidation of, divestiture from, or restructuring of other public enterprises. The Government plans to complete this sectoral reform, including the strengthening of the institutional framework, before June 1991. During the mid-term review, the Government will review with the Fund the progress made in the reform of public enterprises. In the meantime, commercial banks will continue to refuse credit to public enterprises classified as high risk (D). For the purpose of monitoring the performance of public enterprises, the Government will communicate to the Fund, on a quarterly basis, the outstanding credit of each enterprise in this group.

11. The Government will continue to pursue monetary and credit policies consistent with the objectives of the program. Given the balance of payments and inflation targets, the expected impact of the financial sector reforms, and the need to provide adequate resources to finance economic activity, especially for the private sector, money supply broadly defined is projected to increase by 12.5 percent in 1988, compared with a 15 percent estimated increase in nominal GDP. As a performance criterion, total domestic credit, which amounted to FMG 891.2 billion as of end-December 1987 and is estimated at FMG 835.8 billion as of end-April 1988, will not increase by more than FMG 9.2 billion from January 1 through September 30, 1988, and by more than FMG 15.9 billion from January 1 through December 31, 1988. Within these ceilings, three

subceilings have been set, also as performance criteria. First, net credit to Government, which amounted to FMG 349.8 billion as of December 31, 1987, and is estimated at FMG 357.3 billion as of end-April 1988, will decrease by at least FMG 20.4 billion from January 1 through September 30, 1988 and by at least FMG 39.1 billion from January 1 through December 31, 1988. Should the amount of program loans (financial aid) included in the budget be higher than the FMG 91.4 billion projected, the ceilings on total domestic credit and net credit to government will be adjusted accordingly. The same will apply if the amount of Treasury bills subscribed by the nonbanking sector differs from the programmed amount of FMG 2.3 billion. Also, the ceilings on total domestic credit and on net credit to Government will be adjusted downward by the amount corresponding to the unused portion or all of the FMG 10 billion earmarked for writing off doubtful and litigious claims on public enterprises by the banking system, for financing the public enterprises rehabilitation program, and for payment of severance pay and wages due. Second, gross credit to public enterprises, as reported by the credit information office (Centrale des Risques), which reached FMG 228.4 billion as of December 31, 1987, and is estimated at FMG 240.8 billion as of end-March 1988, will not be allowed to increase by more than FMG 1.6 billion from January 1 through September 30, 1988, and FMG 1.6 billion from January 1 through December 31, 1988. Third, no new credit will be extended to public enterprises classified as high risk (D). Moreover, all the necessary steps will be taken to define the ceilings on credit to public enterprises on a net basis; this change in the definition of the ceilings will be made for the March 1989 performance criteria during the mid-term review.

12. As indicated in the letter of December 15, 1987, the Government has decided to accelerate the liberalization of the financial sector and to open its capital to the Malagasy private sector and to foreign financial institutions. To this end, new banking legislation was adopted and published on May 5, 1988. All decrees and instructions referred to in this legislation which allow existing banks to continue their activities, and new banks and institutions to conduct business, will be published before Executive Board approval of the requested stand-by arrangement. The same holds for the decree implementing Articles 5 and 23 of the Ordonnance in question. Also, to establish a healthy and dynamic financial sector, the Government has decided to restructure the portfolios of the three existing banks by actively seeking the participation of the private and foreign sectors. The doubtful and litigious debts of public enterprises and the private sector in the portfolios of the three banks (classified "D"), estimated at FMG 142.9 billion at end-December 1987, have, in a first phase, been partially written off in the amount of FMG 74.1 billion through end-April 1988 against earmarked provisions and accumulated interest charged on these debts (agios réservés). In the second phase of the reform, a distinction is made between the three banks. Regarding the writing off of debts of "D" enterprises and on the basis of the 1986 audits, their total at end-1987, net of provisions and interest charged on these debts (agios réservés), is estimated at about FMG 13.4 billion for the BTM and

FMG 2.2 billion for the BFV. A detailed plan for the writing off of "D" debts and all or part of "C" debts will be prepared on the basis of the audits for 1987, which will be available before end-September 1988. Meanwhile, the amounts from the 1987 OGT, amounting to FMG 1.7 billion for the BTM and FMG 1.9 billion for the BFV, will not be used, nor will any issue of financial instruments be envisaged.

