January 2007
Corrected
IMF Country Report No.07/7

Republic of Madagascar: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver and Modification of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Madagascar

In the context of the first review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for a waiver and modification of performance criteria, the following documents have been released and are included in this package:

- the staff report for the First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver and Modification of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on October 4, 2006, with the officials of the Republic of Madagascar on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 4, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of December 20, 2006 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its December 20, 2006 discussion of the staff report that completed the review.

- a statement by the Executive Director for the Republic of Madagascar.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of the Republic of Madagascar *
Memorandum of Economic and Financial Policies by the authorities of
the Republic of Madagascar *
Technical Memorandum of Understanding by the authorities of the Republic of Madagascar
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver and Modification of Performance Criteria

Prepared by the African Department

(In consultation with other departments)

Approved by Thomas Krueger and Mark Plant

December 4, 2006

- Discussions for the first review of the three-year arrangement with Madagascar under the Poverty Reduction and Growth Facility (PRGF) were held in Antananarivo September 20–October 4, 2006. The mission consisted of Messrs. Ames (Head), Ellyne, Josz (all AFR) and Hallaert (PDR) and was assisted by Mr. van den Boogaerde, the Fund's Resident Representative.

- The Mission met with President Ravalomanana, Prime Minister Sylla, Minister of Economy, Finance, and Budget Radavidson, Governor of the Central Bank Ravelojaona, other senior government officials, and representatives of Parliament, the private sector, nongovernmental organizations, labor unions, and the donor community.

- On July 21, 2006, Executive Directors approved the authorities' request for a three-year PRGF arrangement equivalent to 45 percent of quota and the activation of the Trade Integration Mechanism (TIM). Madagascar's outstanding use of Fund resources through October 2006 amounted to SDR 19.20 million (15.72 percent of quota). The country reached the completion point under the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative in October 2004 and received debt relief from the Fund under the Multilateral Debt Relief Initiative (MDRI) in January 2006.

- The Letter of Intent (LOI), Memorandum of Economic and Financial Policies (MEFP), and Technical Memorandum of Understanding (TMU) are in appendix I, relations with the Fund in appendix II and with the World Bank Group in appendix III, and appendix IV discusses statistical issues.

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Abbreviations and Acronyms

AfDB	African Development Bank
AGOA	Africa Growth Opportunity Act
BCM	Central Bank of Madagascar
EITI	Extractive Industries Transparency Initiative
FAD	Fiscal Affairs Department
JIRAMA	Jiro Sy Rano Malagasy (national public utility company)
MAP	Madagascar Action Plan
MDG	Millennium Development Goals
MID	Interbank Foreign Exchange Market
MDRI	Multilateral Debt Relief Initiative
MFA	Multi Fiber Arrangement
PC	Performance Criteria
PEFA	Public Expenditure Financial Accountability
PFM	Public Financial Management
PSRP	Poverty Reduction Strategy Paper
REER	Real Effective Exchange Rate
SADC	Southern African Development Community

EXECUTIVE SUMMARY AND ISSUES FOR DISCUSSION

Program performance to date has been satisfactory, but full-year tax revenues are likely to be lower than the July 2006 PRGF request expected. Growth, inflation, and the fiscal deficit are on track and the balance of payments and foreign reserves have improved. A waiver is being requested for one of the structural performance criteria (PC) for September 30, 2006 and a modification is being requested for the December 30, 2006 quantitative PC on tax revenue for the second review. Approval is also being requested for the targets and measures for the 2007 economic program. Development in textiles and clothing exports do not warrant an increase in access under the TIM at this time.

Have the authorities satisfactorily implemented their PRGF-supported program so that a waiver for the performance criterion on the issuance of revised expenditure ceilings may be granted?

The authorities have met all quantitative PCs as of July 31, 2006, the first test date, and all but one structural PC through September. The setting of revised expenditure ceilings for the remainder of the year (a structural PC for September) was delayed by one month because the authorities had to wait until Parliament approved the revised 2006 Finance Law. The extension of software to the five largest customs offices (a structural benchmark for September) was also delayed owing to administrative problems on the part of a donor but is expected to be met by year-end.

Should the quantitative PC regarding tax revenue performance at the end of December be adjusted downward?

The macroeconomic framework for the rest of the year is broadly as the program envisaged but tax revenues may fall below the year-end target. While imports in value terms are in line with projections, customs receipts are likely to be lower as tax free export processing zone imports have been stronger than programmed . The authorities indicated that it was too late in the year to implement new tax measures but plan comprehensive tax policy reform next year which will have effect from 2008 onward. Domestic financing of the government fiscal deficit will remain on track, however, because spending reductions, mainly in nonpriority sectors, will offset the lower revenues.

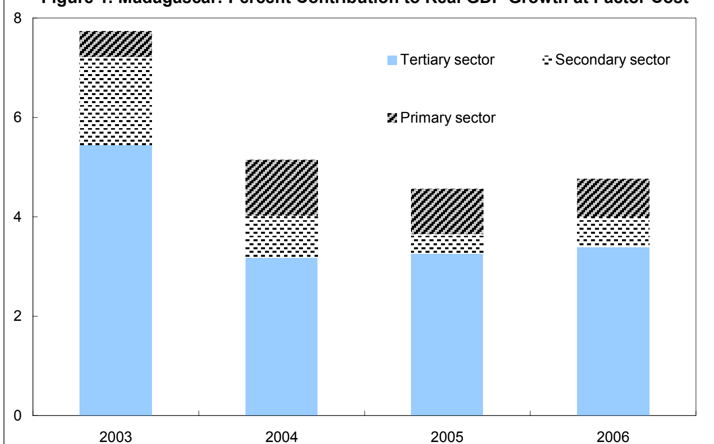
Is the 2007 economic program sufficiently ambitious and realistic?

The macroeconomic framework for 2007 is in line with earlier projections. The economic program is designed to sustain growth, promote fiscal consolidation, and reduce poverty while keeping inflation to single digits and reducing the economy's vulnerability to shocks. Structural measures include a comprehensive reform of tax and customs policy, strengthening of public financial management, participation in the Extractive Industries Transparency Initiative (EITI), recapitalizing and strengthening the central bank, and moving forward with the private concession of the national public utility company (JIRAMA).

I. Recent Developments

1. **Economic activity is on track to reach the real GDP growth target of 4.7 percent for 2006, despite the rise in world energy prices.** The tertiary sector continues to be the principal source of growth, led by strong performance in construction, tourism, and commerce (Figure 1). The secondary sector has also shown a rebound in growth, notably in food processing. Textile exports from the export processing zones have performed better than expected since the Multi Fiber Arrangement (MFA) expired because the industry is diversifying and moving toward higher-value-added products. As a result, augmentation of access under the TIM is not warranted at this time. Moreover, despite earlier concerns over the outbreak of chikunguya, tourism increased throughout the year. Reforms at JIRAMA, such as tariff increases, have resulted in a decline in power outages. However, higher world oil and domestic electricity prices, along with lower private investment as the presidential election nears, have dampened growth.

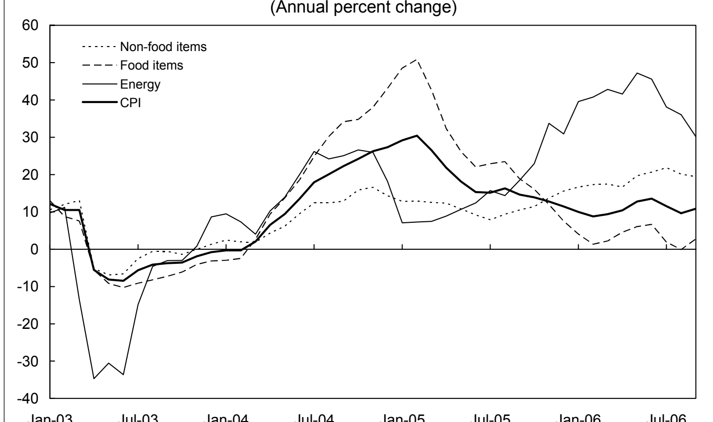
Figure 1. Madagascar: Percent Contribution to Real GDP Growth at Factor Cost



Source: Malagasy authorities and IMF staff estimates.

2. **Though inflation continued to decline in the third quarter, it is still in double digits** (Figure 2). Rising energy prices in June pushed inflation to 13 percent year-on-year, despite declining food prices. However, tight monetary policies and declining energy prices together brought inflation down to 10.6 percent in September. As inflation began to subside, the monetary authorities lowered the central bank rate in August from 16 percent to 12 percent. Since commercial banks were holding excess reserves and not borrowing from the central bank, the authorities recognized that this measure would not directly affect the monetary aggregates—but it would signal to banks that in light of inflation expectations they should consider lowering their lending rates.

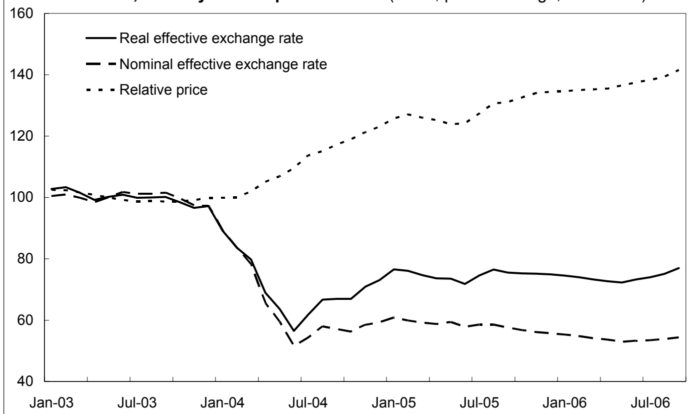
Figure 2. Madagascar: Consumer Price Index, January 2003–September 2006
(Annual percent change)



Source: Malagasy authorities.

3. **Madagascar remains competitive, and the real effective exchange rate (REER) has been relatively stable**. At the end of September the REER was about 2 percent higher than a year ago (Figure 3). Stronger than expected export performance in the first half of 2006 and greater export diversification suggest that the exchange rate is still competitive.

Figure 3. Madagascar: Real and Nominal Effective Exchange Rate and Relative Prices, January 2003-September 2006 (Index, period average, 2003=100)



Sources: Malagasy authorities and IMF staff estimates.

4. **Broad and reserve money grew more than programmed in the third quarter owing to larger than projected foreign exchange accumulation by both the commercial banks and the central bank** (Table 5). The rapid growth in M3 is largely the result of a build up in private sector foreign exchange deposits as exports rose (¶6). At the same time, donor inflows raised central bank foreign assets. Moreover, the central bank purchased foreign exchange on the interbank market in order to smooth variations in the ariary. Although the monetary authorities sterilized part of this injection of liquidity through deposit auctions, it was insufficient to offset the higher-than-programmed increase in net foreign assets.

5. **The banking sector remained healthy in 2006**. Commercial banks continued to be profitable, with rising interest margins and strong noninterest earnings, and have increased their capital base. The share of nonperforming loans declined (Table 7).

6. **The balance of payments in the first half of 2006 was better than expected.** Exports of goods and services increased by 18 percent compared to the first half of 2005, owing largely to shrimp exports and tourism receipts. Imports rose by 10 percent during the same period, mainly on account of higher imports by tax exempt export processing zone companies and a larger oil import bill resulting from the sharp increase in world oil prices. These developments, combined with an increase in official transfers, led to a sizeable reduction of the current account deficit. Foreign reserves exceeded the July target and were equivalent to about 2.9 months of imports of goods and services.

7. **The World Bank and the African Development Bank (AfDB) granted Madagascar debt relief under the Multilateral Debt Relief Initiative (MDRI) on July 1 and September 1, 2006**. Together with that provided by the IMF, total MDRI relief amounts to US$2.3 billion (about 42 percent of GDP).[1]

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[1] The debt service savings for 2006 amounts to US$34 million.

8. **Fiscal performance through the third quarter was on track** (Table 3). Tax revenues exceeded the July 31 target by about 0.3 percentage points of GDP with good performance by both the customs and the tax administrations. While customs revenue fell slightly short of the September 30 target as oil import volumes slowed, domestic revenues were higher than expected so that the program's revenue target was achieved. Government spending remained below target, mainly because parliamentary approval of the revised Finance Law was delayed until October and execution of foreign-financed capital expenditure was slower than expected. As a result, domestic financing of the budget deficit was well below the program ceiling.

9. **The government has finalized its second-generation Poverty Reduction Strategy Paper (PRSP) for 2007-11, the Madagascar Action Plan (MAP).**[2] The MAP builds on lessons learned in implementing the first PRSP, which covered 2002–06. In order to accelerate progress toward the Millennium Development Goals (MDGs), the authorities have set ambitious medium-term macroeconomic objectives, with policy measures and quantifiable indicators in the priority areas of health, education, rural development, infrastructure, and private sector development (MEFP, ¶¶1-2). Since the MAP's objectives assume a substantial increase in yet to be identified concessional financing, the authorities have also created an alternative scenario based on donor assistance flows that seem currently more likely and upon which the PRGF-supported program is based.

10. **The first round of the presidential election is scheduled for December 3, 2006, and parliamentary, regional, and municipal elections for 2007.** Incumbent President Ravalomanana is competing against 13 other candidates. If none receives a majority on the first ballot, the top two contenders will compete in a second round in February 2007.

II. Program Performance and Outlook for 2006

11. **All quantitative PCs for the July 31 test date and all but one structural PC for September were met** (MEFP, Tables 1 and 2). All quantitative indicative targets for September 30, 2006, for which data are available were also met. Revised expenditure ceilings consistent with the latest revenue projections for the rest of the year (a structural PC for September) were issued to line ministries with a delay of one month because the authorities had to wait for the Parliament to approve the revised 2006 Finance Law (MEFP, ¶¶11, 22). The extension of the new ASYCUDA++ software to the five largest customs offices (a September benchmark) was delayed by the administrative problems of a donor but is expected to be met by year-end (MEFP, ¶15). The 2007 Finance Law includes a plan for recapitalizing the central bank (an October benchmark, MEFP, ¶25) and the remaining structural benchmarks should be met by year-end as planned (MEFP, ¶16).

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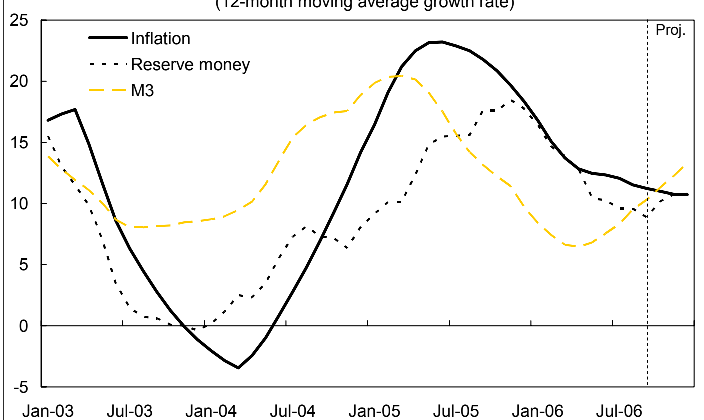
[2] The MAP is expected to be circulated to the Executive Boards of the IMF and World Bank in early 2007. A Joint Staff Advisory Note on the MAP will be circulated shortly thereafter.

12. **The macroeconomic framework for the final quarter remains broadly as envisaged but the revenue target may not be met** (Table 3). While the real GDP growth target is expected to be met, the GDP deflator will be slightly lower than programmed because the deterioration in the terms of trade was smaller than expected and the exchange rate somewhat stronger. Tax revenues will likely be below the year-end target by about 0.3 percentage points of GDP as the share in total imports of tax exempt export processing zone imports was higher than programmed. However, domestic financing of the government fiscal deficit will be on track; spending reductions, mostly in nonpriority sectors (MEFP, ¶22), should offset the lower revenues. The impact of these cuts on growth should be compensated in part by the pick up in investment by export processing zone textile companies as they move into higher value added products. The staff considered that the August reduction in the central bank rate was premature and urged the authorities to tighten monetary policy in the fourth quarter in order to achieve the end-year reserve money and inflation targets (Figure 4). This could be achieved either by the central bank selling foreign exchange or mopping up excess liquidity through deposit auctions. The current account deficit (including grants) is projected to improve relative to the target mainly because of stronger export performance. International reserves are expected to rise in value but remain constant as a share of imports at about 2.9 months.

Figure 4. Madagascar: Inflation, Broad and Reserve Money, 2003-2006
(12-month moving average growth rate)



Source: Malagasy authorities and IMF staff projections.

III. Economic and Financial Policies for 2007

A. The Macroeconomic Outlook

13. **The medium-term outlook is broadly in line with earlier projections** (Table 1**)**. Higher export values—largely a base effect from better-than-expected performance in 2006—and grants result in a modest narrowing of the current account deficit in 2007 and 2008. The fiscal deficit is slightly lower because grants are higher and foreign-financed capital expenditure is lower. The growth and inflation outlook is unchanged.

14. **The 2007 economic program is designed to sustain growth, promote fiscal consolidation, and reduce poverty while keeping inflation to single digits and reducing the economy's vulnerability to shocks.** Program policies and targets in 2007 are consistent with the objectives of: (i) economic growth of 5.6 percent; (ii) a reduction in inflation to 8 percent; (iii) an increase in tax revenue by at least 0.5 percentage points of GDP;

(iv) limiting domestic financing of the fiscal deficit to less than 0.3 percent of GDP; and (v) an increase in foreign reserves to the equivalent of three months of imports. Structural measures include comprehensive reform of tax and customs policy, strengthening of PFM, participation in the EITI, recapitalizing and strengthening the central bank, and moving forward with the private management concession and rehabilitation of JIRAMA.

B. Fiscal Policy and Reforms

Fiscal policy

15. **The 2007 Finance Law adopted by Parliament is consistent with the program's macroeconomic objectives**. Tax revenue is targeted to increase by 0.5 percentage points of GDP, although from a lower base. The increase would primarily result from the implementation of ongoing tax and customs administration reforms (¶16). However, nontax revenues are expected to return to historical levels as exceptional transfers from the central bank to the Treasury end, consistent with the government's proposed central bank recapitalization plan. Grants are also expected to decline from the exceptionally high levels that occurred after the 2002 political crisis and the 2004 cyclone and the end of HIPC debt relief from the IMF, the World Bank, and the AfDB after the MDRI was implemented. The reduction in total revenue and grants will be more than offset by a decline in total expenditure as foreign-financed capital expenditure falls. The overall fiscal deficit (cash basis, including grants) will therefore decline to about 4.4 percent of GDP and domestic financing of the deficit will be small (Text Table 1, Tables 2a and 2b), in line with the growth and inflation objectives and projected external financing on highly concessional terms. The authorities expressed disappointment that scaled-up donor assistance to low-income countries to accelerate progress in achieving the MDGs had not yet occurred. Should external budgetary assistance be higher than projected, the program's targets will be adjusted upward to accommodate priority spending, subject to a ceiling (TMU, ¶27).[3]

[3] The ceiling and adjustor will apply to grants and highly concessional debt (IDA terms); no new nonconcessional loans are permitted under the program.

Text Table 1. Madagascar: Fiscal Indicators, 2006-07
(Percent of GDP) [1]

	2006 [2] (a)	2007 (b)	(b) - (a)
Total revenue and grants [3]	17.2	16.5	-0.7
Tax revenue	10.7	11.2	0.5
Nontax revenue	0.7	0.2	-0.5
Grants [3]	5.8	5.1	-0.6
Total expenditure	21.5	20.7	-0.8
Current expenditure	10.5	10.4	-0.2
Capital expenditure	11.0	10.3	-0.6
Overall balance (commitment basis, including grants) [3]	-4.4	-4.2	0.2
Overall balance (cash basis, including grants) [3]	-4.9	-4.4	0.5
Foreign financing [3]	4.9	4.1	-0.8
Domestic financing [3]	0.0	0.3	0.3
Memorandum items:			
Net external aid [4]	10.6	9.4	-1.2
Priority PRSP spending	10.7	11.0	0.3

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] Aggregates may differ from the sum of components due to rounding.
[2] Revised Program.
[3] Excluding MDRI capital transfers.
[4] Foreign grants and loans, less debt service.

Revenue mobilization

16. **The program's revenue mobilization objective is based on reform of both tax policy and tax administration**. In 2007 the authorities will implement their new time-bound tax administration action plan (MEFP, ¶¶28-29) and continue with customs administration reform (MEFP, ¶¶30-31). They believe that the targeted increase in tax revenues is the maximum feasible from tax administrative measures. The authorities will also develop a comprehensive tax policy reform agenda to simplify and increase the efficiency of the tax and customs codes and to broaden the tax base with a view to moving away from special

regimes and incentives, while augmenting tax revenues by 0.5 percent of GDP annually (MEFP, ¶27).[4] This reform is being designed in close collaboration with the Fund's Fiscal Affairs Department (FAD), the World Bank, and other donors and will be implemented under the 2008 Finance Law.

Expenditure priorities

17. **The spending priorities in the 2007 Finance Law are aligned with those of the MAP**. Thanks in part to the resources freed up by the MDRI, the share in total spending of priority spending (on health, education, infrastructure, justice, agricultural development, and environmental protection) will increase to 58 percent (11 percent of GDP) from 55 percent in the revised 2006 budget (10.7 percent of GDP). The 2007 Finance Law also allows for interest payments at market rates on government securitized debt owed to the central bank,[5] transfers to support the rehabilitation of JIRAMA, regularization of arrears on VAT reimbursements, and full budgeting of the government's obligations on foreign-financed projects (MEFP, ¶25).

Public financial management

18. **Advancing the public financial management (PFM) agenda will be critical to improving budget preparation, execution, and control.** Drawing on the latest Public Expenditure and Financial Accountability (PEFA)[6] assessment (Box 1) and FAD recommendations, the program incorporates measures to simplify budget classification, accelerate budget preparation, improve budget execution and monitoring, strictly enforce the quarterly expenditure commitment ceilings, and improve cash management (MEFP, ¶¶32-35).

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[4] The authorities were considering including investment tax incentives as part of a draft investment law, but decided to remove such incentives and instead launch the comprehensive tax policy reform with a view to safeguarding their revenue objectives under the program.

[5] This amounts to the equivalent of 0.5 percentage points of GDP.

