

**International Monetary Fund**

[Republic of Madagascar](#) and the IMF

**Republic of Madagascar: Letter of Intent**

September 29., 2004

**Press Release:**  
[IMF Approves In Principle Fifth Review Under Madagascar's PRGF Arrangement and Approves US\\$16.6 million Disbursement](#)  
October 18, 2004

The following item is a Letter of Intent of the government of Republic of Madagascar, which describes the policies that Republic of Madagascar intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Republic of Madagascar, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

[Country's Policy Intentions Documents](#)

**E-Mail Notification**  
[Subscribe](#) or [Modify](#)  
your subscription

Antananarivo, September 29, 2004

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

Dear Mr. de Rato:

1. In the context of the Poverty Reduction and Growth Facility (PRGF) arrangement, approved by the IMF Executive Board on March 1, 2001, the government of Madagascar and Fund staff held the discussions for the fifth review in two stages during the period June 29-July 5 and September 3-10, 2004. The discussions focused primarily on economic and financial developments during the first seven months of 2004, structural reforms under way, and on policies and the economic outlook for the rest of the year and 2005. The first progress report on the implementation of the poverty reduction strategy paper (PRSP) was also discussed, in collaboration with World Bank staff. The broad targets for the macroeconomic and budgetary framework for 2005 were agreed on, but discussions on some details are ongoing with Fund staff and will be further deepened during a mission scheduled for December 2004.

**A. Economic and financial developments in the first seven months of 2004**  
**Economic activity, prices, and balance of payments**

2. Madagascar was confronted with exceptional exogenous shocks during the first months of 2004. In January, and then again in March, Madagascar was hit by two particularly violent cyclones, which destroyed or damaged more than 1,000 public buildings (including schools and health centers), leaving over 300,000 people without shelter, and affecting agricultural production. During the first five months of 2004, the Malagasy franc (FMG) fell by about 50 percent against the euro. Factors that contributed to the sharp depreciation included: (i) the correction of a previous overvaluation during 2001 through the second half of 2003; (ii) strong imports as a result of higher international petroleum prices, increased government capital expenditures following the cyclones and acceleration of the execution rate, and an acceleration of private imports in response to the tax and tariff exemptions on consumption and durable goods introduced in September 2003; and (iii) weak exports, stemming from the impact of two cyclones on vanilla and shellfish exports and lower than usual repatriation of export proceeds during the first months of 2004. The foreign exchange market reached a turning point in early June, as import demand weakened and a package of fiscal, monetary, and structural policy measures was implemented to contain inflationary pressures and reduce volatility of the interbank foreign exchange market.

3. Inflationary pressures have intensified and constitute a major source of concern. Consumer price inflation accelerated rapidly from around zero at the beginning of the year to over 17.7 percent (on a year-on-year basis) at end-July, reflecting the impact of the cyclones on agricultural output, high international rice and petroleum prices, and the partial pass-through of the depreciation of the currency during the same period. Excluding rice and petroleum, the price of which increased by 42 percent and 66 percent respectively over the period, inflation stood at 6 percent in July 2004 (on a year-on-year basis). Since the beginning of September, the price of rice has started to decrease following actions taken by the government to facilitate distribution and strengthen competition in the rice sector. Following these actions and other important policy adjustments, discussed below, we intend to secure a reduction of inflation to under 15 percent (on a year-to-year basis) in December 2004.

4. Economic growth is expected to be lower than programmed in 2004. Despite a better than expected performance of the Export Processing Zones (EPZs), which are expected to grow by 28 percent in 2004, and of the tourism and construction sectors, real GDP growth is expected to reach 5.3 percent in 2004 (compared with 6 percent under the program), reflecting the adverse impact of the cyclones and the sharp increase in the cost of inputs.

5. Despite these shocks, Madagascar is making good progress in implementing its poverty reduction strategy. The PRSP progress report was submitted to Fund and World Bank staffs in July 2004. It presents, inter alia, results achieved during the past year, lessons learned, challenges facing our policy makers, and an action plan for 2004-05. The PRSP process continues to be participatory and open. An intermediate progress report covering the first six months of implementation was discussed in six regional workshops held between March and May 2004, involving a wide range of stakeholders (including the private sector, donors, NGOs, and government).

6. Three quantitative performance criteria for end-March 2004 have been met, in addition to the three indicative targets. The performance criterion on the floor on net foreign assets was missed, as the central bank was unable to accumulate sufficient foreign exchange in the context of the sharp depreciation of the FMG. The criteria on tax revenue and the ceiling on domestic financing of the government were missed. While our government undertook several steps to rein in non-essential spending, these two criteria were missed, due to increased domestically financed investment expenditures following the two cyclones (amounting to FMG 45 billion) and the negative impact of the cyclones on revenue (estimated at around FMG 30 billion). In addition, the end-March 2004 performance criterion on non-accumulation of domestic arrears was missed by a small margin, following the accumulation of FMG 7 billion arrears vis-à-vis TELMA, the telecommunications company. These arrears were cleared in June, when the privatization of the company was completed. Moreover, the structural performance criterion on the completion of the bidding process for the privatization of the cotton company, HASYMA, was missed. Five companies expressed interest, but only one bid was received, and had to be rejected, since the bidder did not comply with the terms and conditions (in particular, it asked for HASYMA's debt to be taken over by the government). The structural benchmark on the replacement of the existing system

of exchange rate determination by a continuous interbank trading system was missed for technical reasons, as some of the major banks were not ready to move to the new electronic system.