As regards the action plans for writing off "D" debts and all or part of the "C" debts of the BFV and the BTM, the Government undertakes to define the terms and conditions in agreement with the Fund, the World Bank, and potential private partners before end-1988. In addition, the plan will include a significant private sector participation of a minimum of 25 percent of the equity capital in at least one of the two banks. Such a participation agreement will be concluded before end-1988 and will provide for the effective participation of the private partner by a later date, in any case before end-1989. As regards the BNI, the writing off of the remaining "D" debt and of all or part of the "C" debt existing at end-1987 will take place in the context of the overall restructuring and privatization of the bank. In the meantime, the FMG 6.4 billion from the 1987 OGT will not be used, and any issue of financial instruments will be considered only as part of the bank restructuring exercise. For the restructuring of the BNI, the Government will make contact as quickly as possible with one or more private banks with a view to reaching a participation agreement, which includes the possibility of setting up a private commercial bank. The two main parts of the agreement will be: (i) technical assistance by the private partner(s) for all matters relating to the comprehensive restructuring and rehabilitation of the BNI, including, inter alia, the restructuring of the remainder of its portfolio and the bank's operating procedures from January 1989 until it is actually privatized; (ii) management and share distribution procedures ensuring that the BNI will operate in the same way as a private bank. Among other things, these procedures should ensure control of management by the private partner(s), and thus the private holding of a least a majority of the voting shares in the bank's capital. In the above-mentioned participation agreement, the Government will undertake to adopt all the measures required to attract the private partner(s), including, inter alia, and if necessary, the legal instruments, repatriation of profits, personnel management, agencies, deposit and credit policies, and the Government's contribution to the recapitalization of the BNI. This participation agreement will be approved in its entirety before end-1988. If at least one other private commercial bank is established before end-1988, the first part of the agreement, referred to under (i), will be implemented before end-1988, and the second part of the agreement, referred to under (ii), will be implemented before end-1989. Between now and end-1988, special attention will be given by the monetary authorities and by BNI management to the functioning of the BNI, both as regards the setting of the bank's credit ceilings and the nature of its activities, so as to avoid any significant changes in its balance sheet structure as compared to what it was at end-1987. The implementation of the restructuring of the three banks' portfolios, the agreement of the private sector to

participate in the capital of two of the three banks, and the establishment of independently operating foreign commercial bank(s) are conditions for completion of the mid-term review.

13. Following the reduction in the inflation rate early in the year and in light of the estimated rate for 1988 as a whole, the Government intends to revise the Central Bank's rediscount rate downward from 15 percent to 12 percent. The Government will in any case continue to review domestic price trends closely and will adjust the interest rate levels fixed by the Central Bank to ensure that lending and borrowing rates remain positive in real terms for the duration of the program. The structure and level of interest rates will be examined with the Fund during the mid-term review. Finally, with effect from July 1, 1988, the fixed rate of 16 percent paid by the banks on private 6- to 12-month deposits has been replaced by a minimum rate of 14 percent.

14. As indicated in the letter of December 15, 1987, the Government has decided to accelerate the liberalization of the import regime by progressively introducing an Open General License (OGL) system. Effective February 1, 1988, imports of raw materials and spare parts have been made under the OGL. This system was to be extended on May 1 to imports of capital goods. However, in order to limit the number of changes in the import regime during this short period, the Government decided to postpone this extension until July 1, when the system will be applied to all imports. Between February and July 1988, the Liberalized Import Regime (LIR) will continue to be applied on a transitional basis for products which are not yet covered by the OGL. The monthly LIR allocation, which was maintained at SDR 12 million in January 1988, was reduced to SDR 5 million from February through April and kept at this level in May and June for the reason explained above. Under the OGL, all economic agents, without exception, may import and receive the total amount of foreign currency requested at the prevailing exchange rate. No import license is required, and all administrative formalities are handled by the commercial banks through which the import transaction is executed. Statistical data are gathered by the commercial banks. No restrictions of any kind currently apply or will be imposed in the future on the opening of credit or the means of financing imports. Thus, importers may use their own resources, borrow from the banking system, or avail themselves of external loans, including suppliers' credit, to finance their imports. The requirement under the OGL that importers set aside provisions in local currency covering the full amount of their imports was abolished on May 1, 1988, and each commercial bank is free to decide on the desirability of requiring such a provision, which in no case may exceed 20 percent of the c.i.f. value of the imports. In accordance with Notice (Avis) No. 10-MC/DGCE of January 21, 1988, all import prohibitions have been lifted except for 95 custom nomenclature categories. Before the requested stand-by arrangement is submitted to the Executive Board, the list of these categories will be reduced. The Government will continue to streamline the tariff structure with a view

to reducing progressively the effective protection rate. In this respect, the temporary 30 percent surcharge will be re-examined before completion of the mid-term review.

15. The liberalization of the export sector is also being accelerated. First, since January 1988, state trading companies have no longer had a monopoly on the export of pepper and cloves, both of which have been opened to the private sector. Exports of coffee were also opened to the private sector by Notices (Avis) Nos. 405 and 406 of June 2 and 9, 1988. Thus, all agricultural products, with the exception of vanilla, may be exported freely at prices negotiated directly between exporters and importers. Vanilla exports will continue to be managed by the Stabilization Fund, which represents Madagascar in the centralized international vanilla market. The Government has recently negotiated a contract with Indonesia for the export in 1988 of 10,000 tons of cloves at US\$2.60 per kilogram f.o.b. Storage costs for these exports will be reimbursed to the operators involved as the contract is executed. This contract notwithstanding, private traders and state trading companies have been authorized to continue exporting any quantity of cloves to any market at a price exceeding that negotiated with Indonesia. However, a new Notice (Avis) will be published before completion of the mid-term review, enabling private operators and state trading companies to export to any market at a price freely determined between importers and exporters. Apart from Madagascar's international commitments under the ICO, there will be no prior authorization or any other administrative restriction on coffee exports by economic agents. As part of its functions under the above commitments, the Stabilization Fund will maintain in particular its managerial responsibility for distributing stamps, which will be done fairly and without discrimination. Prior to the 1989 crop year, and in the light of experience, the Government will introduce additional liberalization measures. Discussions on the reform of the Stabilization Fund are to begin no later than September 1988, and the reform is to be introduced before the 1989 crop year. During the transition period, from the beginning of the coffee crop year in May 1988 to its end in May 1989, the Government will introduce the following practical arrangements for coffee exports: (i) as regards export sales, all economic agents, including the Coffee Stabilization Fund, may from now on directly and freely negotiate and execute export contracts. A reference price for exports will be determined in order to serve as a basis for calculating taxes on exports and establishing the amount of foreign exchange to be repatriated. The calculation method used for the purpose will be the subject of prior consultations and understandings with the World Bank. The reference price thus obtained will be revised weekly on the basis of international market data, including those of the International Coffee Organization and the futures market in London. A committee of experts from the coffee trade will monitor the automatic application of the formula. The Stabilization Fund will continue to issue ICO coffee export stamps; these will automatically be issued to applicant operators in possession of an export contract; (ii) the Government officially announced a producer price for coffee on June 2, 1988, solely for the 1988/89 transitional period, in order to launch the