[6] PEFA, which measures progress in PFM in low income countries, is jointly sponsored by France, Norway, Switzerland, the United Kingdom, the European Commission, the Fund, NEPAD, and the World Bank.

Box 1. Madagascar: Progress in Public Financial Management

There has been notable improvement in Madagascar's PFM. As measured by the April 2006 PEFA, Madagascar's PFM score improved over the past year in 13 out of 31 dimensions, principally in the area of budget preparation.

But weaknesses remain. Problems in switching to the new system of performance-based budgeting and inadequate control of budget execution led to a deterioration in five PFM indicators, primarily in the area of budget execution and monitoring. Although the budget information system (SIGFP) is being deployed in most ministries, it is not yet being used to monitor budget execution. As a result, the continued need to reduce spending to offset revenue shortfalls results in delays in preparation of the subsequent year's budget and limits the involvement of technical ministries in budget preparation. Parliament's involvement in budget preparation, execution, and control is also limited. Moreover, the capacity constraints of the Audit Court limit the effectiveness of budget monitoring. Competitive tendering is not used sufficiently in public procurement, although Madagascar has adopted a world-class Procurement Code that was drafted with assistance from the World Bank.

19. **At the October 2006 Oslo Summit the authorities announced their intention to join the EITI.** In 2007, they plan to prepare an action plan and schedule for its implementation drawing on technical assistance provided by the Government of Norway. Given the growing importance of mining and the prospects for offshore oil development, EITI membership should help increase transparency and improve governance over the medium term. (MEFP, ¶36).

C. Monetary and Exchange Rate Policy

20. **Monetary policy will aim for single-digit inflation.** To this end, the central bank will target reserve money to grow at a rate well below the expected growth of nominal GDP. To achieve its target, the central bank will continue to auction deposits/credits, but will also benefit from a new monetary policy instrument. The decision to exchange consolidated government debt to the central bank for tradable securities at market rates of interest adds open market operations to its set of liquidity management instruments (MEFP, ¶38). The authorities have also committed to recapitalizing the central bank in early 2007, the modalities for which are being finalized with technical assistance from the Fund's Monetary and Capital Markets Department (MEFP, ¶40).

21. **The authorities will keep to a managed float exchange rate with no pre-determined path**. Central bank interventions will be limited to smoothing large variations in the exchange rate and meeting the program's foreign reserve target (MEFP, ¶42). The

authorities are committed to taking further steps to improve the operation of the interbank foreign exchange market (MID), notably by publishing transaction data about weighted average price and volume on a real-time basis and by encouraging commercial banks to bring all bids to the MID.

D. External Sector Policies

22. **Trade liberalization will continue by deepening regional integration.** As of November 15, 2006, Madagascar has started to phase out its tariffs on imports from the Southern African Development Community (SADC), with full liberalization planned for 2012. The revenue loss is expected to be minimal. The authorities hope that this will strengthen export diversification, increase textile exports, and foster foreign direct investment, given the opportunities related to the country's proximity to South Africa. The authorities intend to further rationalize the tariff structure over the medium term as part of the comprehensive tax policy reform they are undertaking (¶16). They will consider the possibility of moving to a single (nonzero) unified most favored nation tariff that is revenue-neutral for countries outside regional agreements (MEFP, ¶43).

E. Public Enterprise Reform

23. **The authorities are restructuring and rehabilitating JIRAMA**. With its outdated plants, it is likely that JIRAMA's inefficiencies will continue to disrupt economic activity and increase the cost of doing business. Although electricity tariffs have almost doubled over the past year, JIRAMA continues to require budget transfers. The authorities have committed to a long-term private concession for JIRAMA and expect to launch a call for bids by December 2007. They are also implementing a comprehensive rehabilitation plan to modernize JIRAMA's generation and distribution technologies. According to the International Finance Corporation's Advisory Service, this modernization program will need to be financed by the government and donors in order to attract a private concessionaire. The authorities are also considering expanding production capacity using independent power producers (MEFP, ¶¶49-50).

24. **The government will continue to disengage from other public enterprises**. The divestiture plan covers the remaining six public enterprises to be privatized. The telecommunications and cotton ginning parastatals and the northern section of the national railway have already been transferred to private operators, but not the sugar company and the southern railway. The strategy for privatizing management of the 12 airports in the country has yet to be crafted (MEFP, ¶¶51-52).

IV. Program Monitoring and Targets

25. **The program will be reviewed twice a year.** The test dates for the performance criteria of the second and third reviews are December 31, 2006 and June 30, 2007. Indicative targets have been set for December 31, 2007 and are proposed to be confirmed as

26. performance criteria during the second review. Indicative targets have also been proposed for March 31 and September 30, 2007, to allow quarterly assessment of progress.

27. **It is proposed to set quantitative PCs for June 30, 2007** (MEFP, Table 3)**.** At the request of the authorities, it is also proposed that the floor on central bank accumulation of net foreign assets for December 31, 2006 be denominated in SDRs rather than in local currency and the floor on tax revenue for December 31, 2006 be revised downward (MEFP, Table 1).

28. **Structural PCs and benchmarks apply to the priority areas of the program** (MEFP, Tables 2 and 4). The continuous PC on limiting transactions with the central bank to those authorized by its charter is proposed to be removed at the first review effective January 1, 2007 as agreed with the authorities. The second review will attach particular importance to the planned reforms in tax policy and administration, and the option chosen regarding the private management of JIRAMA and its budgetary consequences.

V. RISKS

29. **Madagascar's capacity to repay the Fund is good.** Debt service to the Fund is projected to remain below 0.2 percent of exports of goods and services now that obligations to the Fund under the MDRI have been cancelled (Table 10). Debt indicators under most shocks are projected to remain well below the thresholds of the joint Bank-Fund Debt Sustainability Framework.[7] Implementation of the Safeguards Assessment recommendations is expected to improve the financial position and institutional capacity of the central bank.

30. **Yet there are risks to program implementation**. While the authorities have stated their commitment to improving domestic revenue collection and keeping spending at levels consistent with their macroeconomic objectives, they may face resistance up to and immediately after the presidential election. However, if revenue performance is worse than programmed, they have indicated that they will reduce expenditure primarily in nonpriority sectors to keep domestic financing below the program ceiling (MEFP, ¶ 20). Volatile commodity prices, possible trade shocks, cyclones, and blackouts caused by delays in rehabilitating JIRAMA could also disrupt the reform effort. Finally, the termination of the Africa Growth Opportunity Act (AGOA) third-country provision in 2007 may reduce textile exports more than expected; if so the authorities could request an augmentation of the access to the PRGF by up to 10 percent of their quota (SDR 12.2 million) if they activate the TIM approved by the Board last July.

[7] IMF Country Report No. 06/306, Appendix IV—Madagascar: Joint Bank-Fund Debt Sustainability Analysis.

VI. Staff Appraisal

31. **The authorities have satisfactorily implemented their PRGF-supported program**. All quantitative PCs as of the July 31, 2006 test date were met. One structural PC and one benchmark for September were not met owing to delays beyond the authorities' control. The structural PC has since been met and the benchmark is expected to be met by year-end.

32. **The program is expected to remain broadly on track through the rest of 2006, although the revenue target may not be met.** Planned spending reductions should offset any shortfall in revenues, however, which would allow the domestic financing target to be met. The staff expects the remaining structural benchmarks to be met by year-end as planned.

33. **The medium-term outlook is in line with the targets in the original program**. Although the local textile industry has undergone structural changes since the MFA ended in early 2005, the impact has been limited and staff does not see a need to increase TIM access at this time.

34. **The 2007 Finance Law is aligned with the priorities of the MAP and is consistent with the program's macroeconomic objectives**. It appropriately emphasizes the need to sustain growth, lower inflation to single digits, and reduce vulnerability to shocks, while mobilizing domestic revenues, increasing priority spending, and strengthening PFM.

35. **Poverty-reducing spending is expected to increase as a share of total spending under the PRGF-supported program, in part using resources freed up by the MDRI**. Emphasis is rightly placed on health, education, infrastructure (including JIRAMA), agriculture, and environmental protection.

36. **The authorities' decision to undertake comprehensive tax policy reform beyond the continuing tax and customs administration measures is commendable**. They are correctly placing priority on simplifying and increasing the efficiency of the tax and customs codes while increasing revenues in order to finance priority expenditure in support of achieving the MDGs. It is appropriate to wait for the full package of tax policy reforms to be formulated in 2007 for implementation in 2008 rather than pursuing a set of ad hoc measures at this time.

37. **While there has been progress in strengthening PFM, more remains to be done** to simplify budget classifications, accelerate budget preparation, better monitor budgets, and strictly enforcing the quarterly expenditure commitment ceilings.

38. **The decision to join the EITI is an important step toward greater transparency and good governance**. Given the growing importance of mining and the prospects for offshore oil, the authorities should make it a priority to accelerate implementation of their obligations under the EITI.

39. **Monetary policy should be tightened in order to achieve the program's reserve money and inflation targets.** The authorities must remain vigilant to achieve low inflation, which will help restore confidence in the economy and facilitate sustainable growth. If there is a rise in inflationary pressures or if banks seek central bank credit, the authorities should increase the central bank rate until single-digit inflation has been achieved.

40. **The managed float exchange rate regime with no predetermined path is also appropriate**. Central bank interventions should be limited to smoothing large variations in the exchange rate and achieving the reserve target.

41. **Deeper integration into SADC could help diversify exports and attract direct investment**. The authorities should further rationalize the tariff structure as part of the comprehensive tax policy reform, perhaps by moving toward a revenue-neutral, single (nonzero) unified tariff.

42. **The private concession for JIRAMA and modernization of its generation and distribution technologies should be beneficial to economic growth**. The authorities will need to play a lead role, along with development partners, in financing the rehabilitation.

43. **There continue to be risks**. Exogenous shocks, uncertainty about donor assistance, blackouts owing to delays in the rehabilitation of JIRAMA, institutional capacity constraints, and political pressures emanating from the presidential election could impede program implementation.

44. **Staff recommends completion of the first review under the PRGF and supports granting of a waiver for the structural PC on the issuance of revised expenditure ceilings**, which was completed with a slight delay owing to the need for parliamentary approval of the revised 2006 Finance Law. Staff also supports the request to change the December 31, 2006 PC on tax revenue because of the higher share of tax exempt export processing zone imports and to eliminate the structural PC on limiting transactions with the central bank to those authorized by its charter effective January 1, 2007. Despite the risks, the program's targets are achievable and the authorities are acting to ensure satisfactory implementation of their program, through such means as additional technical assistance and training.

Table 1. Madagascar: Selected Economic and Financial Indicators, 2004-08

	2004	2005	2006		2007		2008	
		Est.	Prog.[1]	Proj.[2]	Proj.[1]	Prog.	Proj.[1]	Rev. Proj.
	(Percentage change, unless otherwise indicated)							
National income and prices								
Nominal GDP growth	20.3	23.8	16.8	16.5	16.0	15.8	13.2	13.3
Real GDP growth	5.3	4.6	4.7	4.7	5.6	5.6	5.6	5.6
GDP deflator	14.3	18.4	11.5	11.2	9.9	9.7	7.2	7.3
Consumer price index (period average)	14.0	18.4	11.2	10.7	9.6	9.6	7.0	7.1
Consumer price index (end of period)	27.3	11.4	11.3	10.8	8.0	8.0	6.0	6.0
External sector								
Export of goods volume	5.6	13.9	-1.6	3.8	4.1	1.3	5.2	4.8
Import of goods volume	8.4	-13.2	-9.7	-6.1	6.6	2.5	6.6	6.4
Terms of trade (deterioration -)	-14.4	-34.6	-7.1	-4.4	1.5	-1.8	2.3	1.9
Money and credit [3]								
Broad money	23.8	3.1	15.6	17.0	16.0	15.5	13.2	13.3
Net foreign assets	23.3	1.9	22.8	24.2	8.8	5.3	5.9	4.9
Net domestic assets	0.6	1.2	-7.2	-7.2	7.3	10.1	7.3	8.4
Credit to government	-12.3	-5.3	-16.8	-16.8	-1.0	0.5	-0.6	-0.2
Credit to the private sector [4]	36.9	22.4	24.5	21.2	24.3	23.0	22.5	19.7
Velocity of money (M3; average)	3.9	4.6	4.7	4.6	4.7	4.6	4.7	4.6
	(Percent of GDP)							
Public finance								
Total revenue (excluding grants)	12.0	10.9	11.7	11.4	11.9	11.4	12.4	12.1
Of which : tax revenue	10.9	10.1	11.0	10.7	11.5	11.2	12.0	11.7
Grants [5]	8.2	5.7	49.5	47.5	4.2	5.1	3.9	4.0
Total expenditure	25.1	21.2	21.9	21.5	21.2	20.7	20.9	20.7
Current expenditure	12.6	11.0	10.3	10.5	10.4	10.4	10.7	10.4
Capital expenditure	12.5	10.3	11.5	11.0	10.7	10.3	10.2	10.3
Domestic balance	-2.3	-2.2	-0.9	-1.2	-1.3	-1.4	-1.2	-1.4
Overall balance (cash basis, incl. grants)	-5.7	-4.3	38.7	36.8	-5.1	-4.4	-4.6	-4.5
Overall balance (cash basis, excl. grants)	-13.9	-10.1	-10.8	-10.7	-9.3	-9.5	-8.5	-8.6
Domestic financing	-1.0	0.5	-3.1	-3.1	0.1	0.3	0.1	0.1
Savings and investment								
Investment	24.3	22.5	21.8	21.8	22.3	22.1	22.5	22.2
Government	12.5	10.3	11.5	11.0	10.7	10.3	10.2	10.3
Nongovernment	11.8	12.3	10.3	10.8	11.5	11.7	12.3	11.9
Gross domestic savings	9.4	8.9	8.1	8.7	8.7	9.3	9.3	9.7
Gross national savings	15.2	12.1	11.4	11.8	11.5	12.2	12.0	12.3
External sector and public debt								
Exports of goods, f.o.b.	22.9	16.6	15.4	16.9	15.3	15.9	15.2	15.5
Imports of goods, c.i.f.	38.8	32.8	30.4	31.7	30.6	30.6	30.0	29.8
Current account balance (excl. grants)	-12.9	-11.7	-11.6	-11.2	-11.4	-10.7	-11.1	-10.6
Current account balance (incl. grants)	-9.1	-10.4	-10.5	-10.0	-10.7	-9.9	-10.5	-10.0
Public debt	92.4	80.3	34.2	34.2	35.8	34.7	37.1	35.8
External	80.0	69.9	25.6	25.6	28.8	27.2	31.1	29.4
Domestic	12.5	10.5	8.5	8.6	7.0	7.4	6.0	6.4
Net present value (NPV) of external debt								
NPV of debt-to-exports ratio	...	134.7	58.8	52.1	67.1	59.4	74.3	66.4
NPV of debt-to-revenue ratio	...	214.6	83.5	83.4	102.2	93.8	110.0	105.2
	(Units as indicated)							
Gross official reserves (millions of SDRs)	330.4	337.4	348.7	360.9	381.8	391.8	406.7	419.7
Months of imports of goods and services	2.8	3.0	2.9	2.9	3.0	3.0	3.0	3.0
Residual Financing Gap (millions SDR)	0.0	0.0	9.2	7.9	48.9	15.7	42.7	23.3
Ariary per SDR (period average)	2,772	2,958	3,135	3,167	...	...	...	...
Ariary per U.S. dollar (period average)	1,872	2,006	2,180	2,162	...	...	...	...
GDP per capita (U.S. dollars)	251	282	294	296	310	319	326	338
Nominal GDP (billions of ariary)	8,156	10,097	11,795	11,760	13,687	13,622	15,495	15,432

Sources: Malagasy authorities and Fund staff estimates and projections.

[1] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism.

[2] The fiscal numbers correspond to a revised program (see Table 2a, footnote 2).

[3] Growth in percent of beginning of period money stock (M3).

[4] Year-on-year growth.

[5] Includes MDRI capital transfers in 2006.

Table 2a. Madagascar: Government Financial Operations, 2004-08
(Billions of ariary, unless otherwise indicated)

	2004	2005	2006		2007		2008	
		Est.	Prog.[1]	Rev. Prog.[2]	Proj.[1]	Prog.	Proj.[1]	Rev. Proj.
Total revenue and grants	1,653.5	1,682.2	7,214.3	6,920.9	2,196.4	2,251.4	2,525.5	2,487.7
Total revenue and grants (excl. MDRI capital transfers)	...	...	2,044.9	2,020.2	...	...	...	...
Total revenue	982.4	1,102.7	1,376.6	1,340.1	1,626.9	1,552.1	1,919.3	1,865.1
Tax revenue	887.1	1,020.0	1,295.8	1,259.3	1,572.2	1,523.8	1,857.3	1,803.4
Nontax revenue	95.2	82.8	80.8	80.8	54.7	28.3	62.0	61.7
Grants	671.1	579.5	5,837.7	5,580.8	569.4	699.3	606.2	622.5
Current grants	318.7	141.0	182.0	193.8	116.6	150.5	120.9	133.1
Capital grants	352.4	438.5	5,655.7	5,387.0	452.8	548.8	485.3	489.5
Project grants	352.4	438.5	486.3	486.3	452.8	548.8	486.3	489.5
Capital transfers MDRI	...	...	5,169.4	4,900.7	...	...	...	...
Total expenditure (commitment basis)	2,045.3	2,145.5	2,580.5	2,531.0	2,895.3	2,822.4	3,236.0	3,189.6
Current expenditure	1,027.3	1,107.2	1,221.3	1,240.6	1,429.1	1,415.6	1,655.3	1,597.8
Personnel	400.0	456.4	599.8	596.9	721.0	721.1	831.2	827.1
Interest obligations	239.5	266.6	235.4	253.4	219.8	221.1	207.3	218.8
Foreign interest obligations [3]	113.9	97.9	50.6	47.8	45.4	21.5	54.9	47.9
Domestic interest obligations	125.5	168.7	184.8	205.6	174.4	199.6	152.4	171.0
Other	259.2	300.0	373.6	377.8	474.6	459.7	601.2	536.4
Treasury operations (net) [4]	128.6	84.2	12.5	12.5	13.7	13.7	15.5	15.4
Capital expenditure	1,018.0	1,038.3	1,359.2	1,290.4	1,466.2	1,406.8	1,580.7	1,591.8
Domestically financed	245.4	304.8	304.2	286.3	424.7	349.0	510.3	525.3
Foreign financed	772.7	733.5	1,055.0	1,004.1	1,041.5	1,057.8	1,070.4	1,066.4
Net cost of structural reforms [5]	-8.8	-8.5	-6.2	-6.2	0.0	0.0	0.0	0.0
Overall balance (commitment basis)								
Excluding grants	-1,071.7	-1,051.2	-1,210.1	-1,197.1	-1,268.3	-1,270.3	-1,316.7	-1,324.4
Including grants	-400.6	-471.7	4,627.6	4,383.7	-698.9	-571.1	-710.5	-701.9
Including grants, excluding MDRI capital transfers	...	...	-541.8	-517.0	...	...	...	...
Domestic balance (commitment basis) [6]	-185.1	-219.8	-104.5	-145.2	-181.4	-191.0	-191.3	-210.1
Float [7]	-63.2	44.9	-40.7	-40.7	0.0	-3.3	0.0	0.0
Variation of domestic arrears	...	-10.9	-20.0	-20.0	0.0	-23.4	0.0	0.0
Overall balance (cash basis)								
Excluding grants	-1,134.9	-1,017.2	-1,270.8	-1,257.8	-1,268.3	-1,297.0	-1,316.7	-1,324.4
Including grants	-463.8	-437.7	4,566.9	4,323.0	-698.9	-597.8	-710.5	-701.9
Including grants, excluding MDRI capital transfers	...	...	-602.5	-577.7	...	...	...	...
Financing	463.8	437.7	-4,566.9	-4,323.0	698.9	597.8	710.5	701.9
Foreign (net)	518.2	387.8	-4,210.3	-3,966.3	691.0	560.3	693.2	680.6
Drawings	579.3	454.5	710.8	683.8	741.4	634.4	745.3	732.5
Budget	143.2	159.5	142.1	166.0	152.7	125.4	160.2	155.5
Projects	436.1	295.0	568.7	517.8	588.7	509.0	585.1	577.0
Amortization [3]	-188.5	-177.0	-4,921.0	-4,650.1	-50.8	-74.1	-52.7	-52.4
External debt relief	127.4	110.3	0.0	0.0	0.4	0.0	0.5	0.5
Domestic (net)	-84.6	49.4	-362.1	-361.8	7.9	37.5	17.3	21.3
Banking system	-215.6	-111.6	-365.2	-366.0	-25.1	12.1	-16.8	-5.0
Of which: MDRI account	...	...	-325.5	-325.5	36.2	36.2	36.2	36.2
Nonbanking system	107.9	120.0	3.1	4.2	33.0	25.4	34.2	26.3
Treasury correspondent accounts (net)	23.0	41.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	30.2	0.6	5.5	5.0	0.0	0.0	0.0	0.0
Memorandum items:								
MDRI flow debt-service savings	...	...	73.4	72.5	114.7	111.6	127.3	123.4
Net domestic financing [8]	-117.6	84.0	-55.7	-55.7	7.9	10.8	17.3	21.3

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism.

[2] Tax revenue has been revised downwards and spending cut accordingly, in order to meet the original program net domestic financing ceiling.

[3] After MDRI debt relief from 2006 onward.

[4] Includes annexed budgets of quasi-public entities (i.e. port authorities, the post office, government printing office, civil service, retirement funds, and correspondent accounts of local authorities).

[5] Includes: as receipts, loan recovery from nonperforming loans; and as expenditures, costs related to civil service reform, justice reform, privatization and bank restructuring.

[6] Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.

[7] Difference between committed and paid expenditure.

[8] Banking system, nonbanking system, Treasury correspondent accounts (net), privatization receipts, float, and variation in arrears, excluding capital transfer flowing from MDRI assistance from IMF via central bank.