7. At end-June 2004, all quantitative indicative targets were met, except for those pertaining to net foreign assets and tax revenue. The end-June structural performance criterion on the completion of the bidding process for the selection of the company that will manage the sugar company, SIRAMA, was met.

8. In view of the shocks Madagascar faced in the first half of 2004 and the ambitious corrective actions taken, in particular to bring the revenue performance back on track (see below), the government requests a waiver for the nonobservance of the end-March 2004 performance criteria for net foreign assets, tax revenue, net domestic financing of the government, and non-accumulation of domestic arrears. The government also requests a waiver for the nonobservance of the end-March 2004 structural performance criterion for the completion of the bidding process for the privatization of the cotton company, HASYMA. Furthermore, the government wishes to request a modification of the end-September 2004 performance criteria, to reflect the recent macroeconomic developments.

### **Money and credit**

9. The central bank acted to contain the inflationary pressures and reduce volatility on the interbank foreign exchange market. It raised its base rate from 7 to 16 percent in three stages (in April, June, and September) and increased the reserve requirements on demand deposits (from 12 to 15 percent). At the same time, the central bank took other measures, including reducing banks' maximum net open foreign exchange positions from 20 to 10 percent, and lowering the risk concentration limit from 30 percent to 25 percent. In response to these measures, excess liquidity in the banking system decreased sharply. However, banks were able to raise some liquidity by unwinding their stock of Treasury bills.

10. To meet its liquidity objective, the central bank discontinued in July the practice of outright purchase of treasury bills from banks on demand and further tightened monetary policy, by imposing a 15 percent reserve requirement on previously exempted savings and time deposits as well as foreign exchange deposits. The central bank also expanded its intervention instruments. On August 27 and September 16, 2004, it carried out reverse auctions in amount of FMG 170 billion and FMG 265 billion, respectively. As a result of these measures, (i) the foreign exchange market stabilized, notwithstanding very limited interventions by the central bank; and (ii) private sector credit denominated in foreign exchange started to unwind.

11. Interest rates have begun to edge upward. Weighted treasury bill rates rose from 10.7 percent in June to 11.6 percent in July, but remained below ex-post inflation.<sup>1</sup> While two banks responded to the August 27 reverse auctions (with total bids in an amount of FMG 270 billion at interest rates ranging from 13 percent to 13.5 percent), four banks responded to the September auction (with total bids in an amount of FMG 315 billion at interest rates ranging from 13.5 percent to 18 percent).

12. During the first half of the year, M3 grew faster than the program target, reflecting the 17.8 percent increase in credit to the private sector (including the effect of the depreciation on the domestic currency value of credit denominated in foreign currency). Credit in foreign currency increased during the first four months of the year, in conjunction with the financing of vanilla exports, which were delayed because of the cyclones. Credit in local currency also increased, starting in May, in particular those granted to oil companies to finance their imports and short-term credit to enterprises. Reserve money decreased by 3.9 percent during the first half of the year. This was lower than the program target, due to the lower-than-expected accumulation of foreign exchange reserves. Overall, maintaining control over banking sector liquidity and reining in inflation remain central concerns.

### **Public Finance**

13. **Fiscal targets were broadly met during the first six months of 2004, except for fiscal revenue.** The indicative target on domestic financing of the government was met in spite of the impact of the cyclones on domestically financed reconstruction expenditures (which increased by an estimated FMG 90 billion) and on revenue (which decreased by an estimated FMG 42.5 billion). Tax revenue in FMG did not increase despite the sharp depreciation due to the impact of the tax exemptions and persistent weaknesses in tax administration. The government was able to contain non-priority and noninterest current expenditures below the program target, due mainly to a prudent wage policy and the reining in of other non-interest current expenditures. Notwithstanding the surge in inflation and a 16 percent increase in the private sector minimum wage, the government was able to resist demands for a wage hike in the public sector beyond what is included in the 2004 budget.

### **Structural Reforms**

14. The implementation of the government's priority action plan for 2004, which aims at operationalizing the public finance reform program, is well under way. In the fiscal area, the objectives are to strengthen the budget preparation, align the budget closer to PRSP priorities, and improve the budget execution process (with a view to strengthening the tracking of poverty reducing expenditures). Other important reforms that are being implemented include: (i) promulgation of a new legislative framework for public finance;

---

<sup>1</sup> However, excluding volatile rice and petroleum from the consumer price index, real interest rates remained positive.