crop year and serve as a reference for producers and buyers, which, however, neither is obliged to use in settling transactions. Moreover, once the crop year has begun, this price will be reviewed regularly on the basis of surveys of the transactions between producers and buyers in the coffee-growing areas where the Ministry of Commerce has representatives who will be responsible for conducting these surveys. The survey procedure and the reporting of the findings will be discussed with the World Bank. The findings will be published and disseminated through all the media available in Madagascar to inform producers of market conditions and trends; (iii) as regards taxes on coffee exports, the ad valorem tax rate will be determined within the framework of OGT preparation and will be applied to the reference export price mentioned above. The authorities have adopted additional measures to stimulate the export sector. These simplified procedures were published in conjunction with Notice (Avis) No. 402-MC/DGCE of January 18, 1988, and in a concise exporters' guide, which was published on April 26, 1988. It provides for the elimination of exporters' cards and the introduction of a reporting system, which requires only a posteriori declaration. Likewise, the deadline for the repatriation of foreign exchange proceeds has been extended from 30 to 90 days from the date of embarkation of goods. In order to foster economic activity and encourage exports, domestic trade in export crops has been completely liberalized. Thus, all economic agents are allowed to operate in the collection, processing, stocking, loading, shipping, and marketing of products at all stages of internal trade without any restrictions. Consistent with this, the practice of classifying operators and of limiting their trade functions according to their position/rank in the trade chain has been abolished. Any form of quality control or certification by the Government or government agencies of goods for export will be abolished, except for the following four products: vanilla, coffee, shellfish, and meat. Control procedures will be as follows: (i) quality control is understood to be limited to a quality or sanitary inspection certificate from a government agency or a specialized private company of international standing, at the option of the exporter but in conformity with the international agreements to which Madagascar is party; (ii) the quality or sanitary inspection certificate referred to above will be required only for exports of the following four products: vanilla, coffee, shellfish, and meat. Mining products, namely gemstones, are covered by a special arrangement under the Mining Law, which is currently being discussed with the World Bank; (iii) the certificate referred to in point (i) will continue to be required for cloves during an interim period not extending beyond end-1988; (iv) as regards vanilla, coffee, and cloves, during the above-mentioned interim period, the quality control mentioned in point (i) will be effected at the level of stocks and no quality control procedure will be carried out at the time of embarkation, except for the quality certificate issued at the time of the inspection of the stock; (v) for shellfish and meat, in the absence of a mechanism directly agreed by the importer and the exporter, the certificate of origin and sanitary inspection will be included in the documents at the time of embarkation in conformity, however, with the international agreements to which Madagascar is party; (vi) with a view

to promoting exports and with assistance from the UNDP/ITC, the Government intends to enhance the technical capabilities of the existing agencies to carry out quality verification, treatment, phytosanitary inspection, and metrology. These services are rendered solely at the request of the exporter; (vii) the Government has set up an independent committee in charge of examining grievances and receiving suggestions and proposals from exporters and/or importers in connection with the smooth functioning of the liberalized external trade system. The independent committee will have a maximum of 10 members and will comprise, on an equal footing, representatives of private operators, appointed by the professional organizations directly concerned, and government representatives. The committee will operate with the utmost flexibility. Economic agents will be informed through all the media of the procedures for bringing matters before the committee. The committee will reply to matters brought before it within two weeks at most and, if necessary, will advise the authorities directly concerned of the recommended courses of action. The policies and measures outlined above will be included in an Ordonnance, a draft of which will be forwarded to the Fund. Publication of the Ordonnance and the implementing decree for the independent committee constitutes a precondition for Board approval of the requested stand-by arrangement.

16. The liberalization of external trade and the recovery of exports will involve increasing the allocations of foreign exchange authorized for business travel. Effective July 1, 1988, these allocations will be increased from the current equivalent of US\$54 per day to the equivalent of US\$100 per day of travel abroad, under conditions to be specified by the Ministry of Finance; these allocations will be handled by the banks. In this context, the Government intends to ease the administrative procedures covering business travel so as to facilitate the marketing and promotion of Malagasy products abroad.