Table 2b. Madagascar: Government Financial Operations, 2004-08
(Percent of GDP, unless otherwise indicated)

	2004	2005	2006		2007		2008	
		Est.	Prog.[1]	Rev. Prog.[2]	Proj.[1]	Prog.	Proj.[1]	Rev. Proj.
Total revenue and grants	20.3	16.7	61.2	58.8	16.0	16.5	16.3	16.1
Total revenue and grants (excl. MDRI capital transfers)	...	...	17.3	17.2	...	...	...	...
Total revenue	12.0	10.9	11.7	11.4	11.9	11.4	12.4	12.1
Tax revenue	10.9	10.1	11.0	10.7	11.5	11.2	12.0	11.7
Nontax revenue	1.2	0.8	0.7	0.7	0.4	0.2	0.4	0.4
Grants	8.2	5.7	49.5	47.5	4.2	5.1	3.9	4.0
Current grants	3.9	1.4	1.5	1.6	0.9	1.1	0.8	0.9
Capital grants	4.3	4.3	48.0	45.8	3.3	4.0	3.1	3.2
Project grants	4.3	4.3	4.1	4.1	3.3	4.0	3.1	3.2
Capital transfers MDRI	...	...	43.8	41.7	...	...	...	...
Total expenditures (commitment basis)	25.1	21.2	21.9	21.5	21.2	20.7	20.9	20.7
Current expenditure	12.6	11.0	10.3	10.5	10.4	10.4	10.7	10.4
Personnel	4.9	4.5	5.1	5.1	5.3	5.3	5.4	5.4
Interest obligations	2.9	2.6	2.0	2.2	1.6	1.6	1.3	1.4
Domestic Interest	1.4	1.7	1.6	1.7	1.3	1.5	1.0	1.1
Foreign Interest [3]	1.5	1.0	0.4	0.4	0.3	0.2	0.4	0.3
Other	3.2	3.0	3.2	3.2	3.5	3.4	3.9	3.5
Treasury operations [4]	1.6	0.8	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure	12.5	10.3	11.5	11.0	10.7	10.3	10.2	10.3
Domestically financed expenditure	3.0	3.0	2.6	2.4	3.1	2.6	3.3	3.4
Foreign-financed expenditure	9.5	7.3	8.9	8.5	7.6	7.8	6.9	6.9
Net cost of structural reforms [5]	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Overall balance (commitment basis)								
Excluding grants	-13.1	-10.4	-10.3	-10.2	-9.3	-9.3	-8.5	-8.6
Including grants	-4.9	-4.7	39.2	37.3	-5.1	-4.2	-4.6	-4.5
Including grants, excluding MDRI capital transfers	...	...	-4.6	-4.4	...	...	...	...
Domestic balance (commitment basis) [6]	-2.3	-2.2	-0.9	-1.2	-1.3	-1.4	-1.2	-1.4
Float [7]	-0.8	0.4	-0.3	-0.3	0.0	0.0	0.0	0.0
Variation of domestic arrears	...	-0.1	-0.2	-0.2	0.0	-0.2	0.0	0.0
Overall balance (cash basis)								
Excluding grants	-13.9	-10.1	-10.8	-10.7	-9.3	-9.5	-8.5	-8.6
Including grants	-5.7	-4.3	38.7	36.8	-5.1	-4.4	-4.6	-4.5
Including grants, excluding MDRI capital transfers	...	...	-5.1	-4.9	...	...	...	...
Financing	5.7	4.3	-38.7	-36.8	5.1	4.4	4.6	4.5
Foreign (net)	6.4	3.8	-35.7	-33.7	5.0	4.1	4.5	4.4
Drawings	7.1	4.5	6.0	5.8	5.4	4.7	4.8	4.7
Budget	1.8	1.6	1.2	1.4	1.1	0.9	1.0	1.0
Projects	5.3	2.9	4.8	4.4	4.3	3.7	3.8	3.7
Amortization [3]	-2.3	-1.8	-41.7	-39.5	-0.4	-0.5	-0.3	-0.3
External debt relief	1.6	1.1	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	-1.0	0.5	-3.1	-3.1	0.1	0.3	0.1	0.1
Banking sector	-2.6	-1.1	-3.1	-3.1	-0.2	0.1	-0.1	0.0
Of which: MDRI account	...	...	-2.8	-2.8	0.3	0.3	0.3	0.3
Nonbanking sector	1.3	1.2	0.0	0.0	0.2	0.2	0.2	0.2
Treasury correspondent accounts (net)	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Nominal GDP (billions of ariary)	8,156	10,097	11,795	11,760	13,687	13,622	15,495	15,432
MDRI flow debt-service savings	...	...	0.6	0.6	0.8	0.8	0.8	0.8
Net domestic financing [8]	-1.4	0.8	-0.5	-0.5	0.1	0.1	0.1	0.1

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] See Table 2a, footnote 1.
[2] See Table 2a, footnote 2.
[3] See Table 2a, footnote 3.
[4] See Table 2a, footnote 4.
[5] See Table 2a, footnote 5.
[6] See Table 2a, footnote 6.
[7] See Table 2a, footnote 7.
[8] See Table 2a, footnote 8.

Table 3. Madagascar: Quarterly Government Financial Operations, 2006
(Billions of ariary, cumulated since the beginning of the year, unless otherwise indicated)

	March	June	July		September		December	
	Est.	Est.	Prog.[1]	Est.	Prog.[1]	Proj.	Prog.[1]	Rev. Prog.[2]
Total revenue and grants	733.6	1,374.2	6,293.9	6,061.5	6,621.4	6,363.8	7,214.3	6,920.9
Total revenue and grants (excluding MDRI capital transfers)	371.9	1,012.5	1,124.5	1,160.8	1,452.0	1,463.1	2,044.9	2,020.2
Total revenue	276.7	648.4	730.4	759.1	963.4	963.6	1,376.6	1,340.1
Tax revenue	264.7	617.9	695.1	722.0	907.8	908.0	1,295.8	1,259.3
Domestic taxes	128.8	324.9	360.7	374.9	461.0	468.1	636.2	636.2
Taxes on foreign trade	135.9	293.0	334.4	347.1	446.8	439.8	659.6	623.1
Nontax revenue	12.1	30.6	35.3	37.1	55.6	55.6	80.8	80.8
Grants	456.9	725.8	5,563.5	5,302.4	5,658.0	5,400.2	5,837.7	5,580.8
Current grants	27.4	103.9	106.6	110.0	126.1	130.7	182.0	193.8
Capital grants	429.5	621.9	5,456.9	5,192.4	5,531.9	5,269.5	5,655.7	5,387.0
Project grants	67.8	260.2	287.5	291.7	362.5	368.8	486.3	486.3
Capital transfers MDRI	361.7	361.7	5,169.4	4,900.7	5,169.4	4,900.7	5,169.4	4,900.7
Total expenditure	520.4	1,188.9	1,472.4	1,277.2	1,874.8	1,777.9	2,580.5	2,531.0
Current expenditure	279.7	567.1	720.7	658.5	923.5	922.6	1,221.3	1,240.6
Personnel	137.6	298.7	347.2	357.5	446.5	447.6	599.8	596.9
Interest expenditure	62.7	143.7	156.0	156.0	177.1	199.5	235.4	253.4
Foreign interest obligations [3]	13.6	31.3	37.8	34.3	40.4	36.4	50.6	47.8
Domestic interest obligations	49.1	112.4	118.2	121.7	136.7	163.1	184.8	205.6
Other	72.0	135.2	205.7	152.9	288.0	263.6	373.6	377.8
Treasury operations (net) [4]	7.4	-10.5	11.8	-7.9	11.9	11.9	12.5	12.5
Capital expenditure	240.7	621.8	751.6	618.7	951.3	855.3	1,359.2	1,290.4
Domestically financed	51.0	132.5	168.6	137.8	232.8	172.0	304.2	286.3
Foreign financed	189.7	489.3	583.0	480.9	718.5	683.3	1,055.0	1,004.1
Net cost of structural reforms [5]	0.0	-4.0	-4.5	-4.1	-5.5	-5.5	-6.2	-6.2
Overall balance (commitment basis)								
Excluding grants	-243.7	-544.4	-746.5	-522.2	-916.9	-819.8	-1,210.1	-1,197.1
Including grants	213.2	181.4	4,817.0	4,780.2	4,741.1	4,580.4	4,627.6	4,383.7
Including grants, excluding MDRI capital transfers	-148.5	-180.4	-352.4	-120.5	-428.3	-320.3	-541.8	-517.0
Domestic balance (commitment basis) [6]	-40.4	-23.9	-125.6	-7.0	-158.0	-100.1	-104.5	-145.2
Float [7]	-35.0	-23.4	-40.7	-25.6	-31.5	-31.5	-40.7	-40.7
Variation of domestic arrears	0.0	-1.4	-10.0	-1.7	-13.3	-13.3	-20.0	-20.0
Overall balance (cash basis)								
Excluding grants	-278.6	-569.2	-787.2	-547.8	-961.7	-864.6	-1,270.8	-1,257.8
Including grants	178.3	156.6	4,766.3	4,752.9	4,696.3	4,535.6	4,566.9	4,323.0
Including grants, excluding MDRI capital transfers	-183.5	-205.1	-403.1	-147.8	-473.1	-365.1	-602.5	-577.7
Financing	-178.3	-156.6	-4,766.3	-4,752.9	-4,696.3	-4,535.6	-4,566.9	-4,323.0
Foreign (net)	98.4	170.1	-4,589.2	-4,413.9	-4,441.6	-4,128.9	-4,210.3	-3,966.3
Drawings	121.9	229.1	295.5	189.2	443.2	480.4	710.8	683.8
Budget	0.0	0.0	0.0	0.0	87.2	166.0	142.1	166.0
Projects	121.9	229.1	295.5	189.2	356.0	314.5	568.7	517.8
Amortization [3]	-23.5	-59.0	-4,884.8	-4,603.1	-4,884.8	-4,609.3	-4,921.0	-4,650.1
Domestic (net)	-280.0	-330.1	-180.9	-342.4	-259.1	-410.6	-362.1	-361.8
Banking system	-322.1	-349.8	-330.8	-408.6	-342.5	-475.2	-365.2	-366.0
Central bank	-376.5	-374.6	-359.9	-399.6	-362.6	-500.4	-365.2	-366.0
Of which: MDRI account	-361.7	-343.6	-320.1	-343.6	-325.5	-334.6	-325.5	-325.5
Commercial banks & OPCA	53.4	21.8	29.1	-11.9	20.1	25.1	0.0	0.0
Nonbanking system	71.1	52.6	149.9	69.5	83.4	64.7	3.1	4.2
Treasury correspondent accounts (net)	-29.0	-32.9	0.0	-3.3	0.0	0.0	0.0	0.0
Privatization receipts	3.4	3.4	3.9	3.4	4.3	3.9	5.5	5.0
Memorandum items:								
MDRI flow debt-service savings	39.1	39.3	29.6	29.5	55.7	55.1	73.4	72.5
Net domestic financing [8]	49.1	7.3	133.9	-7.5	62.1	-89.8	-55.7	-55.7

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] See Table 2a, footnote 1.
[2] See Table 2a, footnote 2.
[3] See Table 2a, footnote 3.
[4] See Table 2a, footnote 4.
[5] See Table 2a, footnote 5.
[6] See Table 2a, footnote 6.
[7] See Table 2a, footnote 7.
[8] See Table 2a, footnote 8.

Table 4. Madagascar: Balance of Payments, 2004-08
(Millions of SDRs)

	2004	2005	2006		2007		2008	
		Est.	Prog.[1]	Proj.	Proj.[1]	Prog.	Proj.[1]	Rev. Proj.
Current account	-267.8	-354.9	-393.5	-371.7	-436.0	-402.6	-459.4	-439.1
Goods and services	-437.0	-465.5	-515.7	-484.9	-549.1	-521.3	-575.2	-551.2
Trade balance	-296.0	-385.9	-394.3	-371.2	-433.3	-412.5	-451.3	-432.8
Exports	673.2	566.3	579.6	628.5	622.8	645.0	664.0	683.6
Imports	-969.2	-952.2	-973.8	-999.7	-1056.1	-1057.6	-1115.3	-1116.4
Net services	-141.0	-79.6	-121.4	-113.7	-115.8	-108.8	-123.9	-118.4
Income (net)	-53.5	-53.0	-41.6	-49.2	-37.8	-42.8	-40.8	-51.0
Of which: government interest [2]	-40.6	-32.8	-16.1	-15.1	-13.5	-7.0	-15.5	-13.7
Current transfers	222.7	163.6	163.8	162.4	150.9	161.5	156.7	163.2
Government	112.8	43.6	43.8	44.7	24.9	32.0	24.4	27.2
Budget aid	99.1	53.3	53.5	56.7	34.6	43.8	34.1	37.9
Other (net) [3]	13.7	-9.7	-9.7	-12.0	-9.7	-11.8	-9.7	-10.7
Private	109.9	120.0	120.0	117.7	126.0	129.5	132.3	135.9
Capital and financial account	230.1	295.4	514.8	502.2	420.1	417.7	441.5	443.5
Capital account [4]	1056.0	108.6	1809.2	1709.4	134.2	163.8	136.9	139.6
Of which: MDRI grant for debt due after 2006	...	...	1654.1	1555.8	...	...	...	...
Financial account	-774.4	174.5	-1294.4	-1207.1	285.8	253.8	304.6	303.9
Direct investment	35.7	58.0	60.0	61.2	81.1	86.6	109.2	110.0
Other	-810.1	116.5	-1354.4	-1268.3	204.7	167.2	195.3	193.9
Government	-798.3	119.6	-1349.4	-1258.3	204.7	167.2	195.3	193.9
Drawing	203.9	179.8	226.7	215.9	219.8	189.4	210.2	208.9
Project drawings	153.7	125.9	181.4	163.5	174.5	151.9	165.0	164.5
Budgetary support	50.2	53.9	45.3	52.4	45.3	37.4	45.2	44.3
Amortization [4]	-1002.2	-60.2	-1576.2	-1474.2	-15.1	-22.1	-14.9	-14.9
Of which: IDA and AfdF loans	...	...	-1533.7	-1433.1	...	...	...	...
Private sector, net (including banks)	-11.8	-3.1	-5.0	-10.0	0.0	0.0	0.0	0.0
Other (incl. errors and omissions)	-51.5	12.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-37.7	-59.5	121.3	130.5	-15.9	15.0	-17.9	4.5
Financing	37.7	59.5	-130.6	-138.4	-33.0	-30.8	-24.8	-27.8
Central bank (net; increase -)	-6.0	25.3	-148.6	-153.0	-33.1	-30.9	-24.9	-27.9
Use of Fund credit (net)	29.5	3.1	-137.2	-129.4	0.0	0.0	0.0	0.0
Other assets, net (increase -)	-35.5	22.2	-11.3	-23.6	-33.1	-30.9	-24.9	-27.9
Debt relief and cancellation	43.7	34.2	18.0	14.6	0.1	0.1	0.1	0.1
Residual financing gap	0.0	0.0	9.2	7.9	48.9	15.7	42.7	23.3
Possible IMF financing	…	…	…	7.9	…	15.7	…	15.7
Other possible financing	…	…	…	…	…	…	…	…
Memorandum items:								
Grants (percent of GDP)	8.0	4.5	5.3	5.3	3.9	4.8	3.7	3.8
Loans (percent of GDP)	-27.1	3.5	-35.9	-33.9	5.0	4.1	4.5	4.4
Direct investment (percent of GDP)	1.2	1.7	1.6	1.6	2.0	2.1	2.5	2.5
Current account (percent of GDP)								
Excluding net official transfers	-12.9	-11.7	-11.6	-11.2	-11.4	-10.7	-11.1	-10.6
Including net official transfers	-9.1	-10.4	-10.5	-10.0	-10.7	-9.9	-10.5	-10.0
Debt service (percent of exports of goods) [5]	7.1	8.2	2.7	2.6	3.9	3.7	4.0	3.6
Gross official reserves	330.4	337.4	348.7	360.9	381.8	391.8	406.7	419.7
Months of imports of goods and nonfactor services	2.8	3.0	2.9	2.9	3.0	3.0	3.0	3.0
Exchange rate (ariary/SDR, period average)	2,772.1	2,958.8	...	...	...	...	...	...

Sources: Central Bank of Madagascar, Ministry of Finance, IMF Finance Dept., and Fund staff estimates and projections.

[1] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism.

[2] After MDRI debt relief from 2006 onward.

[3] Other official grants less payments due to scholarships and contributions to international organizations.

[4] Includes impact of HIPC completion point in 2004 and MDRI in 2006.

[5] After HIPC and MDRI debt reliefs .

Table 5. Madagascar: Monetary Survey, 2005-08
(Billions of ariary, unless otherwise specified)

	2005	2006								2007				2008
		March	June	July		Sept		Dec.		March	June	Sept.	Dec.	
				Prog. [1]	Actual	Prog. [1]	Est.	Prog. [1]	Proj.	Prog.	Prog.	Prog.	Prog.	Proj.
Net foreign assets	933.4	1,343.5	1,435.5	1,324.7	1,458.2	1,401.1	1,551.5	1,429.6	1,460.3	1,408.6	1,480.9	1,563.6	1,595.8	1,740.8
Net foreign assets (BCM)	526.5	893.7	948.3	899.1	955.1	985.9	1,071.3	1,000.7	1,011.0	933.4	1,005.7	1,088.4	1,120.6	1,243.4
Net foreign assets (domestic money banks)	406.9	449.8	487.1	425.6	503.1	415.2	480.3	428.9	449.2	475.2	475.2	475.2	475.2	497.4
Net domestic assets	1,243.9	925.9	955.9	987.4	922.8	1,019.7	921.6	1,086.7	1,086.8	1,218.8	1,195.8	1,186.9	1,345.0	1,591.2
Domestic credit	1,409.2	1,148.7	1,170.2	1,195.9	1,125.1	1,221.6	1,098.6	1,288.6	1,286.1	1,502.9	1,458.0	1,404.4	1,576.1	1,864.0
Net credit to government (budget)	294.1	-29.0	-58.7	-36.7	-117.4	-48.3	-181.1	-71.1	-71.9	-19.9	-76.5	-113.2	-59.8	-64.8
Other claims on public sector	104.7	109.0	129.4	104.7	128.8	104.7	107.0	104.7	107.0	107.0	107.0	107.0	107.0	107.0
Credit to the economy	1,010.4	1,068.7	1,099.5	1,137.8	1,113.7	1,165.2	1,172.7	1,255.0	1,250.9	1,415.7	1,427.5	1,410.5	1,528.9	1,821.8
Credit to public enterprises	13.3	30.4	23.2	13.3	34.7	13.3	42.9	13.3	42.8	42.8	42.8	42.8	42.8	42.8
Credit to private sector	997.1	1,038.2	1,076.2	1,124.5	1,079.0	1,151.9	1,129.9	1,241.7	1,208.1	1,372.9	1,384.7	1,367.7	1,486.1	1,779.0
Other items (net; asset +) [3]	-165.3	-222.4	-214.0	-208.5	-202.3	-201.8	-177.0	-201.8	-199.2	-284.1	-262.2	-217.5	-231.2	-272.8
M3	2,177.0	2,269.4	2,391.4	2,329.4	2,381.0	2,420.8	2,473.2	2,516.3	2,547.1	2,627.4	2,676.7	2,750.5	2,940.7	3,331.4
Foreign currency deposits	334.3	385.3	417.4	339.5	405.2	339.5	409.8	339.5	403.2	446.6	426.5	443.2	465.5	527.3
M2	1,842.7	1,884.1	1,974.0	2,001.2	1,975.7	2,081.3	2,063.3	2,176.9	2,143.9	2,180.8	2,250.3	2,307.3	2,475.3	2,804.1
Currency in circulation	599.1	584.1	617.3	632.6	617.4	649.0	646.5	692.5	692.1	666.0	678.7	697.5	787.3	878.5
Deposits in local currency	1,214.5	1,270.3	1,328.7	1,339.5	1,329.0	1,403.3	1,386.9	1,455.3	1,421.9	1,484.8	1,541.6	1,579.8	1,658.0	1,895.6
Short-term obligations of commercial banks	29.1	29.6	28.1	29.1	29.3	29.1	30.0	29.1	30.0	30.0	30.0	30.0	30.0	30.0
Memorandum items:					(12-month percentage change unless otherwise indicated)									
M3	3.1	6.2	15.9	12.9	15.4	14.2	16.7	15.6	17.0	15.8	11.9	15.5	15.5	13.3
M2	4.6	8.5	16.3	17.3	15.8	16.2	15.2	18.1	16.3	15.8	14.0	16.8	15.5	13.3
Domestic credit	5.5	-13.5	-14.4	-13.0	-18.2	-8.4	-17.6	-8.6	-8.7	30.8	24.6	24.8	22.6	18.3
Credit to the private sector	22.4	23.5	20.9	26.4	21.3	23.2	20.8	24.5	21.2	32.2	28.7	21.1	23.0	19.7
Net credit to government (NCG)	-27.5	-108.0	-116.8	-110.2	-132.7	-118.1	-167.9	-124.2	-124.4	-31.5	30.4	-37.5	-16.8	8.4
Nominal change in NCG since beginning of year	-111.6	-323.1	-352.8	-330.8	-411.5	-342.5	-475.2	-365.2	-366.0	52.0	-4.6	-41.3	12.1	-5.0
Reserve money	11.7	6.6	16.5	9.0	8.5	11.0	13.6	12.2	12.2	12.7	9.6	17.7	13.6	11.9
Money multiplier (M3/reserves)	2.3	2.6	2.5	2.5	2.6	2.5	2.5	2.4	2.4	2.7	2.6	2.5	2.5	2.5
Velocity of money (GDP/end-of-period M3)	4.6	...	...	...	...	...	...	4.7	4.6	...	...	...	4.6	4.6
Exchange rate (ariary per SDR; end of period) [2]	3,086.6	3,171.2	3,179.8	3,134.7	3,172.1	3,134.7	3,153.3	3,134.7	3,167.3	3,350.2	3,350.2	3,350.2	3,350.2	3,506.9

Sources: Central Bank of Madagascar (BCM) and Fund staff estimates and projections.

[1] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism. December targets are unchanged.

[2] Future exchange rate for monetary programming purposes.

[3] Excluding BCM recapitalization.