(ii) implementation of the recommendations of the independent audit of the Treasury and strengthening of the Treasury accounting system; (iii) comprehensive overhaul of the procurement system (a new Procurement Code was passed by Parliament in July 2004); (iv) strengthening of the internal and external control mechanisms, including increased staffing in the institutions in charge of controlling public entities; and (v) setting up of a specific penal chain for corruption cases, which should help strengthen the judicial system. Public enterprise reforms are discussed in paragraphs 6, 7 above, and 26 below. Governance issues are discussed in paragraph 27. Oil prices were liberalized in July, well before the original target date of end-2004.

15. The government is committed to letting the exchange rate be market determined, and will only intervene on the foreign exchange market to dampen sharp swings in the exchange rate. In this context, the government has introduced a new continuous inter-bank foreign exchange market system in July 2004, and while traded volumes have remained in line with those observed during the same period last year, the central bank has significantly reduced its interventions. Exchange rate volatility was fairly limited, and the new system allows for a continuous quotation not only of the Euro but also of the US dollar, which should help reduce transaction costs. Furthermore, in order to deepen the foreign exchange market, a new decree mandates that all foreign exchange transactions to go through the inter-bank foreign exchange market (MID).

## **B. Outlook for the Rest of 2004 and for 2005**

### **Public finance**

16. The government is committed to implementing a tight fiscal policy, with a view to limiting the second-round effects of the supply-side and exchange rate shocks on inflation and reach the PRSP objective of a 5 percent inflation rate by end 2005 (on a year-on-year basis). To this aim, the government has already taken strong measures, including a 10 percent reduction in non-wage current expenditures, while preserving priority expenditures, and continuation of a prudent wage policy. In particular, no increase in wages nor in benefits beyond those included in the finance law will be granted in 2004. Further, in August 2004, VAT exemptions granted in 2003 on imports of non-investment goods (with the exception of refrigerators and medication) were rescinded, which are expected to increase the revenue in the second half of 2004 by an estimated FMG 60 billion and should help curb the shortfall in fiscal revenue linked to the exemptions.

17. Moreover, additional revenue measures taken to achieve the tax revenue-to-GDP target of 11.2 percent in 2004 include: (i) introduction of anti-corruption measures in the tax and customs departments; (ii) tightening conditions for importers that benefit from a customs duties advance scheme, through the tightening of the eligibility conditions to the scheme and a reduction in its maximum length to one month; (iii) acceleration of customs clearance procedures, notably through an increase in the selectivity of controls; (iv) regular rotation of customs agents (250 agents, equivalent to 25 percent of customs agents, have been reassigned in the last three months, with a view to breaking up some of the corruption

networks); and (v) establishment of performance contracts for customs agents. The tax department has also reinforced its tax recovery efforts, mainly through the acceleration of the recovery of tax arrears, and more systematic information sharing with the public procurement office. These measures have already led to an improvement in revenue performance, as evidenced by preliminary revenue data for July and August, which exceeded original projections by FMG 78 billion and FMG 11 billion, respectively. This indicates that the revenue performance is back on track, and that the targets on tax revenue at end-September and for the year as a whole can be met.

18. Budget execution during 2004 was complicated by the under-budgeting of certain expenditures. Expenditure reallocations in an amount of FMG 101 billion became necessary to ensure that our contractual obligations could be met. The 2005 finance law aims to address this issue in order to avoid the recurrence of similar problems in 2005 (see para. 20 below).

19. Over the remainder of the year, the revenue measures taken so far, coupled with a higher than expected domestic currency value of foreign assistance due to the depreciation of the national currency, would allow for FMG 448 billion (some 1.1 percent of expected GDP) repayment to the domestic financial system. Nevertheless, the domestic balance is expected to worsen slightly, owing to a rise in interest outlays following the increase in the base rate and higher domestically financed capital expenditures in priority sectors (such as education and infrastructure), as the execution rate increased and cyclone-related damages were repaired (overall, almost 1,900 classrooms were built or rebuilt in 2004, and about 550 km of roads constructed).

20. The 2005 budget will adhere to the following broad guidelines. In part due to the phasing-out of domestically financed capital expenditures related to cyclones, and in view of the objective of containing inflation, the domestic balance will be limited to FMG -205 billion, a strengthening of about 1 percent of GDP vis-à-vis the 2004 objective. To achieve this objective, a further gradual increase in the revenue-to-GDP ratio (from 11.2 percent in 2004 to 11.8 percent, consistent with a total objective of FMG 5,423 billion in fiscal revenue, of which FMG 2,683 billion will come from customs revenue) will be required, reflecting the full effect of the tax administration measures taken in 2004, the installation of the most recent ASYCUDA software by UNCTAD (the test phase of the new software is expected to start in December 2004), and the rescinding of remaining tax and tariff exemptions granted in 2003, which is expected in September 2005. Moreover, the following additional measures will be taken: (i) elimination of the customs duties advance scheme (excluding credit for warehouse fees “*crédit d’enlèvement*”), starting in 2005; (ii) reassessment of the specific imports regime; (iii) reassessment of previously granted ad hoc customs exemptions, with a view to reducing them by 20 percent; (iv) mandatory payments of customs duties through the banking system; and (v) elimination of the immunity of customs agents from enquiries and prosecution (Article 4, section 3 of the customs code). These measures are expected to increase fiscal revenue by FMG 216 billion. In addition, customs duties and import taxes will be merged into a single tax starting in 2005. On the expenditure side, the continuation of a prudent wage policy will be required, and the wage bill will be contained to 5 percent of GDP but accommodate increased staffing in priority