17. In 1988, the Government will continue to pursue a flexible exchange rate policy with the aim of ensuring the competitiveness of Malagasy exports on international markets and of supporting the ongoing liberalization of foreign trade. The exchange rate will be adjusted as frequently as needed to reflect changes in the exchange rates and differentials in inflation rates with Madagascar's main trading partners. Also, with the introduction of the OGL system, the Government will actively use the exchange rate to protect the overall balance of payments from undesirable increases in the level of imports and to maintain an appropriate level of foreign exchange reserves to allow a smooth functioning of the system according to the provisions set forth in paragraph 19 below.

18. Foreign trade, which reached an all-time low in 1987, should recover in 1988, as the various pricing and liberalization measures begin to produce results. Export receipts and import payments are projected to increase by about 2.2 percent and 8.2 percent, respectively, over 1987. The external current account deficit is now projected to increase slightly over 1987 to SDR 225.3 million (16.8 percent of GDP). Taking

into consideration net drawings on medium- and long-term loans, and debt relief already obtained from foreign private banks, and from Paris Club V for the first quarter of 1988, the balance of payments is projected to show an overall deficit of SDR 79.8 million. After net purchases from the Fund under the previous and the proposed stand-by arrangements, and including the programmed reduction in external payments arrears, a financing gap of SDR 106 million is envisaged for 1988. This gap could be fully financed through debt relief from official creditors.

19. The level of foreign exchange reserves will be monitored continuously against quarterly benchmarks, and the management of the exchange rate will aim at the achievement of these levels. As an indicative target, the Central Bank's net foreign exchange reserves, which amounted to SDR 133.2 million at end-1987, are estimated at SDR 126.7 million at end-April 1988, and are expected to reach SDR 128 million at end-September 1988, and SDR 131.2 million at end-December 1988. In the event these targets are not met, the Government will consult with the Fund staff to reach understandings on additional adjustment measures. The same will apply if the level of imports is lower than foreseen.

20. The Government will continue to pursue prudent debt management policies. The Government has already negotiated and implemented most of the bilateral agreements with official creditors participating in the Paris Club rescheduling through end-March 1988, and is striving to finalize all remaining agreements. The Government is also in the process of completing rescheduling negotiations with other official creditors on terms comparable to those of the Paris Club rescheduling. The Government has likewise obtained rescheduling from the foreign private banks for the previously rescheduled outstanding debt. In 1988, debt service payments before rescheduling will represent about 101.5 percent of projected revenue from exports of goods and services. In view of this heavy burden, and taking into account the balance of payments financing gap referred to in paragraph 18, the Government will request a further rescheduling of maturities falling due to official creditors beginning on April 1, 1988.

In order to improve the profile of the external debt, ceilings have been placed on debt contracted on nonconcessional terms by the public sector (the Government and public financial and nonfinancial enterprises) and on debt on nonconcessional terms guaranteed or authorized by the Government and/or the Central Bank. Thus, during 1988, new external debt on nonconcessional terms contracted or guaranteed by the public sector will not exceed SDR 5 million for debt with an initial maturity of between one and five years and will not exceed SDR 25 million for debt with an initial maturity of over 5 and up to 15 years. These ceilings will be adjusted correspondingly by any amount of short-term debt rescheduled. A ceiling has also been placed on the stock of outstanding external debt with an initial maturity of one year or less; this amount will not be allowed to exceed SDR 60 million at any time during 1988. Moreover, the stock of external payments arrears, which

amounted to SDR 57.8 million at end-1987, will be reduced through cash payments to SDR 49.8 million at end-September 1988, and SDR 47.8 million at end-December 1988. Finally, no new external payments arrears will be accumulated in 1988. All the above limits also constitute performance criteria.

21. During the program period, the Government does not intend to introduce any new multiple currency practice, or impose new or intensify existing restrictions on payments and transfers for current international transactions or, for balance of payments reasons, introduce new or intensify existing restrictions on imports, and will not enter into bilateral payments agreements with member countries of the Fund which are inconsistent with Article VIII of the Fund's Articles of Agreement.

July 20, 1988

Table . Madagascar: Performance Criteria for 1988

	Dec. 1987 Actual stocks at end-period	Jan. 1, 1988 to Sept. 30, 1988	Jan. 1, 1988 to Dec. 31, 1988
(In billions of FMG)			
Domestic credit	891.2	9.2 <u>1/</u>	15.9 <u>1/</u>
Net credit to Government	349.8	-20.4 <u>1/</u>	-39.1 <u>1/</u>
Gross credit to public enterprises	228.4	1.6	1.6
(In millions of SDRs)			
External payment arrears	57.8	-8.0	-10.0
External debt <u>2/</u>			
1-5 years maturity	2.3	5.0	5.0
5-15 years maturity	21.5	25.0	25.0
Short-term debt	39.6 <u>3/</u>	60.0 <u>4/</u>	60.0 <u>5/</u>

1/ To the extent that the amount of program loans received in the budget is higher than the FMG 79.0 billion programmed through end-September 1988 and the FMG 91.4 billion programmed through end-December 1988, the ceilings on total domestic credit and net credit to Government will be adjusted downward accordingly. Similarly, these ceilings will be adjusted if the net amount of Treasury bonds subscribed by the nonbanking system is higher than the FMG 2.0 billion programmed through end-September 1988 and the FMG 2.3 billion programmed through end-December 1988. The corresponding gross amount of treasury bonds subscribed is programmed at FMG 7 billion through end-September 1988 and FMG 9.9 billion through end-December 1988.