Table 6. Madagascar: Balance Sheet of the Central Bank (BCM), 2005-08
(Billions of ariary)

	2005	2006								2007				2008
		March	June	July		Sept		Dec.		March	June	Sept.	Dec.	
				Prog.[1]	Actual	Prog.[1]	Est.	Prog.[1]	Proj.	Prog.	Prog.	Prog.	Prog.	Proj.
Net foreign assets	526.5	281.8	948.3	899.1	955.1	985.9	1,071.3	1,000.7	1,011.0	933.4	1,005.7	1,088.4	1,120.6	1,243.4
Gross foreign assets	1,041.3	977.4	1,034.4	981.8	1,046.5	1,204.6	1,177.9	1,093.1	1,143.0	1,073.0	1,171.7	1,254.3	1,312.9	1,472.1
Gross foreign liabilities	514.8	83.7	86.1	92.4	91.4	105.4	106.6	35.6	132.0	139.6	165.9	165.9	192.2	228.8
Of which: stock of debt to IMF	458.8	1.4	36.1	35.6	36.0	35.6	60.6	35.6	85.7	90.7	117.0	117.0	143.3	177.5
Net domestic assets	411.3	-15.4	0.8	31.1	-29.3	-21.3	-84.4	51.3	40.9	56.6	34.3	1.6	74.1	93.8
Credit to government (net)	325.3	-51.2	-49.4	-53.5	-74.3	-87.2	-175.1	-14.6	-30.4	44.3	19.9	-17.5	53.8	119.3
Of which : IMF MDRI debt relief [2]	0.0	-361.7	-343.6	-343.6	-343.6	-334.6	-334.6	-325.5	-325.5	-316.5	-307.5	-298.4	-289.4	-253.2
Claims on public enterprises	4.5	4.4	4.6	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Credit to banks	1.1	-9.1	-3.4	1.1	-19.4	1.1	-15.4	1.1	-10.4	-10.4	-10.4	-10.4	-10.4	-10.4
Other items (net; asset +) [3]	80.5	40.5	49.0	53.7	59.9	60.4	101.5	60.4	77.2	18.3	20.3	25.0	26.3	-19.5
Of which : valuation account (losses -)	-4.7	-4.7	-4.8	14.9	-15.7	14.9	-12.3	14.9	1.5	-60.9	-60.9	-58.2	-60.9	-55.8
Reserve money	937.8	878.3	949.2	930.2	925.8	964.6	986.8	1,051.9	1,051.9	990.0	1,040.0	1,090.0	1,194.7	1,337.2
Currency outside banks	599.1	584.1	617.3	632.6	617.4	649.0	646.5	692.5	692.1	666.0	678.7	697.5	787.3	878.5
Bank reserves	338.4	293.8	331.5	297.6	308.0	315.6	340.0	359.4	359.5	323.6	360.8	392.0	407.0	458.1
Currency in banks	40.2	39.4	47.5	45.8	39.8	44.7	39.4	44.7	49.8	41.7	46.8	41.6	56.4	60.7
Deposits	298.2	254.4	284.1	251.8	268.1	270.9	300.6	314.7	309.7	281.9	314.1	350.4	350.6	397.4
Memorandum items:														
Cumulative annual flow														
Net foreign assets	6.4	-244.7	421.8	372.6	428.6	459.4	544.8	474.2	484.5	-77.7	-5.3	77.4	109.6	122.7
excluding MDRI	…	…	…	-24.1	31.9	62.7	148.1	77.5	87.9	…	…	…	…	…
Net domestic assets	91.7	-426.7	-410.5	-379.9	-440.6	-432.3	-495.8	-359.7	-370.5	15.8	-6.6	-39.3	33.3	19.7
excluding MDRI	…	…	…	16.8	-43.9	-35.6	-99.1	36.9	26.2	…	…	…	…	…
Credit to government (net) [4]	60.5	-376.5	-374.6	-359.9	-399.6	-362.6	-500.4	-365.2	-366.0	2.0	5.4	8.7	12.1	12.1
Reserve money	98.1	-59.6	11.3	-7.3	-12.0	27.1	49.0	114.4	114.1	-61.9	-11.9	38.1	142.8	285.3

Sources: Central Bank of Madagascar (BCM) and Fund staff estimates and projections.

[1] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism. December targets are unchanged.

[2] Total amount of MDRI debt relief from the IMF, excluding already received HIPC support (MGA 396.7 billion or SDR128.7 million). Of this amount, MGA 36 billion was repaid to the BCM to cover prior onlending to the government of an IMF disbursement, leaving a balance of MGA 361.7 billion.

[3] Excluding BCM recapitalization.

[4] Excludes treasury bills used for monetary policy purposes.

Table 7. Madagascar: Bank Soundness Indicators, end-of-period, 2003-June 2006

	2003	2004	2005	2006	
				March	June
Capital adequacy			(Ratio; percent)		
Regulatory capital to risk-weighted assets					
Lowest ratio	10.7	7.2	8.8	10.3	10.7
Highest ratio	38.5	31.3	197.8	273.1	...
Asset quality					
Nonperforming loans to total gross loans	16.7	11.5	9.5	8.6	8.4
Risk concentration (highest)	...	54.5	41.3	25.9	25.2
Earnings and profitability					
Return on assets	3.2	4.0	5.0	4.7	4.6
Return on equity	54.7	62.3	89.1	77.6	77.2
Interest margin to gross income		59.3	64.8	68.6	68.9
Noninterest expenses to gross income	46.9	44.8	42.2	45.2	46.3
Personnel expenses to noninterest expenses	38.9	35.4	36.4	36.4	35.4
Liquidity					
Liquid assets to total assets	50.5	47.4	43.4	43.7	41.6
Liquid assets to short-term liabilities	73.2	67.6	61.3	62.8	59.7
			(Billions of ariary; unless otherwise specified)		
Memorandum items:					
Total assets	1,537.2	2,006.6	2,208.8	2319.6	2382.4
Total profits before tax	49.9	80.2	111.3	27.3	...
Foreign exchange exposure (highest ratio)	58.3	127.2	16.8	10.0	9.5

Source: Banking and Financial Supervision Commission, Central Bank of Madagascar (BCM).

Table 8. Madagascar: Sources and Uses of Resources, 2004-2008

	2004	2005	2006		2007		2008	
		Est.	Prog.[1]	Proj.	Proj.[1]	Prog.	Proj.[1]	Rev Proj.
	(Percent of GDP)							
Consumption	90.6	91.1	91.9	91.3	91.3	90.7	90.7	90.3
Public	9.8	8.4	8.4	8.4	8.8	8.8	9.3	8.9
Private	80.8	82.7	83.5	82.8	82.4	82.0	81.3	81.4
Investment	24.3	22.5	21.8	21.8	22.3	22.1	22.5	22.2
Public	12.5	10.3	11.5	11.0	10.7	10.3	10.2	10.3
Private	11.8	12.3	10.3	10.8	11.5	11.7	12.3	11.9
Of which: foreign direct investment (flow)	1.2	1.7	1.6	1.6	2.0	2.1	2.5	2.5
Resource gap	-14.9	-13.6	-13.7	-13.1	-13.5	-12.8	-13.2	-12.5
Exports of goods and nonfactor services	32.6	26.5	24.6	27.5	24.4	26.2	24.1	25.7
Of which: exports of goods, f.o.b.	22.9	16.6	15.4	16.9	15.3	15.9	15.2	15.5
Imports of goods and nonfactor services	47.5	40.1	38.3	40.5	38.0	39.0	37.3	38.2
Of which: imports of goods, f.o.b.	32.9	27.9	25.9	26.9	26.0	26.0	25.5	25.4
Gross domestic savings	9.4	8.9	8.1	8.7	8.7	9.3	9.3	9.7
Government	2.3	2.5	3.3	2.9	3.1	2.6	3.0	3.2
Nongovernment	7.2	6.4	4.9	5.8	5.7	6.6	6.3	6.6
Current account								
Excluding grants	-12.9	-11.7	-11.6	-11.2	-11.4	-10.7	-11.1	-10.6
Including grants	-9.1	-10.4	-10.5	-10.0	-10.7	-9.9	-10.5	-10.0
Gross national savings	15.2	12.1	11.4	11.8	11.5	12.2	12.0	12.3

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism.

Table 9. Madagascar: Millennium Development Goals

	1995	2001	2002	2004	2015 Target
Goal 1. Eradicate extreme poverty and hunger.					
1. Population below US$1 a day (percent)	...	49.1	...	...	
2. Poverty gap ratio at US$1 a day (percent)	...	18.3	...	...	
3. Share of income or consumption held by poorest 20 percent (percent)	...	5.0	...	...	
4. Prevalence of child malnutrition (percent of children under 5)	34.1	...	33.1	42.0	20.5
5. Population below minimum level of dietary energy consumption (percent)	40.0	36.0	...	...	17.5
Goal 2. Achieve universal primary education.					
6. Net primary enrollment ratio (percent of relevant age group)	60.6	66.0	67.0	89.0	
7. Percentage of cohort reaching grade 5	39.7	33.6	...	57.0	
8. Youth literacy rate (percent age 15-24)	...	...	...	70.0	
Goal 3. Promote gender equality and empower women.					
9. Ratio of girls to boys in primary and secondary education (percent)	99.2	96.0	96.0	96.0	100.0
10. Ratio of young literate females to males (percent ages 15-24)	88.8	92.1	92.5	94.0	
11. Share of women employed in the nonagricultural sector (percent)	...	...	...	...	
12. Proportion of seats held by women in the national parliament (percent)	4.0	8.0	8.0	4.0	
Goal 4. Reduce child mortality.					
13. Under-5 mortality rate (per 1,000)	156.0	139.0	135.0	123.0	56.0
14. Infant mortality rate (per 1,000 live births)	95.0	86.0	84.0	76.0	
15. Immunization against measles (percent of children 12-23 months)	55.0	57.0	58.0	59.0	
Goal 5. Improve maternal health.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	580.0	550.0	...	...	123.0
17. Proportion of births attended by skilled health personnel	47.3	46.2	...	51.0	
Goal 6. Combat HIV/AIDS, malaria, and other diseases.					
19. Contraceptive prevalence rate (percent of women ages 15-49)	19.4	...	16.9	27.0	
20. Number of children orphaned by HIV/AIDS	...	18,000	...	30,000	
21. Prevalence of death associated with malaria	...	...	...	...	
22. Share of population in malaria risk areas with effective prevention and treatment	...	...	...	...	
23. Incidence of tuberculosis (per 100,000 people)	...	254.5	...	218.0	
24. Tuberculosis cases detected under DOTS (percent)	51.0	70.0	70.0	74.0	
Goal 7. Ensure environmental sustainability.					
25. Forest area (percent of total land area)	...	20.2	...	22.0	
26. Nationally protected areas (percent of total land area)	1.9	1.9	2.1	4.3	
27. GDP per unit of energy use (PPP $ per kg oil equivalent)	...	...	...	...	
28. CO_2 emissions (metric tons per capita)	0.1	0.1	0.1	...	
29. Proportion of population using solid fuels	...	...	...	...	
30. Access to improved water source (percent of population)	...	47.0	...	45.0	72.0
31. Access to improved sanitation (percent of population)	...	42.0	33.0	...	
32. Access to secure tenure (percent of population)	...	...	...	...	
Goal 8. Develop a Global Partnership for Development. [1]					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	
Female	...	...	...	...	
Male	...	...	...	...	
46. Proportion of population access with access to affordable essential drugs	...	...	...	...	
47. Fixed line and mobile telephones (per 1,000 people)	3.0	12.4	13.0	19.5	
48. Personal computers (per 1,000 people)	1.5	2.4	4.1	5.0	

Sources: World Bank; and Fund staff estimates.

[1] Indicators 33-44 are excluded because they cannot be measured on a country-specific basis. They are related to official development assistance, market access, and the HIPC initiative.

Table 10. Fund Position and Indicators of Fund Credit, 2006-10
(In millions of SDR)

	2005	2006	2007	2008	2009	2010
	Actual	projection				
Total use of fund resources (UFR) outstanding	148.6	27.1	42.8	58.5	66.3	65.2
PRGF (2006-09)						
Disbursements	…	15.7	15.7	15.7	7.9	0
Debt Service	…	0.0	0.1	0.1	0.2	0.2
Repayments	…	0.0	0.0	0.0	0.0	0.0
Interests	…	0.0	0.1	0.1	0.2	0.2
Total debt service to the Fund (incl. previous PRGFs)	8.9	137.6	0.9	0.9	1.0	2.1
Repayments	8.1	137.3	0.0	0.0	0.0	1.1
Interests	0.8	0.1	0.1	0.2	0.2	0.2
Other SDR charges	0.0	0.2	0.8	0.8	0.8	0.8
Memorandum items						
Total UFR as a percentage of quota	121.6	22.1	35.0	47.9	54.3	53.4
Total UFR as a percentage of GDP	4.4	0.7	1.1	1.3	1.4	1.3
Total debt service to the Fund as a percentage of exports of goods and services	1.0	13.5	0.1	0.1	0.1	0.2

Source: Fund Staff estimates.

APPENDIX I—ATTACHMENT I
MADAGASCAR: LETTER OF INTENT

Antananarivo, Madagascar
November 25, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. de Rato,

1. On July 21, 2006, the Executive Board of the International Monetary Fund approved (a) a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in the amount of SDR 55 million to support Madagascar's economic growth and poverty reduction program for 2006-08 and (b) activation of the Trade Integration Mechanism (TIM), allowing augmentation of that amount by up to SDR 12 million to mitigate the anticipated adverse impact of the termination of the WTO's Agreement on Textiles and Clothing (ATC) and the scheduled expiration of certain provisions of the American Growth and Opportunities Act (AGOA) III in 2007.

2. The attached memorandum of economic and financial policies (MEFP) reviews the macroeconomic and financial performance and the implementation of economic policies through September 2006. It also updates the program for 2006 and describes the economic policies and structural reforms that the government of Madagascar will implement in 2007.

3. All quantitative performance criteria at the end of July 2006—the test date for the first review—were met. One structural performance criterion for the end of September 2006 was missed: Revised expenditure ceilings for the remainder of the year consistent with the latest revenue projections were issued to line ministries with a delay of one month because it was necessary to wait till mid-October for parliament's approval of the revised 2006 Finance Law.

4. Given the exceptional circumstance that delayed issuance of commitment ceilings to line ministries, and in view of the temporary nature of such delay, the government of Madagascar requests a waiver for nonobservance of this performance criterion.

5. In reviewing budget execution at the end of September, it became apparent that the fiscal revenue target for 2006 would most likely not be met. While imports in value terms are in line with projections, customs receipts are likely to be lower as tax free export processing

zone imports have been stronger than programmed. While remedial revenue measures could not be taken this late in the year, we have opted instead to cut expenditure in the fourth quarter in order to achieve our fiscal objective. Moreover, we intend to undertake a comprehensive tax policy reform early next year in order to simplify the system and mobilize more revenue. In view of these measures, the government of Madagascar requests that the performance criterion on tax revenue for December 2006 be revised downward, as proposed in Table 1 of the attached MEFP.

6. The government of Madagascar believes that the policies and measures set forth in the attached memorandum will allow it to achieve its program objectives. However, it stands ready to take any further measures that may be appropriate for this purpose. It will consult with the Fund on adoption of such measures in advance of revisions to the policies contained in the MEFP, in accordance with Fund.

7. To facilitate the attainment of the objectives and implementation of the policies described, the government of Madagascar hereby requests completion of the first review and disbursement of the second loan under the current arrangement in an amount equivalent to SDR 7.856 million. At this time, an increase in access to Fund resources under the Tim's deviation feature is not justified.

8. The government of Madagascar undertakes to carry out the second review of the PRGF program by the end of June 2007, and the third review by the end of 2007. The second review will (a) examine the main components of the comprehensive reform of tax policy, including its implications for tax administration reform, that will be implemented in the 2008 budget; and (b) discuss the option chosen to transfer management of the public utility company, JIRAMA, to the private sector under a lease-type contract and its budgetary consequences.

9. The government of Madagascar consents to publication of this letter, the MEFP, the attached Technical Memorandum of Understanding, and the report of Fund staff on the first review of the program.

Sincerely yours,

/s/

Benjamin Radavidson
Minister of Economy, Finance and Budget

/s/

Gaston Ravelojaona
Governor
Central Bank of Madagascar

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

APPENDIX I—ATTACHMENT II
MADAGASCAR: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2006-07

I. MEDIUM-TERM PERSPECTIVES

1. Madagascar is fully committed to achieving the Millennium Development Goals (MDG), which entail halving poverty by 2015. The strategy to be pursued is described in the Poverty Reduction Strategy Paper (PRSP) as updated in June 2005. With the planning and implementation phase of the PRSP ending on December 31, 2006, our government has adopted a successor development policy. The Madagascar Action Plan, the MAP, which outlines this policy, is an innovative five-year plan for 2007 through 2011. Based on the experience acquired with the PRSP, it seeks to take advantage of changes in both domestic and international circumstances to make a qualitative leap forward. The goal is to achieve the targets established in the MDGs and the "Madagascar, Naturally" vision of the future. A relatively high growth rate is necessary if Madagascar is to meet the poverty reduction targets it has set itself in the MAP. It presupposes an approximately 8 percent average annual growth rate through 2011 and a substantial increase in yet-to-be identified concessional financing. The alternative MAP scenario assumes that donor assistance flows and growth rates are as currently expected, in line with the PRGF-supported program.

2. The challenges identified in the MAP can be summarized under eight headings: good governance, infrastructure, educational reform, rural development, health and family planning, the economy and the private sector, the environment, and national solidarity. Regional consultation workshops were already been held as the MAP was being prepared in order to sensitize and consult with representatives of all development stakeholders (public sector, private sector, and civil society) and to ensure that this national strategy is "owned" by and a response to the concerns of the whole population.

II. RECENT ECONOMIC DEVELOPMENTS AND STATUS OF PROGRAM IMPLEMENTATION

A. Recent Economic Developments

3. The sharp rise in international oil prices reduced demand for petrol and weakened economic performance in the first half of 2006. Though inflation reached 13.6 percent in June year-on-year, it began falling in July, thanks to a combination of prudent monetary policy and a tight fiscal program that subdued price increases. The substantial decline in the price of rice (down 11.6 percent in June year-on-year) partly offset the higher prices of other products.

4. The increased pace in July of broad monetary expansion (15.4 percent, year-on-year), compared with December 2005 (3.1 percent) is explained primarily by the significant increase in net foreign assets of the banking system as a result of the robust performance of exports combined with modest imports. Likewise, credit to the economy has increased at a

rate consistent with economic expansion, while net claims on government have declined after an increase in tax revenue and receipt of foreign budget assistance.

5. The exchange rate has shown little volatility since July 2006, after it depreciated by 7.4 percent against the euro and 1.3 percent against the U.S. dollar in the second quarter as the euro strengthened against the dollar on the international market. Since July, the exchange rate has been relatively stable, even appreciating slightly against the dollar. The Central Bank of Madagascar (BCM) has become a net purchaser of foreign exchange in order to replenish its reserves, which declined substantially in the first quarter.

6. In August the BCM lowered the bank rate (its policy rate) from 16 to 12 percent after the drop in inflation that began in June and an improvement in the balance of payments that led the Ariary to strengthen on the exchange market.

7. Tax collection until July was strong and expenditure was below the level envisaged in the program. To improve tax collection, the tax system was simplified and tax administration enhanced. Monitoring and control have been stepped up, particularly with respect to the taxation of large enterprises, by the use of SIGTAS software, and in customs by the use of modern customs clearance control tools in coordination with the pre-shipment inspection company, Société Générale de Surveillance (SGS). To broaden the tax base and improve taxation of small and medium-sized enterprises, the tax administration is moving to tap databases to widen the tax net. The elimination of ad hoc tax and custom duty has also borne fruit. Total tax revenue was higher than in the same period in 2005: MGA 722.0 billion compared with MGA 598.1 billion (an increase of 20.7 percent) and programmed receipts of 695 billion. As expected, there were significant increases in corporate income tax (+33.7 percent) and in taxes collected on foreign trade (+45.3 percent). Revenue performance weakened in August because oil imports were lower than expected, but the end of September target was met.

8. On the expenditure side, the government paid both its foreign debt service and its obligations to the Central Bank. At the end of July total expenditure fell short of the program. The composite fulfillment ratio was 86.8 percent, which breaks down into 91.3 percent for current expenditure and 82.3 percent for capital expenditure. Budget execution was low because some expenditure commitments were suspended by the circular of June 15, 2006. Nevertheless, there was an Ariary 10 billion overrun on payroll because of payment to the military and advanced payment of social security contributions. Domestic debt interest payments were also higher than forecast because of the sharp increase in the interest rate on auctioned treasury bills (BTA). The fiscal deficit (cash basis, excluding capital transfers from the Multilateral Debt Relief Initiative [MDRI]) of MGA 147 billion is much lower than programmed.

9. In the balance of payments, the current account deficit fell from SDR 120.8 million in the first quarter of 2006 to SDR 65.4 million in the second. It narrowed because exports

improved; tourism revenue almost doubled. At the same time, current transfers increased 45 percent because budget assistance was markedly higher. Preliminary customs data for January–September 2006 indicates that exports of textiles have only experienced a limited decline of 2.8 percent compared to the same period in the previous year. Therefore an increase in access to the IMF resources under the Trade Integration Mechanism (TIM) is not needed at this time.

B. Implementation of Quantitative Performance Criteria and Targets Through September 2006

10. All quantitative performance criteria for the end of July have been met (Table 1). Because tax and customs receipts exceeded targets and expenditures fell short, the domestic financing requirement was far lower than planned for. The BCM's net foreign assets surpassed their target and net domestic assets were under the targeted ceiling. The government has not entered into any nonconcessional borrowing agreement since the start of the program; nor has it accumulated new domestic or external payment arrears. All end-September indicative targets for which information is available have also been met.

C. Implementation of Structural Performance Criteria and Benchmarks through September 2006

11. All structural performance criteria have been met, except that the Minister of Economy, Finance, and Budget was not able to issue monthly commitment ceilings to all ministries for the last quarter of 2006 until three and a half weeks after the deadline because of a delay in parliamentary approval of the supplementary finance law (Table 2 and ¶22).