sectors (fight against corruption through the setting up of the anti-corruption bureau and increased staffing for the institutions in charge of controlling public entities, judiciary system and customs, creation of new positions to improve domestic security and strengthen the “education for all” program and the health system). Starting in 2005, the Ministry of Defense’s payroll and wage bill will be managed by the Ministry of Finance, as is already the case for the other ministries. Furthermore, nonwage current expenditure will be maintained at 3.5 percent of GDP.

21. Madagascar should continue to benefit from significant external support in 2005, particularly for investment expenditures. Budgetary support is expected to reach SDR 86.5 million (SDR 40 million in loans and SDR 46.5 million in grants). This should enable our government to incur no new net domestic debt in 2005.

### **Monetary Policy**

22. The objectives of monetary policy will be to contain inflation and excess exchange rate volatility. A significant drop in excess liquidity, the recent increase in interest rates on treasury bills, and the recent appreciation of the exchange rate all point to a tightening of monetary conditions. At end-July 2004, three banks have failed to meet the reserve requirements and have been penalized. The monetary program aims for a 12.6 percent increase in broad money (M3) in December 2004 (on a year-on-year basis), consistent with a small increase in velocity from 4.0 at end-December 2003 to 4.1. Given the impact of rising interest rates on velocity and a repayment of FMG 425 billion in statutory advances to the Treasury, reserve money is targeted to decline by 1.4 percent at end-December 2004. The central bank will take additional measures, as needed and in close consultation with Fund staff, to secure the reserve money target and the inflation objective. To manage liquidity, the central bank will further use reverse auctions, should the need arise. The central bank continues to monitor developments on the new continuous interbank foreign exchange market, with a view to improving its efficiency. In this context, the central bank will ensure that it receives all the information required to implement its foreign exchange policy. The Board of Directors of the BCM will issue a resolution establishing the operational guidelines for BCM’s intervention in the foreign exchange market before the end of 2004.

23. The central bank is committed to strengthening its liquidity management and avoiding inconsistency in the use of monetary policy instruments. We welcome and have started to implement Monetary and Financial Systems (MFD) recommendations presented during the June/July 2004 mission. These included: (i) strengthening BCM’s ability to forecast liquidity and foreign exchange cash flow; (ii) widening the BCM’s instruments to manage liquidity, including through the use of standard and reverse auctions, and, in the medium term, after taking account of the budget financing needs, of the securities issued following the conversion of the Treasury’s debt vis-à-vis the central bank into marketable securities; (iii) strengthening coordination between the treasury and BCM. In particular, weekly meetings are now held between officials from the Ministry of Finance and the central bank to assess and update the Treasury financing needs for the period ahead; and (iv) developing the money market. Regarding the latter, commercial banks have already



started to engage in interbank transactions, in order to meet the reserve requirements, as the central bank discontinued its policy of buying treasury bills from banks on demand.

24. Recommendations of the safeguards assessment report are being implemented. The draft law on foreign exchange regulations is expected to be sent to Parliament during its first session in 2005. Significant progress has also been achieved toward the adoption of a new accounting framework and the Ariary as the unit of account starting January 1, 2005. In this context, the new accounting framework for the central bank, as well as for other financial institutions, is expected to be examined by the High Accounting Council in October 2004 to ensure its consistency with accounting rules. Finally, in September 2004, Madagascar requested to participate in the Bank-Fund Financial Sector Assessment Program (FSAP).

### **Balance of payments and exchange rate**

25. For the rest of 2004, uncertainties remain regarding the balance of payments. While imports are declining, there is a risk that continued increases in the international prices of rice and petroleum products and falling vanilla prices on the international market could weaken the balance of payments further. Furthermore, the extent to which recent developments reflect temporary or permanent adjustments in the current account remains unclear. Nevertheless, the government is confident that exports will pick up in response to recent gains in competitiveness, as evidenced by the strong performance of EPZ.

26. The government's trade policy objectives are to improve competitiveness, reestablish the country's reputation as welcoming to foreign investors, and integrate Madagascar into the regional and global economy. To achieve these objectives, the government (i) simplified the tariff structure, lowered the weighted average tariff rate, and reduced the top tariff rate from 33 percent to 25 percent; (ii) exempted imports of capital goods from tariffs; (iii) began reforming customs operations and port procedures; (iv) streamlined procedures for approval of investment projects through the creation of a one-stop counter for foreign investment related formalities; and (v) simplified the cumbersome regulations on subcontracting of EPZ operations to small local firms. The government is also actively participating, with other 15 COMESA members, in negotiations for an Economic Partnership Agreement (EPA) with the EU. Madagascar has officially joined the Southern Africa Development Community (SADC) in August 2004 and preliminary work is ongoing to ensure the country's full integration into this economic zone over the course of 2005. These measures, combined with a market determined exchange rate, are expected to help integrate Madagascar into the world market.