2/ Annual cumulative contracting of nonconcessional external debt.

3/ External short-term debt outstanding at end-December 1987.

4/ Stock during the period January 1, 1988 to September 30, 1988.

5/ Stock during the period October 1, 1988 to December 31, 1988.

MADAGASCAR - Relations with the Fund

(As of June 30, 1988, 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 200.4 million,
or 301.8 percent of quota

	<u>Amount</u> <u>(SDR millions)</u>	<u>Percent</u> <u>of quota</u>
c. Total Fund credit outstanding	147.3	221.8
Compensatory financing	23.3	35.1
Credit tranche	49.0	73.8
Enlarged access resources	61.7	92.9
SAF loans outstanding	13.3	20.0
d. Reserve tranche position:	--	--

III. Stand-By Arrangements and Special Facilities

- a. Previous stand-by arrangements during the last ten years:
 - i. 1986-88:
 - Duration: September 17, 1986 through March 16, 1988
 - Amount: SDR 30.0 million, or 45.2 percent of quota
 - Utilization: SDR 30.0 million
 - Undrawn balance: None

MADAGASCAR--Relations with the Fund (continued)

ii. 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

iii. 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

iv. 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

v. 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)

vi. 1980-82:

Duration: Initially requested to cover the period from June 27, 1980 to June 26, 1982; was 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 short-fall. 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: July 1, 1987 to June 30, 1990

Amount: SDR 42.2 million

Undrawn balance: SDR 28.9 million

IV. SDR Department

a. Net cumulative allocation: SDR 19.3 million

b. Holdings: SDR 0.41 million, or 2.1 percent of the cumulative allocation

c. Current designation plan: None

V. Administered Accounts

a. Trust Fund loans

i. Disbursed - SDR 25.41 million

ii. Outstanding - SDR 8.0 million

b. SFF Subsidy Account payments: SDR 3.22 million

MADAGASCAR - Relations with the Fund (continued)

VI. Overdue Obligations to the Fund

	Overdue financial obligations	1988 July 1- Dec. 31	Principal and interest due			
			1988	1989	1990	1991 1992
<hr/>						
			(In millions of SDRs)			
Principal	--	16.7	41.2	37.6	24.8	10.1
Repurchases	--	14.6	38.3	34.7	24.7	10.1
Trust Fund repayments	--	2.1	2.9	2.9	0.1	--
Charges and interest (including Trust Fund, SAF, and SDR)	--	5.1	8.8	6.3	4.1	2.8
Total	--	21.8	50.1	43.9	28.9	12.9

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

FMG 1,266.5 per U.S. dollar on March 31, 1988. 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-May 1988.

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. An FAD tax review mission visited Madagascar in November 1981; its recommendations have been partially implemented. Also, an FAD review mission visited the country in March/April 1987 to study the tax system and make recommendations for

MADAGASCAR - Relations with the Fund (concluded)

its improvement. The report of the mission was issued on August 26, 1987, and since then, some of its recommendations have been implemented. 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.

Financial Relations with the World Bank Group

At end-April 1988, World Bank Group lending to Madagascar amounted to US\$769.0 million, of which US\$736.5 million was from IDA. Annual disbursements have increased from US\$23 million in 1980 to US\$77 million in fiscal year 1987. Bank Group assistance has been concentrated on transportation (27 percent) and agriculture (26 percent), and has also included credits aimed at the industrial (19 percent) and energy (12 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, and a forests management and protection project in 1988. In infrastructure, a railways project and a ports rehabilitation project (declared effective in October 1986 and September 1987, respectively), 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. Finally, an Industry and Trade Policy Adjustment Credit, presented to the Bank's Executive Board on June 30, 1987, was declared effective on September 22, 1987.

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, 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. A Public Sector Adjustment operation, 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 was approved by the Board on June 29, 1988. 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 April 30, 1988	Committed <u>1/</u>	Disbursed	Repaid	Out- standing <u>2/</u>
Completed projects (IDA)				
Agriculture and rural development	58.63	56.47 <u>3/</u>	1.64	59.18
Transportation	114.28	114.28	5.12	109.17
Forestry	23.48	21.84	0.24	25.39
Education	13.72	13.72	6.96	6.76
Energy, power, and utilities	52.96	52.96	--	52.96
Industry	4.99	4.99	--	4.99
Urban development	13.50	13.50	--	13.50
Subtotal	281.56	277.76	13.96	271.95
Completed projects (IBRD)				
Agriculture and rural development	2.80	2.80	1.96	0.85
Transportation	18.50	18.50	4.92	13.59
Forestry	6.74	6.74	0.79	5.96
Education	4.53	4.53	1.86	2.67
Subtotal	32.57	32.57	9.53	23.07
Projects in progress (IDA)				
Agriculture and rural development	135.80	69.31	--	79.41
Transportation	73.00	47.70	--	57.87
Forestry	7.00	--	--	--
Education	21.80	10.19	--	12.88
Energy, power, and utilities	36.50	9.67	--	11.96
Industry	143.00	88.91	--	99.03
Urban development	12.80	3.89	--	4.51
Cyclone rehabilitation	25.00	21.23	--	25.58
Subtotal	454.90	250.90	--	291.24
Total	769.03	561.23	23.49	586.26
IDA	736.46	528.66	13.96	563.19
IBRD	32.57	32.57	9.53	23.07
IFC investments	28.88			

Source: World Bank.