12. The government issued a series of regulations at the end of May that stopped all ad hoc exemptions from taxes or customs duties; waivers of obligations to submit inspection reports, drawn up by the SGS, for imports of goods and their removal; and exemptions from SGS evaluation of merchandise. Moreover, as of September 1, 2006, for the sake of transparency, whenever the government Council makes an exceptions to the rule either in the Customs Code or in international treaties and agreements, the decision will be published in the press, on the government's website, and on billboards in customs and tax offices.

13. To enhance the yield on the value-added tax (VAT) and improve its administration, the government ordered an audit, which was completed in September, of public administration's VAT arrears on capital expenditure through 2005. In the 2007 Budget Law it has allocated MGA 10.7 billion to pay fully substantiated arrears and has granted other creditors claiming a total of MGA 22.7 billion one year to complete their files.

14. Since July 2006 transactions between the government and the central bank have been restricted to those specified in the Central Bank Law. The 2007 Budget Law incorporates a plan to recapitalize the BCM, details of which will be drafted with technical assistance from the IMF.

15. There has been a slight delay in implementing the information system, ASYCUDA++, which should simplify, expedite, and enhance the security of customs processing and curb customs fraud. The plan was to install this system in five more customs bureaus by September 30, 2006. Personnel have been trained and the work needed to prepare the locations has been carried out, but because of a delay on the part of the donor financing the equipment, it was not possible to install the system by September 30. It should be installed by the end of 2006.

16. Preparation of an action plan and a schedule of measures to improve tax collection will be completed by December 31, 2006, along with deployment of the information system for monitoring public finance in at least 13 ministries and verification of at least 80 percent of VAT credits outstanding as of June 30, 2006.

17. In June 2006, following the safeguards assessment report of March 2006, the following actions were taken related to the central bank: (i) the BCM published its 2005 accounts; (ii) the Governor of BCM approved an action plan with specific deadlines for implementing the principal recommendations; (iii) the BCM Board of Directors approved an action plan for adopting International Financial Reporting Standards (IFRS), starting with the 2007 accounts; (iv) an international audit firm familiar with International Accounting Standards (IAS) was selected after an external audit tender (the auditor selected to oversee the transition to global application of IFRS is associated with a specialized firm in an international financial center that will countersign the audit report); and (v) the Internal Audit Department set up a database to enable it to monitor implementation of audit recommendations.

III. Program for the Remainder of 2006 and for 2007

A. Macroeconomic Framework

18. Madagascar's principal macroeconomic objectives for 2006 are: (i) to achieve real GDP growth of 4.7 percent; (ii) to lower average inflation to 10.7 percent; (iii) to achieve a tax-to-GDP ratio of 10.7 percent of GDP; (iv) to keep the fiscal deficit (on a cash basis, excluding MDRI capital transfers) to 4.9 percent of GDP; (v) to limit the balance of payments current account deficit to 10 percent of GDP; and (vi) to keep gross foreign assets of the BCM to the equivalent of 2.9 months of imports of goods and nonfactor services. Growth in 2006 will be supported by investment of 21.8 percent of GDP, 11 percent of which will come from the public sector investment and 10.8 percent from the private sector. Primary sector growth is projected at 2.1 percent; secondary sector at 4.7 percent; and tertiary sector at 6.2 percent. To sustain this GDP growth, exports are projected to grow by 11 percent and imports by 5 percent, in SDR terms. Exports will be stimulated by higher international prices, and imports depressed by higher international oil prices, high rice stocks accumulated in 2005, and the good rice harvest in 2006.

19. Annual real GDP growth is projected at 5.6 percent for both 2007 and 2008. Annual inflation is programmed to decline to 8 percent in 2007 and 6 percent in 2008. In 2007, investment is expected to reach 22.1 percent of GDP; the public sector will account for 10.3 percent and the private sector for 11.7 percent. Investment will begin to grow after implementation of structural reforms; MDRI debt relief; construction and rehabilitation of infrastructure; and the activation of large-scale mining and agricultural projects (Integrated Growth Pole [IGP] projects financed by the Millennium Challenge Account [MCA]). Buoyant exports (fishing, tourism, agro industry, mining) combined with a rebound of imports volumes, including a return to normal levels of rice imports, are likely to help stabilize the current account deficit (including grants) at close to 10 percent of GDP. Bringing reserves to approximately three months of imports would then involve a financing shortfall, which would be covered by IMF disbursements under the PRGF program.

B. Fiscal Reform Policy

1. Fiscal policy

20. Efforts to stabilize public finance will continue through 2006 and into the medium term. In 2004, the Government embarked on an ambitious fiscal reform project designed to help it get a better grip on public expenditure, match resource allocations with national priorities, and better control the use of public funds. In the short term the principal fiscal policy target is to reduce net domestic financing of the budget[8] by MGA 55.7 billion (0.5 percent of GDP) in 2006. That will make it possible to keep domestic indebtedness sustainable. Should this year's domestic revenue turn out to differ from the programmed amounts, additional revenue or shortfall that is not offset by external flows will be offset by adjusting the expenditures financed by domestic resources to observe the domestic financing target. Additional receipts will boost the allocations to priority ministries via the advances decree procedure. If there is a shortfall, the Ministry of Economy, Finance, and Budget will issue a circular to adjust spending by regulating commitments mainly in nonpriority sectors.

21. In July the Government introduced a supplementary 2006 budget law that lowers expenditure allocations, excluding interest and wages, and capital expenditure financed by domestic resources by approximately MGA 105 billion (0.9 percent of GDP) compared to the original 2006 budget. Expenditure cuts of MGA 188 billion (1.6 percent of GDP) are needed because expenditures were underestimated in the 2006 budget by MGA 60.5 billion (0.5 percent of GDP), budget support was lower by MGA 58.3 billion (0.5 percent of GDP), tax revenue was lower by MGA 45.6 billion (0.4 percent of GDP), and there was surplus expenditure of MGA 13.3 billion (0.1 percent of GDP). However, MDRI relief has freed up about MGA 72.5 billion (0.6 percent of GDP), which will be earmarked for supplementary priority expenditure, such as the poverty reduction outlays specified in the supplementary

[8] As defined in the Technical Memorandum of Understanding (Attachment III).

finance bill. This will limit the expenditure cuts to about MGA 105 billion. The revised budget cuts expenditure in nonpriority sectors more than in those established as priorities in the PRSP. The National Assembly passed the supplementary budget law on October 4 without amendment. The Senate did so on October 10.

22. In September, it was deemed necessary to reduce the annual expenditure ceiling set in the amended budget law by another MGA 57 billion (0.5 percent of GDP) because: (i) customs revenue projections had to be revised downward by about 0.3 percent of GDP as the share in total imports of tax exempt export processing zones imports will most likely be higher than programmed; and (ii) interest on domestic debt had to be revised upward by about 0.2 percent. On October 24 the Ministry of Economy, Finance, and Budget therefore issued a circular to lower the commitment ceilings of mostly nonpriority ministries, in order to keep to the program's net domestic financing ceiling. In 2006, the government will reduce the stock of its outstanding arrears by paying (prior to 2006) overdue bills amounting to MGA 20 billion to JIRAMA and TELMA.

23. In 2007 the objective is to significantly increase tax revenue, to MGA 1523.8 billion, an increase of 0.5 percentage points of GDP compared to 2006. Realistic appropriations have been assigned to ministries and institutions for capital and recurrent expenditure and payroll to avoid the need to cancel or block appropriations in 2007. Total public expenditure is thus projected at MGA 2822.4 billion (20.7 percent of GDP). The wage bill has been set at MGA 721 billion (5.3 percent of GDP) and current expenditure other than interest and wages at MGA 457.7 billion (3,3 percent of GDP). Public investment will increase to MGA 1406.8 billion (10.3 percent of GDP). The cash basis deficit will therefore be MGA 597.8 billion (4.4 percent of GDP).

24. As the MAP intends, the 2007 Budget Law will be characterized by implementation of appropriate macroeconomic and structural policies and an increase in priority spending on agriculture, education, health, infrastructure, environment, and justice that is at least commensurate with the resources freed up by the MDRI (MGA 111.6 billion or 0.8 percent of GDP). Furthermore, 2007 will be both the third year of program budgeting and the first year of full application of the Organic Law on Budget Laws (LOLF), with the recent entry into force of regulations implementing the new procurement code. The major challenge for 2007 is for the budget to fulfill its role as the means of implementing MAP strategies. Public investment programs will sustain economic growth. Spending will be allocated in terms of a five-year (2007–2011) Medium-Term Expenditure Framework corresponding to the MAP implementation period.

25. However, the Government must also set aside funds for other public expenditure priorities in 2007:

- Elections scheduled for 2007 are expected to cost MGA 15 billion (0.1 percent of GDP.

- To stabilize public finance, the government must begin staggered payment of its arrears to its partners, including the National Social Security Fund (CNAPS) to which the Government will repay the MGA 7.5 billion (0.1 percent of GDP) used in 2003 to bail out the state-owned utility company, JIRAMA. The Government will also repay MGA 23.4 billion (0.2 percent) to the private sector, including 12.7 billion in VAT rebates to export enterprises and 10.7 billion to building companies in VAT owed on capital outlays.

- Stabilizing JIRAMA will require recapitalization of MGA 25 billion (0.2 percent of GDP).

- BCM will also require recapitalization if it is to handle monetary and financial policy effectively. The recapitalization plan is being incorporated into the 2007 budget.

- Finally, the Indian Ocean Island Games, to be held in Madagascar, mean that MGA 16 billion (0.1 percent of GDP) must be spent on building and rehabilitating sport venues and underwriting the Organizing Committee.

2. Tax policy

26. The tax measures planned for 2007 are geared to modernize the tax system and strengthen tax administration to bring about a substantial increase in tax revenue. Other measures planned that are relatively revenue-neutral will: (i) eliminate the 50 percent surtax on the corporate income tax (IBS) for branches of foreign companies; (ii) reduce the tax on corporate financial income (IRCM) from 20 percent to 15 percent for corporations, thereby harmonizing the IRCM rate for corporations and individuals; (iii) relieve corporations from the capital gain tax on real estate (IPVI) but include capital gains in the income subject to the corporate income tax ; (iv) introduce a flat professional tax for the first year of activity of new companies; and (v) merge license fees (*Redevances*) with the excise tax (*Droits d'accise*).

27. Under the MAP the tax system will need to reconcile support for investment with an annual increase in tax revenue of 0.5 percent of GDP. To do so, the Government plans to reform the Tax and Customs Codes with a view to streamlining them, making them more supportive of investment, broadening the tax base, and moving away from special regimes and incentives, in collaboration with the IMF, the World Bank, and other donors. The new codes will be introduced to parliament as part of the 2008 Finance Law.

3. Reform of tax and customs administrations

Tax administration

28. The government is preparing a priority actions program to be implemented with a start date of January 1, 2007, with to improve management of domestic tax collection.

29. At the same time, to improve acceptance of taxes, the actions will focus on potentially high-revenue taxpayers. Therefore:

- Audits of large and medium-sized taxpayers are to be reinforced by using risk analysis and optimizing the use of data obtained from partners like Customs and Treasury).

- Modern methods for managing large taxpayers with a turnover of more than MGA 2 billion will gradually move to tax offices and provincial large enterprise departments that handle medium-size taxpayers (turnover between MGA 0.5 and 2 billion).

- The effectiveness of operational departments will continue to be monitored using performance indicators, and will be moved beyond departments handling large and medium-sized taxpayers.

- Relations with taxpayers will be improved by establishing Approved Management Centers (*Centres de Gestion Agréés* [CGA]) in some regions and an appeals council to be consulted before mediation by the courts. The intention is to bring in the informal sector.

- The VAT system will be improved, first by strictly observing the time limit of 60 days for reimbursing exporters for VAT credits.

Customs administration

30. To achieve the Custom Administration's revenue and trade facilitation objectives, the 2006 measures adopted will be stepped up. They include: (i) elimination of all ad hoc exemptions not provided for by law; (ii) introduction of the ASYCUDA ++ system in all large customs offices, subject to effective delivery of equipment financed abroad; (iii) installation of the information network Tradenet in the port of Tamatave by June 30, 2007 and in all other ports by year-end; and (iv) the continued use of CIVIO software to monitor vehicle values (begun in July 2006). As of 2007 almost 99 percent of customs revenue will come from offices equipped with ASYCUDA ++, where all manual procedures will be eliminated.

31. Customs policy priorities for 2007 are to

- apply the Customs Code adopted in 2006 and eliminate tariff distortions by reviewing the categorization of merchandise;

- review the organization of the General Directorate and enhance customs officer skills;

- strengthen operations by expanding ASYCUDA ++ capabilities, optimizing the fiscal management system (SIGFP), and using new control tools;

- improve efforts to combat fraud by tightening surveillance throughout the whole country, especially deploying the mobile surveillance units (BMS);

- improve the operations of the Anti-Fraud Task Force (*Service de Lutte contre la Fraude - SLF*); and

- ensure that all officers are trained in customs ethics and the Arusha Convention.

4. Public financial management

32. Along with its public financial management reforms, the Government wants to achieve: (i) a tighter grip on macroeconomic management; (ii) a stronger role for the budget as an instrument for economic development; (iii) a major impact in the fight against poverty; (iv) higher-quality services to the public; (v) better use of the LOLF to enhance the effectiveness of government expenditure; (vi) better definition and use of indicators; (vii) more effective budget execution by streamlining budgetary procedures; (viii) more rigorous enforcement of budget execution and control regulations; (ix) improved monitoring of budget execution; (x) improved budget accounting; and (xi) a major contribution to better governance.

33. To achieve these goals, the authorities will continue to implement the fiscal management priority action plan worked out in coordination with development partners. It seeks to improve the management and effectiveness of government expenditure and to better supervise both budget execution and cash management.

34. In managing expenditure, the Government will attempt to achieve marked improvement in budget preparation and execution, paying particular attention to filling the gaps in commitments control. The measures it is instituting are

- monthly reports on commitments, payment orders, and payments for each major heading in the budget as of March 2007, to be produced within no more than 30 days of the end of the month by at least the 13 central government ministries in which the SIGFP information system for monitoring fiscal management is operational;

- the deployment of the SIGFP to all ministries by the end of 2007 and in 2008 eliminate all manual procedures in the ministries equipped with the SIGFP;

- enhancement of SIGFP capabilities in the six provinces;

- improvement of the quality of government procurement and effective enforcement of related new laws;

- improvement of the budget process by starting 2008 budget preparation at the same time as the macroeconomic survey (February 2007), and simplifying the budget nomenclature, starting with the 2008 budget;

- implementation of the recommendations of the analytical and organizational audit of financial control mechanisms to be carried out with donor support;

- improvement of government cash management by continuously refining the cash flow plan and strengthening procedures for updating it in connection with quarterly review of commitments and the monthly commitment plans of the ministries; quarterly commitment ceilings will be issued in January for the first two quarters of 2007, and in June 2007 for the two last quarters of the year; and

- production of budget execution reports every four months on an economic classification basis by all the ministries, within five weeks of the end of the period.

The result should be better budget execution and monitoring from the line ministry up through the Ministry of Economy, Finance, and Budget.

35. The government will draw conclusions from the public expenditure review the World Bank is helping conduct to improve preparation, execution, and evaluation of public investment in education, transport , environment protection, health, nutrition, and agricultural development.

36. The government plans to ensure full transparency and accountability for the growing revenue expected from mining and oil exploration and development. It therefore announced its intention to join the Extractive Industries Transparency Initiative (EITI) at the Oslo Conference in October 2006 and will draft and execute a time-bound action plan to do so in the coming months.

C. Monetary Policy and Financial Sector Development

37. BCM monetary policy through 2007 will be geared to achieving its inflation target. To do so, it will manage banking sector liquidity using indirect monetary policy instruments, such as the bank rate, reserve requirements, and operations to inject or mop up liquidity on the money market. Subject to meeting its inflation target, the BCM will also attempt to meet its foreign exchange reserve target and allow enough growth of credit to the economy to attain the GDP growth objective and to meet government financing requirements.

38. BCM intends to make more effective use of and expand its monetary policy instruments by: (i) improving coordination with the Treasury so as to enhance forecasting and liquidity management; and (ii) transforming consolidated public debt into marketable instruments for monetary policy. The mechanism for the latter was established in June 2006 and should be in place by year-end.

39. Other measures to improve money market operations under way are: (i) broader access to auctions of treasury bills, while reducing the minimum denomination from MGA 40 million to MGA 20 million and extending the auctions to cities other than Antananarivo; (ii) establishment, with the help of an IMF technical assistance mission, of mechanisms to cover counterpart risks on the interbank money market; and (iii) shortening of BCM clearance times for interbank transactions, for which the diagnostic study was financed by the Millennium Challenge Account (MCA).

40. The authorities will implement their action plan to make the BCM more financially viable in line with the recommendations of the March 2006 Safeguards Evaluation. The recapitalization plan in the draft 2007 Budget will be implemented after details are finalized with technical assistance from the IMF. The BCM's controls, accounting, and data communication and audit systems will be strengthened. The IMF Internal Audit Department will check the consistency of the data on net domestic and foreign assets reported to the IMF for program monitoring. The Government undertakes to restrict transactions between it and the BCM to those authorized by law. The external auditor's annual report will discuss such transactions and their conformity with the BCM charter.

41. To strengthen financial supervision and promote financial sector development, the following measures will be implemented, in accordance with the 2005 Financial Sector Assessment Program (FSAP) recommendations: (i) more resources will be allocated to the General Secretariat of the Banking and Financial Supervision Commission (CSBF); (ii) a regulatory framework conducive to the development of microfinance institutions will be put in place; (iii) the justice system's capacity to deal with commercial law will be strengthened; (iv) the credit rating agency will be expanded to facilitate the opening of new microcredit institutions, the promotion of new lending instruments for rural areas, and the training of microfinance managers (with the help of the World Bank and the MCA); (v) the law regulating the creation of a capital market will be drafted; and (vi) access to bank loans will be promoted by modernizing the land register so that land can be used as collateral.

D. Exchange Rate Policy and the Efficiency of the Foreign Exchange Market

42. The BCM will intervene in the interbank foreign exchange market (MID) only to avoid excessive exchange rate volatility and achieve its foreign reserve targets. It will continue to improve the efficiency of the MID, which has functioned well in allowing the exchange rate to fluctuate in response to market conditions. It will: (i) continue to rigorously observe the MID operating procedures; (ii) require all commercial banks to observe MID

rules (set out in the local MID agreement); (iii) insist that all supply offers are placed on the market; and (iv) publish more information for the general public on the volume and prices of transactions (including weighted average rates and the amounts exchanged for each currency) in the official media, in the press, and in real time on the BCM website.

E. Trade Policy

43. Among the measures designed to boost export growth are efforts to: (i) lower production costs and promote the development of productive sectors by, e.g., streamlined regulations, especially for customs clearance, the growth and diversification of financing instruments, and more effective economic and social infrastructure; (ii) diversify exports by continuing to expand both traditional and nontraditional exports and explore new export products (essential oils, mining products, etc.); and (iii) further streamline the tariff structure.

44. Trade liberalization will continue, above all via the regional integration process and the implementation of an appropriate trade policy. Madagascar plans to continue its integration into the Southern African Development Community (SADC). Accordingly, as of November 15, 2006, the majority of customs duties on products from other members of SADC were eliminated (this affected 86 percent of tariff positions). This decision is sending a strong signal to investors and bringing new export opportunities to major trading partners, particularly since SADC members count on Madagascar to be the region’s breadbasket. In the medium term, the idea is to rationalize the tariff structure further. The authorities intend to eliminate other distortions that could be considered hidden taxes. By 2007, the Government will embark on a study of the advisability and fiscal and economic impact of a uniform nonzero customs tariff and of other options to enhance regional integration.

F. Foreign Debt and Support

45. Foreign debt management policies for 2006 are mainly geared to keeping debt sustainable. Actions already undertaken to ensure that are avoidance of accumulation of arrears on external debt arrears and the decision to limit new foreign borrowing to concessionary loans.

46. To improve management of the public debt, the Government will, in collaboration with the United Nations Conference for Trade and Development (UNCTAD), (i) implement the new version 5.3 of the SYGADE software and train Treasury and BCM staffs to use its latest applications; and (ii) acquire the debt sustainability software DSM+ and train Treasury and BCM staffs to use it.

47. To help ensure that MAP development goals are attained, the World Bank, France, the European Union, and the African Development Bank will continue their financial assistance for Madagascar through the partnership framework. The objective of this framework is to strengthen cooperation between the Government and its partners with a view to making use of external financial support more effective by: (i) harmonizing the partners’

processes and procedures; (ii) stepping up dialogue between the Government and the partners; (iii) increasing the predictability (schedule and amount) of partner financial support flows; (iv) better aligning financial support with national processes; and (v) coordinating support with capacity-building. Performance is being jointly monitored against stated criteria in the course of a review and update process.

48. Efforts to attract foreign, especially private, capital will continue in order to mitigate shortages of official capital transfer flows and other external financing.

G. Reform of Public Enterprises

49. The government will continue to implement its plan to restore the financial viability and operational efficiency of JIRAMA, the national utility for power and water services, with donor support. It will adjust retail tariffs in accordance with the price adjustment mechanism under discussion with the World Bank and the International Finance Corporation (IFC). To help JIRAMA to recover from a situation of chronic underinvestment, the government will take the necessary steps in order to secure donor support and financial assistance. And to bring additional financing, leverage donor support, and improve efficiency, it will increase the role for the private sector, including through the promoting public-private partnerships.

50. As part of this plan, in 2007 the government intends to transfer management of JIRAMA to a private operator under a lease-type contract (*Affermage*). To ensure that there is time to prepare the bidding documents, including the Affermage contract, the government expects to approve the Affermage option in the first half of 2007, taking into account the financing that will need to be committed to the Affermage Contract over the medium term. The government will choose the option with assistance from the International Finance Corporation (IFC) in its capacity of principal advisor and upon legal, technical and financial due diligence, and in close collaboration with development partners led by the World Bank. To ensure the financial viability of the Affermage contract, in each budget from 2008 through 2012 the Government will allocate resources to rehabilitate and expand the electricity distribution network. The government will issue an international tender for this Affermage contract before the end of December 2007.