### **Structural reforms**

27. The government's public enterprise reform program is back on schedule. The privatization of the telecommunications company, TELMA, was completed in June 2004. The private company that will manage the sugar company, SIRAMA, was selected at end-June 2004. The government has re-launched the bidding process for the purchase of the cotton company, HASYMA, in early June with World Bank support, and the privatization is

expected to be completed by end-September 2004. Completion of this bidding process is a prior action for Board consideration of the fifth review. The company that will manage the energy company, JIRAMA, is expected to be selected by October 2004. Moreover, the transportation sector was also liberalized and 74 operators were granted preliminary licenses, resulting in a containment of transportation prices, especially in the capital Antananarivo.

28. The government continues to see improving governance as a key policy priority, and some progress has been secured. In particular, new legislation has been passed by Parliament in July allowing for the creation of an independent anti-corruption bureau of 100 agents. The hiring of its staff, especially the general director and the deputy general director, expected in September 2004, is a prior action for Board consideration of the fifth review. The bureau will be responsible for investigating (but not for prosecuting) corruption cases, and will conduct education and prevention campaigns. The government will also conduct independent audits of randomly selected investment projects and of specific public services. Furthermore, the government is committed to improving the operational efficiency of the commercial sections of the lower courts, reinvigorating its judicial reform strategy, and better prioritizing its action plan, with a view to accelerating our judicial reform agenda.

### **C. Program Monitoring**

29. The program supported by the IMF under the PRGF will be monitored through semiannual reviews, and through quantitative and structural performance criteria and benchmarks, indicative targets, and quarterly monitoring indicators. Table 1 contains the structural performance criteria and benchmarks for the fifth review of the PRGF-supported program. The following measures constitute prior actions for completing the fifth review under the PRGF arrangement: (i) hiring of staff and beginning operation of the Independent Anti-corruption Bureau; and (ii) completion of the bidding process for the privatization of the cotton company, HASYMA.

### **D. Consultation with the IMF**

30. The government believes that the policies set forth herein are adequate to achieve the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Madagascar will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in our Letter of Intent and its attachments, in accordance with the Fund's policies on such consultation.

Sincerely yours,

Benjamin Radavidson  
Minister of Economy, Finance, and the Budget  
Antananarivo, Madagascar

Gaston Ravelojaona  
Governor  
Central Bank of Madagascar  
Antananarivo, Madagascar

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets  
for 2004 under the PRGF Arrangement  
(In billions of Malagasy francs, unless otherwise indicated) 1/

	2004									
	March Performance Criteria			June Indicative			September Performance Criteria		December Indicative	
	Program 2/ 12:07 PM 30-Sep-04	Adjusted	Actual	Program 2/	Adjusted	Actual	Program 2/	Revised Program	Program 2/	Revised Program
<b>I. Quantitative performance criteria</b>										
(a) Ceiling on external arrears (in millions of SDRs) 3/	0.0		0.0	0.0		0.0	0.0	0.0	0.0	0.0
(b) Floor on net foreign assets (NFA) of the central bank 3/ 4/ 5/ 6/	221.8	215.1	166.9	80.9	103.0	-139.9	941.7	1,132.1	869.8	918.7
(c) Ceiling on net domestic assets (NDA) of the central bank 5/ 6/ 7/	23.5	30.2	-176.1	249.0	226.9	13.7	-561.0	-463.8	-455.3	-219.6
(d) Ceiling on domestic financing of the government 7/ 8/	-83.3	-76.6	-2.3	108.7	94.2	68.7	-65.1	-550.3	-315.1	-659.5
(e) Ceiling on contracting or guaranteeing of external debt on nonconcessional terms 9/	0.0		0.0	0.0		0.0	0.0	0.0	0.0	0.0
(f) Floor on tax revenue	1,010.5		997.6	2,164.3		2,125.6	3,120.3	3,191.3	4,210.0	4,417.9
(g) Ceiling on accumulation of domestic arrears	0.0		7.0	0.0		0.0	0.0	0.0	0.0	0.0
<b>II. Indicative targets</b>										
(h) Ceiling on reserve money	236.3		-92.9	320.9		-137.5	371.7	-79.5	405.6	-49.5
(i) Ceiling on broad money (including foreign currency deposits) (M3)	617.6		164.1	838.1		356.9	970.5	980.1	1,058.7	1,071.7
(j) Floor on arrears payments	140.8		230.0	175.3		271.6	302.0	287.0	347.3	347.3
<b>III. Memorandum items:</b>										
(k) Budget support grants and loans (in millions of SDRs)	18.0		18.0	30.1		32.1	119.7	118.7	141.2	139.7
(l) External cash debt service (in millions of SDRs)	8.2		8.9	24.9		25.2	33.6	29.3	55.9	42.4
(m) External privatization proceeds	0.0		0.0	0.0		7.5	0.0	7.5	0.0	7.5
(n) Total privatization proceeds	2.2		10.1	23.4		127.1	46.0	127.1	72.8	136.1
(o) External privatization related costs	0.0		0.0	0.0		0.0	0.0	0.0	0.0	0.0

1/ Cumulative change since end-December.