1/ Original principal minus cancellations.

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

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

Madagascar - Statistical Issues

1. Outstanding Statistical Issues

a. Real sector

No production data are published in IFS, and the data for the national income accounts are weak. The methodology underlying the national income accounts and the consumer price index needs to be reviewed.

b. Government finance

No government finance data are published in IFS. Data published in the 1987 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. During a government finance statistics mission which visited Antananarivo in March 1988 for the purpose of training government officials in the GFS methodology, the authorities stated their intention of establishing a statistical working group in order to resume regular reporting to the Fund.

c. Monetary accounts

Data reporting continues to be irregular. In response to a request from the 1988 Article IV consultation mission, the Madagascar authorities stated their intention of improving the currentness and timeliness of data submitted for IFS.

d. Balance of payments

Data are not current; the latest period for comprehensive balance of payments data is 1984.

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 July 1988 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Madagascar. For the external sector, no data have been received in the past year; data were updated from the United Nations Statistical Bulletin. Monetary accounts data during the past year have been provided on an infrequent basis.

Status of IFS Data

		<u>Latest Data in July 1988 IFS</u>
Real Sector	- National Accounts	
	GDP	1986
	Components	1984
	- Prices	January 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	Q1 1987
	- Deposit Money Banks	Q1 1987
	- Other Financial Institutions	n.a.
Interest Rates	- Discount Rate	September 1987
	- Bank Lending/Deposit Rate	n.a.
	- Bond Yields	n.a.
External Sector	- Merchandise Trade:	
	Values	Q2 1987
	Prices (principal commodity exports)	Q4 1985
	- Balance of payments	1984
	- International Reserves	Q2 1987
	- Exchange rates	April 1988

Madagascar - Basic Data

Area, population, and GDP per capita

Area	587 thousand square kilometers
Population: Total (1986)	10.5 million
Growth rate	2.9 percent
GDP per capita (1986)	SDR 218

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u> Est.
<u>GDP (at current prices;</u> in billions of Malagasy francs)	1,221	1,369	1,553	1,817	2,210	2,541

GDP (at 1984 prices)

Total (in billions of Malagasy francs)	1,346	1,369	1,400	1,419	1,439	1,467
Agriculture (percent of total)	42	42	42	43	43	...
Secondary sector (percent of total)	15	16	16	16	16	...
Annual real rate of growth (percent)	0.9	1.7	2.3	1.3	1.4	2.0
Investment as percent of GDP	13	14	14	13	13	14

Prices (percent changes)

GDP deflator	22	10	11	15	20	13
Consumer price index	20	10	11	15	16	...

Central government finance

(In billions of Malagasy francs)

Total revenue and grants	185.5	243.2	251.5	280.4	420.7	512.3
Current expenditure	-159.9	-188.1	-210.9	-228.6	-298.6	-341.6
Current surplus/ deficit (-)	25.6	55.1	40.6	51.8	122.1	170.7
Capital expenditure	-87.6	-110.5	-114.7	-122.4	-192.4	-234.7
Overall cash deficit	-81.6	-66.2	-72.4	-72.2	-96.8	-93.9
External financing (net)	46.3	36.6	48.1	51.3	100.0	130.7
Domestic bank borrowing	36.5	32.0	20.9	17.8	-10.7	-39.1
Domestic nonbank borrowing	-1.2	-2.4	3.4	3.1	7.5	2.3
Overall deficit as percent of GDP	-6.7	-4.8	-4.7	-4.0	-4.4	-3.7

Madagascar - Basic Data (continued)

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u> Est.
<u>Money and credit</u> (In percentage change)						
Domestic credit	18	18	12	10	8	2
Government	14	10	6	6	-3	-15
Nongovernment	22	27	18	15	17	13
Money and quasi-money	-2	18	13	24	18	13
<u>Balance of payments</u> (In millions of SDRs)						
Exports, f.o.b.	290	325	275	281	240	245
Imports, f.o.b.	-354	-344	-331	-282	-244	-264
Trade balance	-64	-18	-56	-2	-4	-19
Services and private transfers (net)	-224	-223	-197	-207	-183	-207
Current account balance	-288	-241	-253	-209	-187	-225
Official transfers (net)	57	66	59	94	83	85
Capital account (net) 1/	184	180	164	181	183	61
Drawings 2/	181	118	143	164	174	207
Amortization 2/	-183	-127	-147	-133	-160	-154
Rescheduled debt service	186	165	152	160	164	28
Allocation of SDRs	--	--	--	--	--	--
Other 3/	-42	24	21	-6.9	-8.0	--
Overall surplus or deficit (-)	-89	16	-8	65	64	-80
Current account deficit as percent of GDP	-10.9	-10.4	-10.9	-9.1	-11.7	-16.8
Central Bank gross reserves 4/	...	...	7.1	16.9	22.1	18.9
<u>External public debt</u>						
Disbursed and outstanding (end of period)	1,899	2,086	2,223	2,420	2,484	2,623
Debt service as percent of exports of goods and services						
Before rescheduling						
Including the Fund	87.0	75.6	94.3	90.9	101.1	101.5
After rescheduling	31.4	33.4	49.2	45.2	50.2	61.3