51. The Technical Secretariat for Privatization, in cooperation with the Treasury, will continue to sell or liquidate state-owned enterprises. With financial help from development partners, the schedule for 2006-07 envisages liquidation of 22 government enterprises, the largest of which are ROSO (distribution), FIMA (transport), SIB (wood industry), COROI (distribution), and Port de Manakara (transport).

52. The personnel reduction program at the sugar enterprise SIRAMA, which began in 2005, will be continued at Nosy-Be in 2006 and Brickaville in 2007. When the management contract ends, the preferred form of disengagement is leasing the company assets to a private manager. As for the airports management company, ADEMA, the Government is currently examining an IFC strategic orientation report on the franchising of 12 airports. Leasing is

also a preferred option for the RNCFM, the southern rail network, but its economic and financial state needs to be studied; a report is expected in the first half of 2007.

H. Governance

53. In the fight against corruption, where the Superior Integrity Council (CSI) and the Independent Anti-Corruption Bureau (BIANCO) are already active, steps taken in 2006 will be intensified in 2007, through: (i) a public opinion survey to asses the impact of the first year of BIANCO operations; (ii) establishment of an anticorruption unit in each ministry; (iii) stepped up enforcement measures; and (iii) focusing of investigations in 2006-07 on the key economic sectors, including energy, mining, environment, and rural development. The anticorruption strategy will also be brought up to date and the legal framework strengthened.

54. In the justice sector, the aim is to have a judiciary that is effective and impartial. To do this, the Government intends to: (i) strengthen the anticorruption mechanism within the judiciary; (ii) ongoing implementation of the judicial institutions provided for in the Constitution; (iii) strengthen the existing institutions; (iv) streamline procedures for adopting laws and handling cases; (v) draw up a plan of action for ensuring that laws are effectively applied.

55. To guarantee security, more law enforcement officers (police, gendarmes) will be deployed in both urban and rural areas; in high risk zones, the number of security operations will be increased. The government will also move to improve collaboration between the police and the judiciary.

I. Social Policies and Poverty Reduction

56. To improve the welfare of the population, reduce poverty, and reinforce Madagascar's competitiveness, the government will continue to make special efforts in the fields of education and health.

57. The government has decided to push ahead with its policy of education for all. It will therefore set out to: (i) improve access to education by rehabilitating schools and building new classrooms in rural areas, particularly for primary schools; (ii) more precisely identify needs by better mapping schools; (iii) recruit, train, and rationally distribute new teachers, especially for primary schools; and (iv) procure basic teaching materials and essential equipment. If the repetition rate is to be significantly reduced, more full-cycle schools are needed and more multigrade classes in rural areas, especially in isolated localities; and (v) promote less formal education to strengthen human capital.

58. In the health sector the government will focus on: (i) improving public access to quality services by building and refurbishing basic health centers (CSBs); (ii) raising the quality of referral hospitals by rehabilitating old and providing technical equipment and materials; (iii) building human resources by recruiting medical and paramedical staff, support

personnel, and specialists; (iv) giving budgetary priority to new structures in remote areas; (v) studying a system of incentives for doctors in remote areas; (vi) improving maternal and children's health and addressing malnutrition and illnesses, (vii) preventing and treating HIV/AIDS, tuberculosis, and malaria; and (viii) improving access to drinking water and good sanitation.

IV. Program Monitoring

59. A Committee for Monitoring Public Finance has been established by a joint decision of the institutions that influence the shaping of Madagascar's economic policy. It is chaired by the Chief of Staff of the President of the Republic and has on it representatives of the Offices of the President and the Prime Minister; the Ministry of Economy, Finance, and Budget (MEFB), the Ministry of Industry, Commerce, and Private Sector Development; and the BCM. The Committee is assisted in its work by Directors General and the MEFB General Coordinator of Fiscal Reforms.

60. The Committee's functions are to serve as a platform for the exchange of information and for discussions on economic, especially macroeconomic, issues, and for reaching consensus on them, and to monitor high-priority areas. The Committee meets monthly. It identifies issues to be discussed and monitored, especially revenue collection; ensures that partner programs are monitored by taking part in joint missions of donors and creditors for fiscal support and observing during the main donors and creditors' supervision missions; and invites experts to speak on specific subjects as needed. The committee also meets with the IMF staff to discuss the Memorandum on Economic and Financial Policies during missions and closely monitors its implementation between missions.

61. The program supported by the IMF within the PRGF framework will be monitored through six-month reviews and by applying quantitative and structural performance criteria and benchmarks, as well as the indicative targets mentioned in Tables 1-4.

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets for the PRGF Arrangement, 2006 [1]
(Billions of Ariary, cumulative from the beginning of the year, unless otherwise indicated)

	July 31 Performance Criteria				September 30 Indicative Targets				December 31 Performance Criteria	
	Program [2]	Adjusted Program	Actual	Status	Program [2]	Adjusted Program	Actual	Status	Program [2]	Revised Program
I. Quantitative performance criteria										
External										
(a) Ceiling on accumulation of new external arrears (millions of SDRs) [3]	0.0	…	0.0	Met	0.0	…	0.0	Met	0.0	0.0
(b) Ceiling on contracting or guaranteeing of new external debt on nonconcessional terms [3]	0.0	…	0.0	Met	0.0	…	0.0	Met	0.0	0.0
Central Bank										
(c) Floor on net foreign assets (NFA) of the BCM [4,5]	-24.1	-18.2	31.9	Met	62.7	90.2	148.1	Met	77.5	77.5
(d) Ceiling on net domestic assets (NDA) of the BCM [4]	16.8	8.7	-43.9	Met	-35.6	-65.3	-99.1	Met	36.9	36.9
Fiscal										
(e) Ceiling on domestic financing of the central government [4]	133.9	133.9	-7.5	Met	62.1	37.7	n.a.	n.a.	-55.7	-55.7
(f) Floor on tax revenue	695.1	…	722.0	Met	907.8	…	908.0	Met	1,295.8	1,259.3
(g) Ceiling on accumulation of new domestic arrears [3]	0.0	…	0.0	Met	0.0	…	0.0	Met	0.0	0.0
II. Memorandum items:										
Floor on net foreign assets (NFA) of the BCM NFA (in millions of SDRs) [5]	-7.7	-7.7	10.1		20.0	20.0	47.0		19.9	19.9
Net external budget (program) support (SDR millions)	-1.1	…	1.4		30.4	…	55.5		46.5	59.0
Budget support grants and loans (millions of SDRs)	16.6	…	16.8		48.6	…	70.9		73.6	84.0
External cash debt service (millions of SDRs)	17.7	…	15.4		18.2	…	15.4		27.1	25.0
Exchange rate (MGA/SDR)	3,134.7	…	3,172.1		3,134.7	…	3,153.3		3,134.7	3,167.3

Sources: Malagasy authorities and Fund staff estimates and projections.

[1] See Technical Memorandum of Understanding (TMU) for full description of variables and adjustments.
[2] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism.
[3] To be observed on a continuous basis.
[4] Excluding capital transfer flowing from MDRI assistance from IMF via central bank.
[5] For December 2006, the revised floor on NFA is set in SDR terms.

Table 2. Madagascar: Structural Performance Criteria and Benchmarks for the PRGF Arrangement, 2006

	Timing	Status
Performance Criteria		
▪ No waivers of the requirement to present pre- and post-customs inspection reports for the import and clearance of goods (*Rapport d'inspection recevabilit*é [RIR] and *Rapport d'inspection enlèvemen*t [RIE], or on the use of the pre- and post inspection company SGS valuation of goods.	Continuous	Met
▪ No granting of ad hoc tax or tariff exemptions outside those specified in the Customs Code and international treaties or conventions.	Continuous	Met
▪ Finalization of an audit of the VAT arrears owed by the government on capital expenditure.	September 30, 2006	Met
▪ No transactions carried out between the government and the central bank that are contrary to the provisions of the Central Bank Charter.	Continuous	Met
▪ Issuance of monthly commitment ceilings for the last quarter of 2006 by the Ministry of Finance to all ministries on the basis of the latest cash flow plan prepared by the Treasury.	September 30, 2006	Met on October 24, 2006
Benchmarks		
▪ Extension of the new ASYCUDA++ software to the five largest customs bureaus.	September 30, 2006	Expected for December 31, 2006
▪ Inclusion of a recapitalization plan for the BCM in the 2007 Budget Law.	October 31, 2006	Met
▪ Development of a comprehensive time-bound action plan translating the 2003 and 2006 IMF FAD tax administration recommendations in operational terms.	December 31, 2006	
▪ Install the expenditure tracking information system SIGFP in 13 ministries.	December 31, 2006	
▪ Completion of the verification of at least 80 percent of outstanding VAT credits at end-June 2006.	December 31, 2006	

Table 3. Madagascar: Quantitative Performance Criteria and Indicative Targets for the PRGF Arrangement, 2007 [1]
(Billions of Ariary, cumulative form the beginning of the year, unless otherwise indicated)

	March 31, 2007 Indicative Targets	June 30, 2007 Performance Criteria	September 30, 2007 Indicative Targets	December 31, 2007 Indicative Targets
I. Quantitative performance criteria				
External				
(a) Ceiling on accumulation of new external arrears (millions of SDRs) [2]	0.0	0.0	0.0	0.0
(b) Ceiling on contracting or guaranteeing of new external debt on nonconcessional terms [2]	0.0	0.0	0.0	0.0
Central Bank				
(c) Floor on net foreign assets (NFA) of BCM (in millions of SDRs, excluding MDRI)	-40.6	-19.0	5.7	15.3
(d) Ceiling on net domestic assets (NDA) of the BCM	15.8	-6.6	-39.3	33.3
Fiscal				
(e) Ceiling on domestic financing of the central government	86.9	-16.8	-53.8	10.8
(f) Floor on tax revenue	339.7	761.3	1,136.9	1,523.8
(g) Ceiling on accumulation of new domestic arrears [2]	0.0	0.0	0.0	0.0
II. Memorandum items:				
Net external budget (program) support (SDR millions)	-3.5	19.3	42.1	47.2
Budget support grants and loans (millions of SDRs)	0.0	33.5	60.4	76.3
External cash debt service (millions of SDRs)	3.5	14.2	18.3	29.1
Exchange rate (MGA/SDR)	3,350.2	3,350.2	3,350.2	3,350.2

Sources: Malagasy authorities; and Fund staff estimates and projections.

[1] See Technical Memorandum of Understanding (TMU) for full description of variables and adjustments.
[2] To be observed on a continuous basis.

Table 4. Performance Criteria and Structural Benchmarks for the PRGF Arrangement, 2007

	Timeline
Performance criteria	
• No granting of ad hoc tax or tariff exemptions outside those specified in the Customs Code and international treaties or conventions.	Continuous
• No waivers of the requirement to present pre- and post-customs inspection reports for the import and clearance of goods (*Rapport d'inspection recevabilit*é [RIR] and *Rapport d'inspection enlèvemen*t [RIE] or on the use of the pre- and post-inspection company SGS valuation of goods for custom offices that are not linked with the information system Tradenet.	Continuous
• No exemption for custom offices that are linked with the Tradenet information system from the requirement to generate a cargo tracking slip (BSC) in advance of all imports.	Continuous
• Implementation a recapitalization plan for the BCM which would include at a minimum the issuance of a government bond to recapitalize the BCM and a written agreement between the Treasury and the BCM to pay market-related rates of interest on the Treasury's debt to the BCM.	March 31, 2007
• Production of a report on commitments, payment orders, and payments by major spending lines during the first quarter of 2007, in at least 13 ministries where the budget information system, SIGFP, is operational.	April 30, 2007
• Issuance of quarterly commitment ceilings by the Ministry of Economy, Finance and Budget to all ministries taking into account the most recent outlook for external and internal resources.	June 30, 2007
Structural benchmarks	
• Provide the BCM with new instruments (securities) through the securitization of government debt to help it better manage liquidity.	January 31, 2007
• Complete a study on the opportunity of a single nonzero customs tariff, its budgetary and economic impact, and other possible options within the framework of regional integration.	June 30, 2007
• Inclusion in the 2008 Finance Law of articles streamlining the Tax and Customs Codes, while meeting the 2008 fiscal revenue objective of the program.	October 31, 2007
• Adopt a streamlined budget classification in the 2008 Finance Law to establish a clear link between each ministry and its programs to ensure accountability and clearly identify poverty reducing expenditure in the budget.	October 31, 2007
• Establish a computerized communication network between the Tax Directorate, the Customs Directorate, and the Treasury to closely monitor tax collection and broaden the tax base.	December 31, 2007
• Implement a comprehensive time-bound action plan to modernize tax administration in line with the Fund's Fiscal Affairs Department recommendations of June 2006.	December 31, 2007
• Issue an international tender for the transfer of JIRAMA's management to a private operator under a lease (*affermage*).	December 31, 2007

APPENDIX I—ATTACHMENT III

MADAGASCAR: TECHNICAL MEMORANDUM ON MONITORING THE DECEMBER 2006 AND 2007 TARGETS FOR THE PROGRAM SUPPORTED BY THE ARRANGEMENT UNDER THE POVERTY REDUCTION AND GROWTH FACILITY (PRGF)

1. This technical memorandum defines the variables used to establish the quantitative performance criteria (PCs) and indicative targets for the program, how they are calculated, and any adjustments that may be necessary. It also explains the monitoring of contingent variables upon which adjustments may be made, for example, the actual exchange rate or balance of payments assistance received. Unless otherwise indicated, flow variables are measured as cumulative from the beginning of the year. The quantitative objectives for December 31, 2006, and June 30, 2007, are performance criteria; those for March 31, September 30, and December 31, 2007 are indicative targets. Program targets exclude stock adjustments for the Multilateral Debt Relief Initiative (MDRI). Actual outcomes for quantitative performance criteria and targets will be adjusted (as explained below) for comparison to program targets. The external and central bank PCs for December 2006 are unchanged from the original program (IMF Country Report No. 06/306); the fiscal PCs are based on the revised program, which takes into account not only the modified fiscal revenue target but also the revised net balance of payments support projections and the revised exchange rate projection. The outcomes for the two categories of PCs will be adjusted for exchange rates and net balance of payments assistance accordingly (as described below).

I. QUANTITATIVE CRITERIA

A. Ceiling on External Payments Arrears

2. These arrears consist of overdue debt-service obligations (i.e., payments of principal and interest) related to loans contracted or guaranteed by the government or the Central Bank of Madagascar (BCM). Debt service obligations (including unpaid penalties and interest charges) are overdue if they have not been paid by the due date or within a grace period agreed with, or unilaterally granted by, each creditor before the due date. They exclude arrears resulting from nonpayment of debt service for which rescheduling negotiations are under way or that are in dispute. This performance criterion should be observed on a continuous basis.

B. Ceiling on Nonconcessional External Borrowing

Definition

3. Nonconcessional external debt has a grant element of less than 35 percent. This performance criterion applies not only to debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (IMF Executive Board Decision No.

12274-00/85, August 24, 2000), but also to commitments contracted or guaranteed for which value has not been received. Under the program, nonconcessional debt includes financial leasing and any other instrument giving rights to a current financial liability, under a contractor guarantee by the central government (CG) of Madagascar (defined in paragraph 9) or guarantee by the CG, but it excludes debt contracted under rescheduling agreements and normal import-related credits of less than one year. If the CG has a special need for external nonconcessional financing, IMF staff should be informed in advance to consider including the request in the program. This performance criterion should be observed on a continuous basis.

Calculation

4. Calculation of the degree of concessionality of new external borrowing is based on the 10-year average of the OECD's commercial interest reference rate (CIRR) for loans with maturities greater than 15 years and the six-month average CIRR for loans maturing in less than 15 years.

C. Floor for Net Foreign Assets (NFA) of the Central Bank of Madagascar

Definition

5. NFA are defined as the "Net Foreign Position" of the BCM, which is the difference between its gross foreign assets and total foreign liabilities, including debt to the IMF. The IMF 2006 debt relief under the MDRI, which reduces NFA by SDR 128.75 million, is excluded from the calculation.

Calculation

6. The programmed change in NFA will be measured in SDRs, subject to adjustment for any shortfall or excess in net external balance of payments assistance as described below.

D. Ceiling on Net Domestic Assets (NDA) of the Central Bank of Madagascar

Definition

7. The NDA of the BCM is the difference between reserve money and the NFA of the BCM. It includes net credit to the government, credit to enterprises and individuals, claims on banks, liabilities to banks (including the proceeds of BCM deposit auctions—*appels d'offres négatifs*), and other items net. IMF debt relief in 2006 under the MDRI is excluded from the calculation (¶5).

Calculation

8. The outturn for NDA will be adjusted for the variation of the actual versus the program exchange rate, applied to the level of net foreign assets and foreign exchange deposits held by the CG. The outturn will also be adjusted for the excess or shortfall in the net external balance of payments support, as explained below. Finally, the outturn for NDA will be adjusted for changes in the reserve requirement in an amount equal to the percentage point change in the reserve requirement ratio times the amount of deposits held by the public with commercial banks.

E. Ceiling on the Net Domestic Financing Requirements of the Central Government

Definition

9. The CG corresponds to the scope of operations of the treasury, as shown in the o*pérations globales du Trésor* (or OGT). (see Table 3 for quarterly breakdown.)

10. The net domestic financing of the CG (excluding any net cash payments or bonds or treasury bills issuance that are part of the BCM recapitalization plan and not included in the 2007 budget) is the sum of the following components:

a. the variation in net bank claims on the CG (excluding the transfer of capital flowing from IMF MDRI assistance), plus

b. the change in CG debt to the nonbank system (domestic and nonresident), plus

c. the variation in net debt to treasury correspondents (*correspondants du Trésor)*, plus

d. domestic or foreign receipts from privatization operations, plus

e. the variation in the level of CG domestic payments float (*paiements en instance*), plus

f. the variation in identified domestic arrears.

11. The amount of CG domestic payments float is the difference between committed and paid expenditure.

12. Domestic arrears are defined in paragraph 19 below. The stock of outstanding domestic arrears will be reduced in 2006 and 2007 a specified in the MEFP (¶¶ 22 and 25).

13. Net bank claims on the government are measured by the change in net credit to government in the monetary survey; they consist of BCM and commercial bank claims on the CG, including auctioned treasury bills (BTAs) and other securities and liabilities, net of CG

deposits with the BCM and commercial banks, including foreign currency deposits. The one-time increase of government deposits in 2006 owing to the IMF MDRI relief is excluded (see below).

14. Nonbank claims consist of BTAs and other treasury bills (BTs) and bonds placed with nonbank institutions (domestic and nonresident) and the public.

Calculation

15. To compare actual outturn with the target amount for net bank claims on the government, the former will be adjusted to take account of CG foreign exchange deposits valued at the program exchange rate. The net transfer of IMF MDRI (MGA 361.7 billion) to the government is excluded from the calculation. The government should inform Fund staff of any substantive changes in CG accounts with the banking system, which may affect the calculation of bank claims.

16. For nonbank borrowing, BTAs and other government securities should be recorded at their net value at time of issue, not their redemption value.

17. Net domestic financing is subject to adjustment for the excess or shortfall in balance of payments assistance less cash debt service, as described in Section III, and for exchange rate variation from the program rate.

F. Floor on Tax Revenue

Definition

18. Tax revenue includes all domestic taxes and taxes on foreign trade received by the treasury, including suspense items and those related to public investment.

G. Ceiling on Accumulation of New Domestic Payments Arrears

Definition

19. Payments arrears consist of: (i) all Treasury expenditures for which payment orders have been issued but not paid within three months (*dépenses ordonnancées mais non-payées*); and (ii) VAT credits to exporters that are not reimbursed within 60 days of the receipt of a valid request by the Tax Directorate (Direction Générale des Impôts, DGI). A VAT credit is considered reimbursed when the taxpayer has been notified that a check is ready to pick up as the DGI. This performance criterion should be observed on a continuous basis.

II. Monitoring Variables and Memorandum Items

A. Balance of Payments Assistance

Definition

20. External balance of payments assistance is defined as cash budget loans and grants not linked to projects, excluding HIPC assistance, that are provided as financing and result in funds available to the treasury (budget support), excluding International Development Association (IDA) and African Development Fund (AfDF) debt cancellation under MDRI. It excludes any disbursement of loans or debt relief by the IMF and assistance that gives rise to counterpart funds for the treasury with a delay of longer than one year. (see TMU Tables 1 and 2, for specification of flows.)

Calculation

21. Programmed financial assistance is recorded in foreign exchange and converted into MGA at the program exchange rate. Actual outturns will be adjusted for comparison to program amounts as described below. Counterpart funds to assistance in kind should be posted when deposited with the treasury.

B. Cash Debt Service

22. This is the amount of external debt service the CG expects to pay in cash, net of HIPC and MDRI debt relief. (see TMU Tables 1 and 2 for specification of flows.)

C. Program Exchange Rate

Definition

23. For program purposes, foreign exchange stocks and flows that affect the December 2006 fiscal performance criteria have been converted to Ariary at the revised program exchange rate of SDR 1 = MGA 3,167.25. (amounts denominated in U.S. dollars and in euros are converted to SDRs by applying the program rates of US$1.4683 = SDR 1, and €1.1745 = SDR 1.) However, foreign exchange stocks and flows that affect the December 2006 monetary performance criteria have been converted to Ariary at the original program exchange rates. (i.e., SDR 1 = MGA 3,134.7, US$1.44=SDR 1, and €1.20=SDR 1). For 2007, foreign exchange stocks and flows that affect the fiscal and monetary performance criteria have been converted to Ariary at the program exchange rate of SDR 1 = MGA 3,350.2. (amounts denominated in U.S. dollars and in euros are converted to SDRs by applying the program rates of US$1.4853 = SDR 1, and €1.1619 = SDR 1).

III. Exchange Rate and Net Balance of Payments Assistance Adjusters

A. Differences Between Program and Actual Exchange Rate

24. To compare actual outturns to program targets, those foreign exchange stocks and flows in the actual outturn will be converted at the programmed SDR exchange rate.

B. Excess or Shortfall in Balance of Payments Assistance less Cash Debt Service

25. Net external balance of payments assistance is defined as external budget support for grants and loans (¶20 above) less external cash debt service (¶22). For December 2006, the central bank PCs will be adjusted according to the original program values for balance of payments assistance less cash debt service; whereas the fiscal PCs will be adjusted based on the revised program values (Table 1).