2/ EBS/04/33, (03/3/04). Note that the original program for 2004 was written based on projections of end-December.

3/ Excludes all debt service outstanding that is subject to rescheduling. During the program period, the government will not accumulate any new arrears.

4/ Defined as gross reserves minus all foreign liabilities of the BCM, both long and short term, including use of Fund credit, evaluated at the program exchange rate.

5/ Adjusted for any excess disbursements of external budget support (grants and loans; in millions of SDRs) relative to the cumulative amounts indicated in III.

6/ Adjusted for any deviation from programmed amounts of privatization receipts from abroad, net of privatization-related outlays.

7/ Adjusted for the impact of exchange rate changes.

8/ Defined as bank and nonbank financing plus treasury correspondent account (net), privatization receipts, and net accumulation of arrears.

9/ Excluding normal import-related credits.

Table 2. Structural Performance Criteria and Benchmarks  
for the Fifth Review of the PRGF-Supported Program

	Timing	Status
<b>Structural performance criteria</b>		
Submission of draft budget execution laws for 2000 and 2001 to the Audit Court.	By end-December 2003	Done
Completion of the bidding process for the purchase of HASYMA.	By end-March 2004	Not met
Completion of the bidding process for the selection of the company that will manage SIRAMA.	By end-June 2004	Done
No tax or tariff exemptions will be granted beyond those specified in the 2004 budget law.	Continuous	Done
<b>Structural benchmarks</b>		
Publication of the BCM's 2001, 2002, and subsequent financial statements and attendant audit opinions in the <i>Journal Officiel</i> , and/or other official outlets and the BCM website.	By end-March 2004	Done
Replacement of the existing system of exchange rate determination by a continuous interbank trading system.	By end-March 2004	Not met

Table 3. Structural Performance Criteria and Benchmarks  
for the Sixth Review of the PRGF-Supported Program

	Timing	Status
<b>Structural performance criteria</b>		
No tax or tariff exemptions will be granted beyond those specified in the 2004 budget law.	Continuous	
Issue a resolution approving the newly installed ASYCUDA ++ software and setting a date for the use of the software by customs.	End-December 2004	
<b>Structural benchmarks</b>		
Issue a resolution by the Board of Executive Directors of the Central Bank (BCM) establishing the operational guidelines for BCM intervention in the interbank foreign exchange market (MID).	End-December 2004	
Publish the BCM's complete audited financial statements for 2003.	End-December 2004	
<b>Prior action for Board consideration of the fifth review</b>		
Hire staff and begin operation of the Independent Anti-corruption Bureau.		
Complete the bidding process for the privatization of the cotton company, HASYMA.		

## **MADAGASCAR**

### **Technical Memorandum on Monitoring the 2004 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 and benchmarks for the program, how they are calculated, and any adjustments deemed necessary. It also explains the monitoring variables, that is, anticipated balance of payments assistance and direct investment flows connected with the privatization of public enterprises. Unless otherwise indicated, in the case of stocks, variables for end-June 2003, end-September 2003, and end-December 2003 are expressed as cumulative variations from December 31, 2002 onward, and in the case of flows as cumulative flows from January 1, 2003 onward. Variables for 2004 are expressed as cumulated variations from December 31, 2003 in case of stocks, and cumulated flows from January 1, 2004 onward, in the case of flows. The objectives for end-September 2003 and end-June 2004 are benchmarks; those for end-June 2003, end-March 2004, and end-September 2004 are performance criteria.

#### **I. QUANTITATIVE CRITERIA**

##### **A. Ceiling on External Payments Arrears**

2. This variable is expressed in terms of the stock of arrears. These arrears will consist of all overdue debt-service obligations (i.e., payments of principal and interest) arising in respect of loans contracted or guaranteed by the government or the Central Bank of Madagascar, (BCM) including unpaid penalties or interest charges associated with these arrears, excluding arrears resulting from nonpayment of debt service for which rescheduling negotiations are under way. This performance criterion should be observed on a continuous basis.

##### **B. Ceiling on Nonconcessional External Borrowing**

###### **Definition**

3. The nonaccumulation of nonconcessional debt contracted or guaranteed by the government is a performance criterion. Nonconcessional external debt is defined as having 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 contractual arrangement by the government of Madagascar or guaranteed by the government of Madagascar, but it excludes debt contracted under rescheduling agreements and normal import-related credits of less than one year.

### **Calculation method**

4. Calculation of the degree of concessionality of new external borrowing is based on the ten-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 difference between gross international reserves and all foreign liabilities of the BCM, including debt to the IMF and other short- and long-term liabilities of the BCM. Gross international reserves are defined as assets in convertible currency that are readily available to, and controlled by, the BCM for financing payments imbalances, excluding assets that are pledged, collateralized, or otherwise encumbered.