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- 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 - Basic Data (concluded)

IMF Data

Data of membership	September 23, 1963
Quota	SDR 66.4 million
Intervention currency and the rate	The U.S. dollar and the French franc are normally used as intervention currencies; on March 31, 1988, the exchange rates for the respective currencies were US\$1 = FMG 1,266.5 and F 1.0 = FMG 225.2.
SDR/Local currency equivalent	SDR 1 = FMG 1,756.9 (on March 31, 1988)

June 30, 1988
(In millions of SDRs)

Total Fund credit outstanding	147.3
Under tranche policies	110.7
Ordinary	(49.0)
Enlarged access	(61.7)
Compensatory financing	23.3
SAF loans outstanding	13.3
Total Fund currency holdings	200.4
Net cumulative SDR allocation	19.27
Holdings of SDRs	0.41
Trust Fund loans outstanding	8.0

Madagascar - Social and Demographic Indicators 1/

<u>Area</u>	<u>Population</u>	<u>Density (1986)</u>
587.0 thousand sq. km.	10.5 million (1986)	17.9 per sq. km.
Agricultural (percent of total): 63.1	Rate of growth (1986): 2.9 %	28.3 per sq. km. of agricultural land
<u>Population Characteristics</u>		<u>Health (in thousands)</u>
Life expectancy at birth	52	Population per physician 10.0
Infant mortality (aged under 1, per thousand)	109	Population per nurse 1.7
Child death rate (aged 1-4, per thousand)	21	Population per hospital bed (1978) 0.51
<u>Income Distribution (1983)</u>		<u>Distribution of Land (1980)</u>
Percent of national income Highest quintile	60.1	Percent area exploited by top 11 percent of farmers ...
Lowest quintile	5.2	Percent area exploited by smallest 12 percent of farmers ...
<u>Access to Safe Water</u>		<u>Access to Electricity (1976)</u>
Percent of population Total	20.0	Percent of dwellings Urban ...
Urban	73.0	Rural ...
Rural	9.0	
<u>Nutrition</u>		<u>Education (1983)</u>
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

Source: World Bank, Social Indicators of Development, 1987.

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

Madagascar: Matrix of Structural Policies and Measures, 1988-91

Objective	Strategy/Measure	Timing
I. <u>Public finance</u>		
1. Improve the tax structure	a. Recommendations of technical assistance mission (FAD):	Midterm review
	i. Replacement of confiscatory taxation of incomes and profits with a marginal tax structure having low rates and limited exemptions.	1989 budget
	ii. Establishment of a single, lower rate for corporate taxes.	1989 budget
	iii. Abolition of taxes levied for historical reasons and having limited revenue-raising importance.	1989 budget
	iv. Reduction of the effective rate of taxation of traditional exports while increasing revenue from domestic sources.	1989-91
	v. Implementation of tariff reform.	1989-91
2. Improve the structure of public expenditure	Formulation of a three-year rolling public expenditure program (PEP), starting with 1988-91.	Midterm review
	Formulation of a public investment program (PIP), 1988-91.	Midterm review
	Recommendations of technical assistance mission (FAD):	Midterm review
	i. Presentation of the budget on a commitment basis, a payment-order basis, and on a cash basis.	1989 budget
	ii. Improvement in the monitoring of public expenditure.	1989 budget
	Joint presentation to the National Assembly of the budget and PIP.	1989 budget

Madagascar: Matrix of Structural Policies and Measures, 1988-91

Objective	Strategy/Measure	Timing
	Review of personnel expenditure:	
	a. Audit of the personnel listing.	Midterm review
	b. Completion of the census of permanent civil servants.	Before April 1989
	c. Completion of the census of nonpermanent civil servants.	Before October 1989
II. <u>Public enterprises</u>		
Reduce the size of and improve the efficiency of the public enterprise sector	Completion of public enterprise sector reform.	June 1991
	Macroeconomic framework for public enterprises:	
	a. No new public enterprises will be created, with the exception of enterprises authorized under the reform of the sector or in the framework of public expenditure program reviews.	1988-91
	b. No increase in budgetary transfers beyond the 1987 level to the group of public enterprises whose loans are classified as high risk.	1988-91
	c. No increase in gross bank credit to each of these enterprises beyond their commitments at end-1987.	1988-91
	Structural measures in the public enterprise sector:	
	a. Divestiture from 7 public enterprises.	Before end-1988
	b. Timetable for the liquidation of and divestiture from about 20 more public enterprises.	Before end-1988
	c. Timetable for the liquidation of, divestiture from, and restructuring of other public enterprises.	Before end-1989