26. If there is a shortfall in net external balance of payments assistance versus the programmed amount on December 31, 2006, March 31, 2007, June 30, 2007, September 30, 2007, or December 31, 2007, actual outturns will be adjusted by the amount of the shortfall up to a cumulative maximum of SDR 15 million per year, according to the following method:

a. The BCM's NFA outturn will be adjusted upward by an equal amount up to a cumulative maximum of SDR 15 million.

b. The BCM's NDA outturn will be adjusted downward by an equal amount up to a cumulative maximum of SDR 15 million (a net balance of payments assistance shortfall will be converted into MGA at the programmed exchange rate).

c. The CG net domestic financing outturn will be adjusted downward by an equal amount up to a cumulative maximum of SDR 15 million (a net balance of payments assistance shortfall will be converted into Ariary at the programmed exchange rate).

27. If there is a cumulative excess of more than SDR 15 million in net external budget support, the actual outturns will be adjusted by the amount of the excess (above SDR 15 million), according to the following method:

a. The BCM's NFA outturn will be adjusted downward by the excess.

b. The BCM's NDA outturn will be adjusted upward by the excess (the excess for net balance of payments assistance will be converted into Ariary at the programmed exchange rate),

c. The CG net domestic financing outturn will be adjusted upward for the excess (the excess for net balance of payments assistance will be converted into Ariary at the programmed exchange rate).

IV. Information and Data to be Supplied to Fund Staff

28. The Malagasy authorities will provide Fund staff with the following information and data by email or facsimile at the frequency noted and as soon as available; the Fund's resident mission will be copied on all such exchanges of information.

A. The Central Bank of Madagascar will Report the Following Statistics

Monthly

- Market results of treasury bill auctions, including the bid level, bids accepted or rejected, and interest rates
- Data on the secondary market for treasury bills and other government securities
- Information on monetary developments, as required by the IMF Statistics Department (STA)
- Monthly balance sheets of the BCM and deposit money banks
- Bank lending by economic sector and by term
- The banking risk situation
- Money market operations and rates
- Changes in bank liquidity
- The foreign exchange cash flow table, including foreign debt operations
- The table of interbank foreign exchange operations on the MID, including the amount of unsatisfied bids for sales and purchases
- Banking sector prudential ratios
- Data on foreign trade (exports and imports).

Quarterly

- Updated balance of payments reconciled with monetary and fiscal information.

B. The Ministry of Economy, Finance, and Budget will Report the Following Information

Monthly

- OGT data on cash and commitment basis and the related tables

- Comprehensive cash plan based on monthly cash inflow and outflow projections
- Monthly commitment ceilings to spending ministries on the basis of the cash plan
- Expenditure on structural reforms
- Central government revenue and expenditure (current and capital), including short-term treasury on-lending
- Treasury liabilities (including statutory advances and operations on the treasury bill market showing holding by banks and nonbanks)
- External public debt operations (debt contracted and publicly guaranteed, settlement of arrears, and operations of public enterprises) and debt service paid
- Any other contingent liabilities
- Consumer price indices
- Indicators of sectoral economic activity.

Quarterly

- Consolidated Treasury accounts (balance consolidée des comptes du Trésor)

Every four months

- Reports on budget execution by ministry (rapports quadrimestriels sur l'exécution du budget par ministère).

29. Information on important measures adopted by the government in the economic and social areas that would affect program developments; changes in legislation, including laws passed by the National Assembly and new rules established by the Banking Supervision Commission (CSBF); and any other pertinent legislation should be promptly reported to Fund staff for consultation or information.

Table 1. Madagascar: Programmed Net Balance of Payments Assistance, 2006 [1]
(Millions of SDRs, cumulative from 1st January, 2006)

	July 31		September 30		December 31	
	Program [2]	Actual	Program [2]	Prelim.	Program [2]	Rev. Fisc. Prog.
Budget support	16.6	16.8	48.6	70.9	73.6	84.0
Grants	16.6	16.8	20.8	18.5	28.3	31.5
European Union [3]	16.6	16.8	20.8	18.5	28.3	25.6
UNDP	0.0	0.0	0.0	0.0	0.0	5.9
Loans	0.0	0.0	27.8	52.4	45.3	52.4
World Bank	0.0	0.0	27.8	27.8	27.8	27.8
African Development Bank	0.0	0.0	0.0	24.6	17.5	24.6
External debt service (budget, cash basis)	17.7	15.4	18.2	15.4	27.1	25.0
Interest	12.1	12.0	12.3	12.0	16.1	15.1
Amortization	5.6	3.4	5.9	3.4	11.0	9.9
Net balance of payment assistance	-1.1	1.4	30.4	55.5	46.5	59.0

Source: Malagasy authorities and Fund staff estimates and projections.

[1] Cash payments through the budget, net of HIPC and MDRI debt relief.

[2] IMF Country Report No. 06/306, Republic of Madagascar: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Activation of the Trade Integration Mechanism.

[3] Includes STABEX and PASA.

Table 2. Madagascar: Programmed Net Balance of Payments Assistance, 2007 [1]
(in Millions of SDRs, cumulative from January 1, 2007)

	2007			
	31-Mar	30-Jun	30-Sep	31-Dec
Budget grants	0.0	23.0	23.0	38.9
European Union	0.0	9.5	9.5	18.9
STABEX and PASA	0.0	6.5	6.5	12.9
UNDP grants	0.0	7.1	7.1	7.1
Budget loans	0.0	10.5	37.4	37.4
World Bank	0.0	0.0	26.9	26.9
African Development Bank	0.0	10.5	10.5	10.5
Total program grants and loans	0.0	33.5	60.4	76.3
External debt service (budget, cash basis)	3.5	14.2	18.3	29.1
Interest	0.6	3.7	4.1	7.0
Amortization	2.9	10.5	14.2	22.1
Net balance of payments assistance	-3.5	19.3	42.1	47.2

Source: Malagasy authorities and Fund staff estimates and projections.

[1] Cash payments through the budget, net of HIPC and MDRI debt relief.

Table 3. Madagascar: Quarterly Government Financial Operations, 2007
(Billions of ariary, cumulated since the beginning of the year, unless otherwise indicated)

	March Prog.	June Prog.	September Prog.	December Prog.
Total revenue and grants	501.6	1,135.6	1,659.1	2,251.4
Total revenue	340.8	767.2	1,154.9	1,552.1
Tax revenue	339.7	761.3	1,136.9	1,523.8
Nontax revenue	1.1	5.9	17.9	28.3
Grants	160.8	368.4	504.2	699.3
Current grants	7.2	88.5	92.7	150.5
Capital grants	153.7	279.9	411.6	548.8
Total expenditure	721.2	1,378.4	2,065.0	2,822.4
Current expenditure	363.8	705.7	1,044.9	1,415.6
Personnel	180.3	360.6	540.8	721.1
Interest expenditure	54.5	115.2	163.0	221.1
Foreign interest obligations [1]	1.9	11.4	12.8	21.5
Domestic interest obligations	52.6	103.8	150.2	199.6
Other	120.2	217.2	328.2	459.7
Treasury operations (net) [2]	8.9	12.7	12.8	13.7
Capital expenditure	357.4	672.7	1,020.1	1,406.8
Domestically financed	61.2	133.2	226.7	349.0
Foreign financed	296.2	539.5	793.4	1,057.8
Net cost of structural reforms [3]	0.0	0.0	0.0	0.0
Overall balance (commitment basis)				
Excluding grants	-380.5	-611.2	-910.1	-1,270.3
Including grants	-219.7	-242.8	-405.8	-571.1
Domestic balance (commitment basis) [4]	-82.4	-60.3	-103.9	-191.0
Float [5]	-10.0	17.2	9.2	-3.3
Variation of domestic arrears	-23.4	-23.4	-23.4	-23.4
Overall balance (cash basis)				
Excluding grants	-413.9	-617.4	-924.3	-1,297.0
Including grants	-253.1	-249.0	-420.0	-597.8
Financing	253.1	249.0	420.0	597.8
Foreign (net)	132.7	259.5	459.6	560.3
Drawings	142.5	294.8	507.2	634.4
Budget	0.0	35.2	125.4	125.4
Projects	142.5	259.6	381.8	509.0
Amortization [1]	-9.8	-35.2	-47.6	-74.1
Change in external arrears	0.0	0.0	0.0	0.0
Domestic (net)	120.3	-10.6	-39.6	37.5
Banking system	52.0	-4.6	-41.3	12.1
Central bank	2.0	5.4	8.7	12.1
Of which: MDRI account	9.0	18.1	27.1	36.2
Commercial banks & OPCA	50.0	-10.0	-50.0	0.0
Nonbanking system	68.3	-5.9	1.7	25.4
Treasury correspondent accounts (net)	0.0	0.0	0.0	0.0
Memorandum items:				
MDRI flow debt-service savings	27.9	55.8	83.7	111.6
Net domestic financing [6]	86.9	-16.8	-53.8	10.8

Sources: Ministry of Economy, Finance, and Budget; and Fund staff estimates and projections.

[1] See Staff Report Table 2a, footnote 3.
[2] See Staff Report Table 2a, footnote 4.
[3] See Staff Report Table 2a, footnote 5.
[4] See Staff Report Table 2a, footnote 6.
[5] See Staff Report Table 2a, footnote 7.
[6] See Staff Report Table 2a, footnote 8.

APPENDIX II—MADAGASCAR: RELATIONS WITH THE FUND

(As of October 31, 2006)

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

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	122.20	100.00
Fund holdings of currency	122.17	99.98
Reserve position in Fund	0.03	0.02

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	19.27	100.00
Holdings	0.26	1.35

IV. Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
PRGF Arrangements	19.20	15.72

V. **Latest Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	Jul 21,2006	Jul 20, 2009	54.99	7.86
PRGF	Mar 01,2001	Mar 01, 2005	91.65	91.65
PRGF	Nov 27,1996	Nov 30, 2000	81.36	78.68

VI. **Projected Payments to Fund (after HIPC and MDRI assistance)**
(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal					1.13
Charge/interest	0.23	0.87	0.87	0.87	0.86
Total	0.23	0.87	0.87	0.87	2.00

VII. Implementation of HIPC Initiative:

Commitment of HIPC Initiative assistance	Enhanced Framework
Decision point date	Dec 2000
Assistance committed (NPV terms)	
Total assistance (US$ million)[1]	835.75
Of which: Fund assistance (US$ million)	19.17
(SDR equivalent in millions)	14.73
Completion point date	Oct 2004
Disbursement of IMF assistance (SDR million)	
Assistance disbursed to the member	14.73
Interim assistance	5.62
Completion point balance	9.11
Additional disbursement of interest income[2]	1.69
Total disbursements	16.42

VIII. Implementation of MDRI Assistance:

Total Debt Relief (SDR million)[3]	137.29
Of Which: MDRI	128.50
HIPC	8.79

Debt Relief by Facility (SDR million)

Eligible Debt

Delivery Date	**GRA**	**PRGF**	**Total**
January 2006	N/A	137.29	137.29

[1] Because assistance committed under the original framework is expressed in net present value (NPV) terms at the completion point, and assistance committed under the enhanced framework is expressed in NPV terms at the decision point, these two amounts can not be added.

[2] Under the enhanced framework, an additional disbursement is made at the completion point corresponding to interest earned on the amount committed at the decision point but not disbursed in the interim period.

[3] The Multilateral Debt Relief Initiative (MDRI) provides 100 percent debt relief to eligible member countries. The debt relief covers all debt owed to the Fund as of end-2004 that remains outstanding at the time the member qualifies for such debt relief. The MDRI is financed by bilateral contributions, the Fund's own resources, and resources already disbursed to the member under the HIPC Initiative (see Section VII above).

IX. Safeguards Assessments:

A safeguards assessment of the Central Bank of Madagascar (BCM) was completed on March 17, 2006; a previous assessment was completed in November 2001. The 2006 assessment identified continued weaknesses in BCM internal controls, financial reporting, and legal framework, and made recommendations to address the observed vulnerabilities. The recommendations included: (i) an annual external audit report on the BCM's transactions with the government and their compliance with the central bank law; (ii) quarterly reviews by the BCM's internal audit function of monetary program data reported to the Fund; (iii) adoption of International Financial Reporting Standards (IFRS) for BCM accounting; and (iv) measures to strengthen the quality of the BCM's external audit, e.g., appointment of an international audit firm with experience in IFRS and international auditing standards.

X. Exchange System and Exchange Rate Arrangements:

After April 1982, when the peg to the French franc was discontinued, the exchange rate was managed with reference to a basket of 10 currencies. However, by the end of1991, the authorities stopped the practice of adjusting the exchange rate to offset inflation differentials with key trading partners. The exchange rate regime is classified as a managed float with no predetermined path. Since July, 2004, the Malagasy franc has been determined through a continuous interbank foreign exchange market system and on January 1, 2005, the Ariary (AR) replaced the Malagasy franc as the country's official unit of account, at the rate of AR 1=FMG 5. The exchange rate in terms of the SDR at end-July 2006 was AR 3,175.8 = SDR 1.

Madagascar accepted the obligations under Article VIII, Sections 2(*a*), 3, and 4 on September 18, 1996 and maintains no restrictions on the making of payments and transfers for current international transactions.

XI. Last Article IV Consultation:

The 2005 Article IV consultation staff report was discussed by the Executive Board on June 1, 2005 (Country Report No. 05/350, September 27, 2005).

II. Technical Assistance:

Department	Dates	Purposes	Results of Missions
FAD	January–February 2003	Examine and assess tax and customs administration.	Comprehensive action plan and report on establishment of an oversight committee prepared.
FAD	July–August 2003	Examine and assess tax policy and assist in tax policy design.	Comprehensive action plan and report on next steps prepared.
FAD	May–June 2004	HIPC Assessment and Action Plan (AAP).	Comprehensive action plan established.
FAD	July 2005	Examine and assess the status of recent reforms in PEM.	Short and medium term strategy for continuation of reforms established.
FAD	March 2006	Examine and assess tax and customs administration.	Comprehensive recommendations proposed.
LEG	July 2005	Diagnostics for the drafting of a new foreign exchange code.	Factual aspects of the current FX regime were clarified and a number of issues identified that must be resolved. Discussions are ongoing.
MFD	September 2004	Review operations of the new interbank foreign exchange market.	Recommendations are being implemented.
MFD	November–December 2004	Strengthen banking supervision.	Recommendations are being implemented.
MFD	February–March 2005	Review monetary and exchange operations, bank liquidity management, and banking supervision.	Recommendations are being implemented.

Department	Dates	Purposes	Results of Missions
MFD	April–May and July 2005	Financial sector assessment program (FSAP) mission.	The report has been circulated to the Board.
MFD	September–October 2005	Strengthening the financial supervision of the central bank.	Recommendations have been made.
MFD	October 2005	FSAP follow-up.	Recommendations are being implemented.
MFD	November 2005	Assist the central bank in improving foreign reserve management.	Recommendations have been made.
MFD	February–April 2006	Assist the central bank in further strengthening its foreign exchange, monetary, and banking supervision areas.	Recommendations have been made.
MFD	September 2006	Assess the recapitalization of the Central Bank of Madagascar.	Consultants findings were incomplete – additional mission required.
STA	February 2004	Multisector statistics mission.	Recommendations for data improvements accepted.
STA	February 2006	Improve national account statistics.	Reviewed estimation of national income accounts and provided technical guidance to move base year to 2005.

XIII. Resident Representative:

Madagascar has had a Fund Resident Representative since September 1989. Mr. Pierre van den Boogaerde took up the post in February 2006.

APPENDIX III—MADAGASCAR: RELATIONS WITH THE WORLD BANK

(as of October 31, 2006)

Partnership in Madagascar's Development Strategy

1. **The Government has been implementing its poverty reduction strategy (PRSP) since 2003.** The Annual PRSP Progress Reports consider implementation to have been satisfactory despite a difficult macroeconomic environment and external shocks. The 2005 progress report and the accompanying JSAN were distributed to the Boards of the IMF and the World Bank in July 2006. The Bank's Country Assistance Strategy (CAS) for Madagascar, finalized in October 2003, outlines the Bank's program of support for FY04–06. The main objective of the CAS was to support implementation of the PRSP's three priorities: (i) improving governance; (ii) promoting broad-based growth; and (iii) providing human development and security.

2. **In November 2004 the Government articulated a vision up to 2015 called *Madagascar Naturellement*.** Recognizing the enormous potential of Madagascar, it states that Madagascar will be a newly industrialized country with maximized competitiveness by 2020. The core of growth will be derived from the country's unique natural resources and from the transformation of its natural products. The vision is to build a diversified and rich natural resource base (agriculture, livestock, fisheries, and mining) that will contribute to creation of products with high value- added, such as essential oils, agribusiness, pharmaceuticals, and mining products. A broader impact of growth and progressive redistribution of its benefits will help reduce poverty substantially. The priorities identified include: reinforcement of the effectiveness of government, good governance, infrastructure, education for all, rural development and environment, drinking water for all, health and AIDS prevention, private sector development, and tourism.

3. **The Government is preparing the follow-up strategy to the PRSP—the Madagascar Action Plan (MAP)—**which is its new roadmap for development. The purpose of the MAP is to produce a quantum leap in the development process by having a five-year plan that will mobilize the Malagasy people and the country's international partners to ignite rapid growth, thus leading to the reduction of poverty. Its goal is to ensure that the country develops in response to the challenges of globalization and in accordance with the national vision, "Madagascar Naturellement."

4. **The MAP goals are ambitious targets that the Government is committed to achieving in the coming five years.** It is recognized that these targets are challenging but at the same time it is expected that results will be delivered by mobilizing the full array of available resources (human, technical, and financial), combined with strong leadership, hard work, creativity, and excellent coordination. The MAP outlines eight areas of focus: (i) good governance; (ii) educational transformation; (iii) health and family planning;

(iv) infrastructure; (v) rural development; (vi) the economy and the private sector; (vii) environment; and (viii) national solidarity. Quantified goals to be achieved by 2012 are set out for each of these areas; the goals will be further refined, costed, and clearly linked to the MDGs during 2006.

5. **The MAP is a direct follow-on from the PRSP and covers the period 2007-2011.** The Government believes that it has effectively implemented the initial PRSP and intends now for the MAP to supersede the PRSP as the country's main development strategy. The MAP is expected to be finalized in the last quarter of 2006.

6. **A summary of IMF-World Bank collaboration in Madagascar is provided in Table 1.** The IMF leads in supporting Madagascar's medium-term program for maintaining macroeconomic stability. The World Bank leads the policy dialogue on structural and institutional reforms aimed at: (i) strengthening governance in the public sector; (ii) accelerating pro-poor economic growth and supporting foreign investment and private sector development; and (iii) ensuring human development and security, as in health, education, nutrition, and social protection.

Bank group strategy and lending operations

7. **The World Bank's FY04-06 Country Assistance Strategy (CAS) for Madagascar was fully aligned to the Government's program**. For the first year of the CAS (FY04) the Bank approved new projects in transport, environment, and governance. The CAS proposed a gradual transition from investment to programmatic lending with annual Poverty Reduction Support Credits (PRSC) starting in FY05. The first PRSC addressing governance, education, and nutrition was approved in July 2004. A second PRSC was approved in July 2005 and a third PRSC in July 2006. Investment projects have also been approved for the Integrated Growth Poles Project addressing infrastructure and private sector development, a repeater project for HIV/AIDS, and a health supplemental credit. An Energy Sector Project was approved by the Board in July 2006 and a Supplemental Credit to the Community Development Project (FID) was approved in August 2006. A Watershed Management Project and a Supplemental Credit to the Second Community Nutrition Project are being prepared for presentation to the Board in November 2006.

8. **The Bank is preparing its new CAS for FY07-11.** It will be fully aligned with the MAP and will support MAP implementation in the areas where the Bank can most effectively have an impact, add value, and maximize its comparative advantages in relation to other development partners. As of October 2006 the Bank's portfolio consists of 15 IDA projects and one GEF project with total commitments of US$934 million. Of that, US$393 million is not yet disbursed.

IMF-World Bank Collaboration in Specific Areas

Areas where the Bank takes the lead

9. Areas where the World Bank takes the lead are related to specific sector advice in areas where the Bank has active lending operations (especially in the social sectors, infrastructure, agriculture, and environment) as well as through a number of analytical studies. Together with the Government and other donors, the Bank is involved in supporting aid coordination, which has included mobilizing donor support for the Government's PRSP and the Education for All initiative.

Areas where the IMF takes the lead

10. Areas where the Fund takes the lead relate to policy advice and reforms with respect to: (i) macroeconomic policies and targets; (ii) tax policy and administration; (iii) budgetary accounting; (iv) treasury procedures; (v) public sector wage policy; and (vi) monetary management and exchange rate policy. The Bank team actively participates in discussions between the Fund and the Government in all these areas, especially with respect to tax policy and the setting of macroeconomic targets.

Areas of joint responsibility

11. IMF and World Bank staff maintain a close working relationship, especially with respect to: (i) monitoring the PRSP; (ii) analysis and reforms in public financial management; (iii) other governance reforms, including customs; and (iv) financial sector assessment. Joint policy advice is given on budgetary procedures, including expenditure execution, and the functioning of internal and external budget controls. Table 1 briefly describes each areas and specific support from the two institutions with respect to policy advice.

TABLE 1: BANK/FUND COLLABORATION

Area	Description	Specialized Advice/ Reforms Supported by Fund	Specialized Advice/ Reforms Supported by Bank
Support to PRS and accompanying JSANs	Together with other multi- and bilateral donors, Bank and Fund provided continuous technical assistance for completion of the full PRSP in 2003 and are providing support to the MAP.	Macroeconomic framework: growth, revenue, expenditure, trade projections.	Poverty analysis; rural poverty study; education and health sector work.
HIPC completion point reforms	Regular joint supervision missions; joint preparation of HIPC 'Tracking Poverty-Related Spending' assessment and action plan.	Reforms linked to budgetary accounting and controls.	Reforms in education, health, rural transport.
Public financial management	Joint missions analyzing fiscal management.	Tax analysis and reform, strengthening controls; expenditure management.	Budget formulation, expenditure monitoring and analysis, especially in sectors important for poverty reduction; procurement; strengthening internal and external controls.
Other governance reforms	The Government has embarked on a large governance reform agenda; Bank and Fund staff work closely with UNDP, EU, and AfDB staffs on assisting development of implementation plans.	Customs	Anticorruption agenda, decentrali-zation, judicial sector reform, and support to the customs action plan.