#### **Calculation method**

6. For purposes of calculating this criterion, NFA must be converted into Malagasy francs (FMG) at the program exchange rate.

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

#### **Definition**

7. The BCM's NDA include net credit to the government, credit to enterprises and individuals, claims on banks, liabilities to banks in the form of central bank deposit auctions (*appels d'offres négatifs*), and other items net, excluding the foreign exchange adjustment item.

8. Foreign exchange deposits and credits must be converted into Malagasy francs at the program exchange rate.

9. For the purposes of the program, NDA will be adjusted for changes in the reserve requirement in an amount equal to the change in percentage points in the reserve requirement times the amount of deposits held by the public with the commercial banks.

### **E. Ceiling on the Net Domestic Financing Requirements of the Central Government (CG)**

#### **Definition**

10. Net domestic financing requirements of the central government are defined as the sum of (a) the variation in the stock of the central government's domestic debt to the banking and nonbanking system, and variation in net debt to treasury correspondents; (b) domestic or foreign receipts from privatization operations, as defined in Section III.B of this technical memorandum; and (c) the variation in central government domestic arrears. Central government (CG) corresponds to the scope of operations of the treasury as indicated in the overall treasury operations table (*opérations globales du Trésor*, or OGT). The change in deposits of the treasury correspondents (*correspondants du Trésor*) is considered a component of domestic financing.

11. The variation in the stock of domestic payments arrears consists of the amount to be recommitted and net payments delays (clearings, items in process of payment, and expenditure committed but with no payment orders issued), as defined in the OGT.

12. Net bank claims consist of BCM and commercial bank claims on the CG, including auctioned treasury bills (BTAs) and other treasury bills and liabilities, net of CG deposits with the BCM and commercial banks, including foreign currency deposits. The change in net bank claims is defined to exclude the impact of exchange rate changes on net bank claims on the government.

13. Nonbank claims consist of BTAs and other treasury bills (BTs) and bonds placed with nonbank institutions and the public. The valuation of nonbank claims is based on the change in outstanding conventional treasury bills (maturities of one to five years), auctioned treasury bills (maturities of one month to three years), and outstanding domestic government loans (Lova, Hasimbola, and Fanambina).

#### **Calculation method**

14. Net deposits in foreign exchange must be converted into Malagasy francs at the program exchange rate.

15. BTAs must be posted at their net value at time of initial issue.

### **F. Floor on Tax Revenue**

16. Tax revenue includes not only that received by the treasury, but also suspense items, including those related to the public investment program.



## **G. Ceiling on Accumulation of Domestic Payments Arrears**

### **Definition**

17. Payments arrears consist of (1) all expenditure for which payment orders have been issued but have not been paid by the treasury within three months, and (2) the amount of VAT reimbursable to taxpayers which has not been reimbursed after three months.

## **II. INDICATIVE LIMITS OR CEILINGS**

### **A. Ceiling on Reserve Money**

#### **Definition**

18. Reserve money consists of notes and coins issued and demand deposits of commercial banks with the BCM (including both required and excess reserves).

19. Central bank deposit auctions (*appels d'offres négatifs*) are excluded from reserve money and are classified in NDA.

20. For the purposes of the program, the ceiling on reserve money will be adjusted for changes in the reserve requirement in an amount equal to the change in percentage points in the reserve requirement times the amount of deposits held by the public with the commercial banks.

### **B. Ceiling on Broad Money**

#### **Definition**

21. Broad money (M3) includes notes and coins in circulation, demand and time deposits with banks, including foreign currency deposits of residents, and bonds issued by banks.

#### **Calculation method**

22. Foreign currency deposits must be converted into Malagasy francs at the program exchange rate.

### **C. Floor on Payments of Domestic Payments Arrears**

#### **Definition**

23. Payments of domestic arrears are equal to the variation in the stock of domestic payments arrears defined in paragraph 10, with an opposite sign.

### III. MONITORING VARIABLES AND MEMORANDUM ITEMS

#### A. Projected Balance of Payments Assistance

##### Definition

24. External balance of payments assistance is defined as loans and grants (nonproject) provided as structural adjustment financing and resulting in funds available to the treasury. It excludes the assistance that gives rise to counterpart funds for the treasury with a delay of longer than one year.

##### Calculation method

25. Financial assistance in foreign exchange must be converted into Malagasy francs at the program exchange rate. Assistance in kind must be posted when the counterpart funds are deposited with the treasury.

#### B. Projected Investment Flows Connected with the Privatization of Public Enterprises

##### Definition

26. The cost of privatization operations is included above the line in central government operations. Apart from covering reform-related costs, **gross receipts from the privatization of public enterprises (PEs)** will be used to reduce outstanding domestic debt.

### IV. ADJUSTERS

#### A. Excess/Shortfall in Balance of Payments Assistance

27. In the event that net external financing (balance of payments assistance less public debt service on a cash basis) exceeds the amount programmed, (a) the floor on the BCM's NFA will be adjusted upward (the adjustment will be converted at the exchange rate used in the operation); (b) the ceiling on the BCM's NDA will be adjusted downward (the adjustment will be converted into Malagasy francs at the exchange rate used in the operation); and (c) the ceiling on the net domestic financing requirements of the central government will be adjusted downward (the adjustment will be converted into Malagasy francs at the exchange rate used in the operation).