Madagascar: Matrix of Structural Policies and Measures, 1988-91

Objective	Strategy/Measure	Timing
III. <u>Financial sector</u>		
Improve financial inter-mediation and open the financial sector to the Malagasy private sector and foreign financial institutions	<p>Implementation of the restructuring of the three banks' portfolios, the agreement of the private sector to participate in the capital of two of the three banks, and the establishment of foreign commercial bank(s) operating independently.</p> <p>Banking legislation:</p> <p>a. New banking law.</p> <p>b. Publication of all decrees and regulations referred to in the banking law that allow existing banks to continue their activities and new banks and institutions to conduct business.</p> <p>Restructuring of the portfolios of the BTM and BFV:</p> <p>Plan for the restructuring of the portfolios, including private sector participation at a minimum of 25 percent of equity capital in at least one of the two banks.</p> <p>Restructuring of the BNI:</p> <p>a. Participation agreement including:</p> <p>- Technical assistance by the private partner(s) for all matters relating to the comprehensive restructuring and rehabilitation of the BNI, including, inter alia, the restructuring of the remainder of its portfolio and the operating procedures of the BNI from January 1989 until it is actually privatized.</p>	<p>Conditions for completion of the midterm review</p> <p>May 1988</p> <p>Before Executive Board approval of the stand-by arrangement</p> <p>Before end-1988</p> <p>Before end-1988</p>

Madagascar: Matrix of Structural Policies and Measures, 1988-91

Objective	Strategy/Measure	Timing
	<ul style="list-style-type: none"> - Management and stock distribution procedures ensuring that the BNI operates in the same way as a private bank. Among other things, these procedures should assure control of management by the private partner(s), and thus at least, a majority of the private voting stock in the bank's capital. 	1989
	b. Privatization of the BNI	Before end-1989
IV. <u>External sector</u>		
1. Liberalize the import regime	<p>Full implementation of the Open General License (OGL) system:</p> <ul style="list-style-type: none"> - All economic agents, without exception, are allowed to import and receive the total amount of foreign exchange requested at the prevailing exchange rate. - No import license is required, and all administrative formalities are handled by the commercial banks through which the import transaction is executed. - No restrictions of any kind currently apply or will be imposed in the future on the opening of letters of credit or the means of financing imports. Thus, importers can use their own resources, borrow from the banking system, or avail themselves of foreign loans, including suppliers' credits, to finance their imports. <p>Gradual reduction in effective tariff protection:</p> <ul style="list-style-type: none"> - Examination of the temporary surcharge on imports. <p>Reduction in the number of import prohibitions from 95 custom nomenclatures.</p>	<p>July 1988</p> <p>Completion of mid-term review</p> <p>Prior condition for Board approval of the stand-by arrangement</p>

Madagascar: Matrix of Structural Policies and Measures, 1988-91

Objective	Strategy/Measure	Timing
2. Liberalize the export sector	<p>New legislation on the complete liberalization of the export sector.</p> <p>Elimination of the monopoly of state trading companies on the exports of:</p> <ul style="list-style-type: none"> - Pepper - Cloves - Coffee <p>- All agricultural products, with the exception of vanilla, can be exported freely, at prices negotiated directly between exporters and importers.</p> <p>Elimination of all administrative controls on the quality of export goods, except for the following 4 products: vanilla, coffee, shellfish, and meat.</p> <p>Complete liberalization of internal trade in export crops:</p> <ul style="list-style-type: none"> - All economic agents are allowed to operate in the collection, processing, stocking, loading, shipping and marketing of products at all stages of internal trade, without any restrictions. - The practice of classifying operators and of limiting their trade functions according to their position/rank in the trade chain is abolished. 	<p>Prior condition for Board approval of the stand-by arrangement</p> <p>January 1988 January 1988 June 1988</p> <p>1988</p> <p>1988</p> <p>1988</p>
3. Reduce restrictions on services and transfers	<p>Increase allocations of foreign exchange authorized for business travel to the equivalent of US\$100 per day.</p>	<p>Prior condition for Board approval of the stand-by arrangement</p>
4. Improve the allocation of resources and ensure export competitiveness	<p>Follow a flexible exchange rate policy.</p>	<p>1988-91</p>

Madagascar: Matrix of Structural Policies and Measures, 1988-91

Objective	Strategy/Measure	Timing
V. Sectoral policies		
1. Agriculture: Develop industrial crops	Oil producing plants: Liberalization of prices and trade, including liquidation of and divestiture from public enterprises in this sector.	May 1988
	Sectoral strategy report	September 1988
	Cotton: Sectoral review, including marketing	1988
2. Forestry: Protect forests	Strengthening of forest management and village replanting	1988-91
3. Industry and transport: Rehabilitate infrastructure and establish conditions for long-term growth	Development of minerals	1988-91
	Rehabilitation of rural routes and main arteries.	1988-91
4. Health: Reduce the mortality rate	Detailed strategy report	March 1989
	Improvement in the primary health care system:	
	- Enlarge program of oral vaccination and rehydration	1988-91
5. Education: Improve basic education	- Program against malaria Information and education campaign	1988-91
	Gradual restructuring of the education system.	1988-91