APPENDIX IV: MADAGASCAR—STATISTICAL ISSUES

1. Serious shortcomings in data provision hamper economic analysis and surveillance. Madagascar's database remains weak, particularly in the areas of real sector, government finances, the balance of payments, and social statistics. The authorities are aware of these deficiencies and are working, with technical assistance from the international community, including the Fund, to ameliorate them. Madagascar participates in the General Data Dissemination System (GDDS), and its metadata were posted on the Data Dissemination Bulletin Board (DSBB) on May 20, 2004. Since 2000, Madagascar has benefited from STA technical assistance missions in the following areas: balance of payments (June 2001); monetary and financial statistics (July 2001); multisector statistics (February 2004); and national accounts (February 2006).

Real sector

2. Production of complete national accounts (based on benchmark data) is infrequent and depends on irregularly collected source data. The last complete sets of benchmark data are for 1995 and 1984. For the intervening years, only estimates of GDP at current and constant (1984) prices broadly following the *1968 SNA* methodology have been produced. These estimates are revised frequently and are unreliable due to gaps in the source data and methodological shortcomings. In particular, the estimates of agricultural activities are poor because there is no suitable information about the size and the evolution of this sector. Moreover, service activities are not properly covered and little information is available on the magnitude of the informal sector. The February 2006 national accounts mission reviewed progress made by the statistical agency, INSTAT, since the 2002 multisector mission and helped the authorities complete a comprehensive exercise for 2001 GDP. INSTAT plans to complete the details of the 2001 national accounts exercise and use it as the passage to a new base year, 2005.

3. INSTAT currently produces two industrial production indices, one for the export processing zone (IPI-ZF) and the other for enterprises outside the export processing zone (IPI-RC). These two indices have different survey frameworks and base years (2000 for the IPI-ZF and 2001 for IPI-RC). Both are quarterly but are released irregularly, sometimes with a lag of up to one year.

4. A currently compiled consumer price index (CPI) covers the four principal cities, has a base year of 2000, and has expenditure weights based on the 1999 household survey. The CPI is generally reported to Fund staff on a timely basis. INSTAT plans to update the base year to 2005 and to derive new weights from the 2005 household expenditure survey in the near future. Data on producer prices and nationwide employment are not available. Various considerations underlie current work on revising the wholesale price index (WPI). The key

issue is the relative importance of commercial activities in the Malagasy economy. However, the utility of the WPI is reduced due to limited coverage of manufacturing products.

Government finance

5. The 2004 multisector mission found that data on central government financial operations are disseminated only annually, and data on public debt are not disseminated at all. The mission recommended monthly dissemination of central government data, and quarterly dissemination of the public debt data, but monthly reporting of both types of data to STA for publication in *IFS*. The mission also found significant gaps in the coverage of government financial statistics (GFS) and recommended that it be broadened to include public agencies that are part of the central government. Finally, the mission made recommendations for the classification and recording of transactions, as well as the calculation of domestic arrears.

6. The latest data reported to STA and published in the *GFS Yearbook* relate to the consolidated central government for 2004. However, they do not cover all extra budgetary units within the central government and classification problems remain, which require extensive use of adjustment entries to current expenditure. Moreover, since 1996, detailed breakdowns of data on budgetary and nonbudgetary transactions and central government debt have not been provided. Madagascar does not report sub-annual data for publication in *International Finance Statistics* (*IFS*).

Balance of payments

7. Since 1984, the Central Bank of Madagascar (BCM) has been in charge of compiling and disseminating balance of payments statistics: in 1997, it implemented the fifth edition of the *Balance of Payments Manual (BPM5)*. However, the current compilation system is flawed in many respects: external trade data are derived from customs data, which suffer from inadequate coverage and deficient recording procedures. Moreover, the significant amount of smuggling, particularly in the mining sector, further reduces the reliability of the trade data. Because the customs processing system has experienced numerous technical disruptions since 1998, the trade data have limited serviceability and require many manual corrections. The current implementation of the ASYCUDA (Automated System for Customs Data, Version 2.7) was largely completed by mid-2002, with the system installed in most customs offices. Plans to further upgrade the customs processing system to ASYCUDA++ throughout the country should be completed by end-2006.

8. The 2004 multisector technical assistance mission reviewed progress in the transition to *BPM5* and found that the authorities had implemented foreign direct investment enterprise surveys and are using an upgraded international transactions reporting system (ITRS). The mission noted that the compilation system is still hampered by such recurring issues as

excessive processing lags due to partial automation of customs reports and inadequate coverage of, for example, transactions for the private sector, NGOs, and foreign embassies. Also, debt relief obtained from multilateral financial institutions is still misclassified as a current transfer rather than as a capital transfer.

9. The EPZs that process goods and reexport them to a third economy are not properly identified within other business services (merchandising and other trade related services).

10. Although ASYCUDA and port authorities can provide separate data for freight, insurance and other categories, the current 12 percent c.i.f./f.o.b. correction for balance of payments statistics is entirely attributable to freight. Data for the services and income accounts rely excessively on the ITRS reports, their accuracy is not routinely assessed against other readily available data.

11. As noted by previous STA missions, INSTAT and the BCM continue to use different techniques to adjust customs data and publish two distinct series of trade statistics, bringing into question the reliability of Madagascar's balance of payments statistics.

12. The compilation of external debt statistics is generally satisfactory, and the United Nations Conference on Trade and Development (UNCTAD) is installing the latest version of the Debt Management and Financial Analysis System (DMFAS). This system is not yet fully operational; some data entry is still to be done, and certain DMFAS modules have yet to be installed.

Monetary and financial statistics

13. The 2004 multisector mission assessed the status of the 2001 mission's recommendations and made additional recommendations to improve monetary and financial statistics. It found that recommendations were still pending for: i) improvement of the staff and computer resources of the unit in charge of compiling monetary statistics; (ii) electronic transmission of monthly call report forms by the commercial banks to the BCM; and (iii) expansion of broad money survey to include the microfinance institutions that issue liabilities that meet the national definition of broad money. Furthermore, the mission recommended improvements to the source data and the compilation of monetary statistics in accordance with the Fund's *Monetary and Financial Statistics Manual (MFSM)* methodology.

14. Since August 2001, the BCM has reported monetary data to STA by e-mail for publication in *IFS*. After a brief interruption in 2002, regular data reporting resumed in July 2002. Data for the monetary authorities and deposit money banks through July 2006 have been published in the November 2006 *IFS* release. In August 2005 the BCM began reporting monetary data to STA using the new Standardized Report Forms.

Madagascar: Table of Common Indicators Required for Surveillance
As of November 15, 2006

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	Nov. 2006	Nov. 2006	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sept. 2006	Nov. 2006	M	M	M
Reserve/Base Money	Sept. 2006	Nov. 2006	M	M	M
Broad Money	Sept. 2006	Nov. 2006	M	M	M
Central Bank Balance Sheet	Sept. 2006	Nov. 2006	M	M	M
Consolidated Balance Sheet of the Banking System	Sept. 2006	Nov. 2006	M	M	M
Interest Rates[2]	Sept. 2006	Nov. 2006	Q and M	Q and M	Q and M
Consumer Price Index	Sept. 2006	Nov. 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	July 20066	Oct. 2006	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	July 2006	Oct. 200	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Dec 2005	Mar. 2006	A	A	A
External Current Account Balance	June 2006	Sept. 2006	Q	Q	Q
Exports and Imports of Goods and Services	June 2006	Sept. 2006	M	Q	Q
GDP/GNP	2005	Mar. 2006	A	A	A
Gross External Debt	Dec 2005	Mar. 2006	A	A	A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

Statement by the IMF Staff Representative
December 20, 2006

Since the issuance of the staff report (December 6, 2006), the following information has become available. The thrust of the staff appraisal remains unchanged.

- **Revenue shortfalls continue, but the revised end-year target remains within reach.** The authorities revised downward their preliminary estimate for taxes on wages at end-September by about MGA 2 billion (0.01 percent of GDP) based on actual data, implying that the quantitative indicative revenue target was missed by about the same amount. Budget execution data at end-September indicate that the quantitative indicative target on domestic financing of the central government was met. The authorities are confident that they will achieve their revised revenue objective for the year as a whole as they are redoubling their efforts to recuperate tax arrears. If these efforts are successfully implemented, the staff concurs that the revised revenue target can be met.

- **Inflation remains on track to meet the end-year target.** Consumer prices rose by 11.4 percent (year-on-year) in November, down from 13.6 percent in June, mainly due to a decline in nonfood inflation. The monetary program is on track as central bank net foreign assets are expected to be well above the floor and net domestic assets below the ceiling set for December.

- **Structural reforms are proceeding as expected, except for the modernization of customs bureaus.** The new customs software (a structural benchmark for September 30, 2006) has been deployed in two offices, but deployment in the remaining three offices is now scheduled for March 2007 owing to delays in the construction of buildings to house the new computer systems. The verification of at least 80 percent of outstanding VAT credits at end-June 2006 (a structural benchmark for December 31, 2006) has been completed and the remaining two structural benchmarks are expected to be completed by year end as planned.

- **Madagascar will benefit from the U.S. Congress's extension to 2012 of the Africa Growth and Opportunities Act's Third-Country Fabric Provision.** This provision, which applies to Madagascar and 13 other African countries, was scheduled to expire in September 2007.

- **Unofficial results indicate that President Ravalomanana was re-elected**. Complete, but unofficial, results indicate that incumbent President Marc Ravalomanana won the December 3 presidential election with close to 55 percent of the vote. The final results need to be confirmed by the Constitutional Court.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 06/297
FOR IMMEDIATE RELEASE
December 21, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under Madagascar's Three-Year PRGF Arrangement and Approves US$11.8 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the first review of Madagascar's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. This enables Madagascar to draw an amount equivalent to SDR 7.9 million (about US$11.8 million), bringing the total disbursement under the PRGF to SDR 15.7 million (about US$23.6 million).

The Executive Board approved the three-year arrangement on July 21, 2006 (see Press Release No. 06/163), for a total amount of SDR 55.0 million (about US$80.8 million) to support the government's economic program for 2006-2008.

Following the Executive Board's discussion of Madagascar's IMF-supported economic program, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, said:

"The Malagasy authorities are to be commended for the progress achieved in implementing their economic program in 2006. Despite higher world energy prices, real GDP growth remains solid and inflation, while still high, is declining. The balance of payments and international reserves positions have improved, with strong export growth despite the expiration of protected market access for certain textile exports.

"As continued shortfalls in tax revenue would limit the scope for additional priority spending, there is a need to increase tax revenues through the strengthening of tax policy and the modernization of tax collection. Comprehensive tax policy reform in 2007, aimed at simplifying and increasing the efficiency of the tax and customs codes, is, therefore, welcome. Ongoing tax and custom administration reforms also need to be intensified.

"The resources freed up by the Multilateral Debt Relief Initiative provide room for additional priority spending, in support of the Millennium Development Goals. The increased allocation of resources to priority sectors should be accompanied by steps to further strengthen public financial management.

“The Central Bank of Madagascar should maintain a tight monetary policy in order to achieve the inflation objective. In line with this, measures taken by the Malagasy authorities to strengthen the financial position of the central bank are welcome.

“Given the importance of the national public utility company (JIRAMA) for economic performance, the financial and technical problems of the utility should be addressed promptly. The authorities, together with their development partners, should play a lead role in financing the parastatal’s long overdue rehabilitation in order to attract a private concessionaire,” Mr. Lipsky said.

The PRGF is the IMF's concessional facility for low-income countries. It is intended that PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Statement by Laurean W. Rutayisire, Executive Director
for the Republic of Madagascar
December 20, 2006

I. Introduction

I also would like on behalf of my Malagasy authorities, thank management and staff for their support and constructive policy dialogue over the past year, which has led to the conclusion of the current PRGF-supported program. My Malagasy authorities are also grateful to the Executive Board for their continued understanding and support. They remain committed to implementing structural reforms and sound policies, in order to continue making significant progress in public expenditure management, in macroeconomic performance and in poverty reduction. This commitment has enabled them to satisfactorily implement the current PRGF-supported program in meeting all quantitative performance criteria at the end of July 2006. The structural performance criterion missed in July has since been observed and the remaining benchmark is also expected to be met by year end.

My authorities are committed to ensure that the program will remain on track through the rest of the year a part from the revenue target, due to the lower than envisaged of customs receipts as tax free export processing zone imports have been stronger than programmed. In view of such unexpected revenue shortfall, my authorities are requesting the Board's support for waiver and a downward revision of the performance criterion on tax revenue for December 2006, together with the completion of the first review and disbursement of the second loan under the three- year arrangement under the Poverty Reduction and Growth Facility.

My Malagasy authorities are strongly committed to pursue policies and measures set out in their PRGF-supported program and the Madagascar Action Plan, in order to reach stronger and more stable economic growth, enhance good governance and promote better public services. Notably as articulated in my authorities MAP, the 2007 Budget Law will be characterized by implementation of appropriate macroeconomic and structural policies and an increase in priority spending on agriculture, education, health, infrastructure, environment and justice. My Malagasy authorities are aware that the country faces difficult development challenges, owing in particular to exogenous shocks, institutional capacity constraints and weaknesses at the public utility company (JIRAMA). To this end my authorities will continue to deepen their regional integration efforts in order to increase their export diversification and resilience of Malagasy economy. They are also committed to restoring the financial viability of JIRAMA and transferring its management to a private operator.

II. Recent developments and program performance

Despite the rise in world oil and domestic energy prices, the real GDP for 2006 is expected to reach 4.7 percent, driven mainly by strong performance in construction, tourism and commerce. The export processing zones have also performed better than expected since the multi fiber arrangement expired. Inflation declined from 13 percent in June to 10.6 percent in September 2006, thanks to the decrease in food prices and tight monetary polices. Exports of goods and services increased by 18 percent, compared to the first half of 2005 and imports rose by 10 percent during the same period, in spite of the sharp increase in world oil prices. These developments, coupled with an increase in official transfers, resulted in a sizeable reduction of the current account deficit. Foreign reserves exceeded the targets and were equivalent to 2.9 months of imports. The exchange rate, supported by a stronger than envisaged export performance, has remained competitive.

In the fiscal area, tax collection until July was strong and expenditure was below the target set out in the program. In their efforts to improve tax collection, the authorities simplified the tax system and enhanced the tax administration. In this context, monitoring and control of the taxation of large enterprises have been stepped up. The elimination of ad hoc tax and custom duty has been pursued. On the expenditure side, the authorities' spending was below target owing to the delay in the approval by the Parliament of the revised Finance Law and the slower than expected in the execution of foreign-financed capital expenditure. As a result, domestic financing of the budget deficit was well below the program ceiling.

In December 2005, Madagascar qualified for debt relief under the MDRI. This achievement has led the World Bank and the African Development Fund, together with the Fund, to provide the country with a total MDRI relief amounting to US$2.3 billion, equivalent to 42 percent of GDP. Resources freed up by the MDRI are effectively used to fight poverty. Moreover, my authorities are undertaking needed actions to avoid accumulation of arrears and limit new foreign borrowing to concessionary loans, in order to strengthen the sustainability of the country's foreign debt.

As regards program performance, all quantitative performance criteria for end of July have been met. The domestic financing requirement was lower than planned, owing to the increase in tax and customs receipts exceeding program targets, while expenditure were contained. In addition, the net foreign assets exceeded their target and net domestic assets stood at below their ceiling. On the other hand, all structural performance criteria have also been observed, except the parliamentary approval of the supplementary finance law. It is worth noting that the authorities ordered an audit of public administration's VAT on capital expenditure through 2005, which was completed in September. Since July 2006, all transactions between the treasury and the central bank have been restricted to those specified in the central bank law. The information system to enhance the security of customs processing and curb frauds will be installed by the end of 2006. Along with the deployment of the information system, the authorities will complete by December 2006 an action plan and a schedule of measures in order to improve tax collection.

III. Medium-Term Policy Framework

Maintaining macroeconomic stability and pursuing the necessary structural reforms to address the challenges and weaknesses facing the economic remain at the center of my Malagasy authorities’ policy agenda. In this regard, the macroeconomic objectives set out for 2007 and 2008 are: (i) achieving a real GDP growth of 5.6 percent from 4.7 percent in 2006; (ii) bringing down inflation to 8 percent in 2007 and 6 percent in 2008; (iii) building up international reserves to cover three months of imports; (iv) keeping the fiscal deficit on a cash basis to less than 5 percent of GDP and (v) raising tax-to GDP ratio more than 10.7 percent target for 2006. My authorities are hopeful that investment will grow significantly with the implementation of structural reforms, construction and rehabilitation of infrastructure and the activation of large-scale mining and agricultural projects. Furthermore, buoyant exports, combined with a rebound of imports, including a return to normal levels of rice imports, will help stabilize the current account deficit around 10 percent of GDP.

In spite of significant progress made under the current PRGF-supported program, my Malagasy authorities are cognizant of the daunting challenges ahead and the vulnerability of Madagascar’s economy to a number of risks. They reiterate their commitment to prudent fiscal and monetary policies and sound reforms with the continued support and advice of the Fund and their development partners. They will pursue implementing their reform agenda, in order to consolidate the substantial achievements they have made so far and to promote sound and transparent management of their national resources.

Fiscal policy

The authorities will pursue reforms to improve the public financial management through (i) a tighter grip on macroeconomic management; (ii) a stronger role for the budget as an instrument for economic development; (iii) a major impact in the fight against poverty; (iv) higher-quality services to the public; (v) better use of the organic law of finance laws to enhance the effectiveness of government expenditure;(vi) better definition and use of indicators;(vii) more effective budget execution by streamlining budgetary procedures;(viii) more rigorous enforcement of budget execution and control regulations; (ix) improved monitoring of budget execution;(x) improved budget accounting and (xi) a major contribution to better governance. In the short-term, the principal fiscal policy target is to reduce net domestic financing, in order to keep domestic indebtedness sustainable. In 2007, the objective is to significantly increase tax revenue by 0.5 percent points of GDP, compared to 2006. With the full application of the Organic Law on Budget Laws, the major challenge for 2007 is for the budget to play its role as the means of implementing the Madagascar Action Plan (MAP) strategies. In addition, the authorities plan to reform the tax and customs codes, in order to make them more supportive to investment, broaden the tax base and move away from special regimes and incentives. These crucial steps will be implemented with the IMF, the World Bank and other donors’assistance.

Monetary Policy and Financial Sector Development

The authorities will continue to implement a monetary policy geared to achieving inflation target in a flexible exchange rate environment. Indeed, the authorities are aware of the need to achieve low inflation, which will help enhance confidence and facilitate sustainable growth. Therefore, indirect monetary instruments will be widely used in managing the banking sector liquidity such as the bank rate, reserve requirements and operations to inject or mop up liquidity on the money market. In addition to meeting the inflation target, the authorities will also seek to attain the foreign exchange objective, while allowing enough growth of credit to the economy, in order to sustain a strong economic growth. Moreover, to make the central bank more financially viable in line with the recommendations of the Safeguards Evaluation, the authorities will implement their action plan with technical assistance from the IMF. Regarding the financial sector development, the recommendations contained in the 2005 FSAP will be fully implemented, notably the strengthening of the financial sector supervision.

Reform of public enterprises

In this area, restoring the financial viability and operational efficiency of the national utility for power and water services (JIRAMA) will be at the center of my authorities' efforts with the support from the World Bank and IFC. In this regard, they intend to increase the role for the private sector, including through the public-private partnerships. The authorities' program to sell or liquidate state-owned enterprises will be pursued. This program schedules for 2006-07 the liquidation of 22 public enterprises evolving mainly in the sectors of distribution, transport and wood industry. As for the airports management company, the strategic orientation report presented by IFC on the franchising of 12 airports is under consideration. Regarding the southern rail network, a leasing option is preferred and a report on its economic and financial state is expected in 2007.

Social Policies and Poverty Reduction

My authorities are committed to improving the standard of living of the population and enhancing the economy's competitiveness. To this end, they will continue to make special efforts in the fields of education, health and infrastructure. The resources freed up under the MDRI debt relief will be allocated to these fields in line with the PRSP and the MAP.

Trade Policy

Trade liberalization will continue through the regional integration process and the implementation of an appropriate trade policy. My authorities plan to strengthen Madagascar's integration into the Southern African Development Community. In this respect, the majority of customs duties on products from SADC members have been eliminated. A study on economic impact of a uniform nonzero customs tariff and other options will be undertaken in 2007 with a view to enhance the regional integration.

Governance

The process of democratization has continued to solidify as Madagascar's population went to presidential elections on December 3, 2006 as scheduled. Parliamentary, regional and municipal elections will also be held as scheduled in 2007.

Further steps in the area of governance will be further intensified in 2007 through; (i) a public opinion survey to assess the impact of the operations conducted by the Independent Anti-Corruption Bureau (BIANCO); (ii) setting up of an anticorruption unit in each ministry;(iii) stepped up enforcement measures and (iv) focusing of investigations in 2006-07 on the key economic sectors. In the Justice sector; the authorities'aim is to establish an effective and impartial judiciary system. Given the growing importance of mining and oil sectors, the authorities have decided to adhere to EITI, as it is an important step towards greater transparency and good governance. In this context, they will accelerate the implementation of their obligations under this initiative.

IV. Conclusion

My Malagasy authorities highly value the continued support and policy advice they benefited from the Fund over the past years. They are also very appreciative for the valuable technical assistance they have received. They remain committed to economical and financial reforms needed to sustain high growth and reduce poverty and achieve the MDGs. They will continue to require a strong support from the international community in their efforts to enhance macroeconomic stability, sustain competitiveness and improve the business environment for private sector-led growth. Therefore, I would like to seek the Executive Board's support of my authorities' reform efforts, including their request for waiver for the structural performance criterion on the issuance of revised expenditure ceilings, so that this first review under the PRGF arrangement can be completed.