28. In the event of a shortfall in net external financing at end-March 2004, end-June 2004, end-September 2004, or end-December 2004 against the programmed amount for the corresponding period of 2004, the floors and ceilings will be adjusted as follows: by a maximum of SDR 11 million for the first quarter of 2004, by a maximum of SDR 17 million for the first half of 2004, and by a maximum of SDR 45 million for the first nine months of

2004 and for the full year of 2004, according to the following method: (a) the floor on the BCM's NFA will be adjusted downward by the amount indicated above (the adjustment will be converted at the program exchange rate); (b) the ceiling on the BCM's NDA will be adjusted upward by the same amount (the adjustment will be converted into Malagasy francs at the program exchange rate); and (c) the ceiling on the central government's net domestic financing requirements will be adjusted upward and capped at the above-mentioned maximum amount (the adjustment will be converted into Malagasy francs at the program exchange rate).

### **B. Privatization-Related Transactions**

29. Adjustments will be made for any deviation in (a) privatization receipts; and (b) current privatization-related expenditure. **The floor on net foreign assets** will be adjusted upward or downward by a maximum of SDR 12 million from the programmed floor if net disbursed foreign resources from privatizations are higher or lower than programmed. The adjustment will be limited to a maximum of SDR 5 million for the periods from end-2002 to end-June 2003, end-September 2003, and end-December 2003. Similarly, the BCM's NDA will be adjusted downward or upward (at the actual average exchange rate of the pertinent quarter). **The ceiling on domestic government financing** will be adjusted to take account of any discrepancies between actual privatization-related expenditures and those programmed (upward adjustment if expenditure exceeds the amount programmed and downward, in the opposite case, up to the difference reported).

### **C. Program Exchange Rate**

30. The amounts of balance of payments assistance and debt service denominated in SDRs will be converted into Malagasy franc at the FMG/SDR exchange rate of FMG 8,904.7 for the first and second quarters of 2004 and FMG 13,739.3 for the third and fourth quarters of 2004. In 2004, corresponding amounts denominated in U.S. dollars and in euros will be converted by applying the rate of US\$1.44=SDR 1, and €1.25=SDR 1, and the Malagasy franc/SDR rate indicated above.

## **V. CONSULTATIONS WITH FUND STAFF ON THE PERFORMANCE CRITERION FOR NFA AND THE BROAD MONEY BENCHMARK**

31. In the event that demand for money is stronger than expected and the exchange rate appreciates, the central bank should intervene on the interbank foreign exchange market (MID) to offset this appreciation, taking into account programmed limits (floor/ceiling) on the accumulation of net foreign assets and the level of broad money. Given the program limits on these criteria and benchmarks, if broad money growth since end-December 2003 exceeds 15 percent and/or if the level of net foreign assets exceeds the programmed level by more than 5 percent of broad money at end-2003, the authorities will consult Fund staff on measures to be taken in the context of exchange market and monetary policy management.

## **VI. INFORMATION AND DATA TO BE SUPPLIED TO FUND STAFF**

32. The Malagasy authorities will provide Fund staff with information and data according to the schedule provided, either directly (e-mail or facsimile) or through the Fund's resident mission.

**The Central Bank of Madagascar will report the following statistics:**

### **Monthly**

- market results of treasury bill auctions, including the bid level, the bids accepted or rejected, and the level of interest rates;
- data on the secondary market;
- information on monetary developments, as required by the Statistics Department of the International Monetary Fund (STA);
- monthly balances 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 on an end-of-month basis (required reserves and free reserves);
- the foreign exchange cashflow table, including foreign debt operations;
- the table of interbank foreign exchange operations on the MID; and

### **Quarterly**

- data on foreign trade (exports and imports).

**33. The Ministry of Economy, Finance, and Budget will report the following information:**

### **Weekly**

- weekly report of the customs and tax directors to the committee monitoring the customs and tax administration reforms.

**Monthly**

- OGT data on a cash and commitment basis and the related tables;
- expenditure on structural reform;
- central government revenue and expenditure, including short-term treasury on-lending;
- treasury liabilities (statutory advances and operations on the treasury bill market);
- central government capital expenditure;
- external public debt operations (debt contracted and publicly guaranteed, settlement of arrears, and operations of public enterprises) and debt service paid;
- the consumer price indices; and
- indicators of sectoral economic activity.

34. Moreover, information on important measures adopted by the government in the economic and social areas that would have an impact on program development, 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 will be reported to Fund staff on a timely basis for consultation or information, as appropriate.

/s/

Gaston Ravelojaona  
Governor  
Central Bank of Madagascar  
Antananarivo, Madagascar

/s/

Henri Bernard Razakariasa  
Secretary General  
Ministry of Economy, Finance,  
and Budget  
Antananarivo, Madagascar