

International Monetary Fund

[Republic of Madagascar](#) and the IMF

Republic of Madagascar: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

Press Release:

[IMF Executive Board Approves US\\$80.8 Million PRGF Arrangement for the Republic of Madagascar and Activation of the Trade Integration Mechanism](#)

July 24, 2006

July 6, 2006

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.

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MADAGASCAR: LETTER OF INTENT

July 6, 2006

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

Dear Mr. de Rato:

1. The government of Madagascar has been committed to a program of economic reform aimed at restoring fiscal discipline and financial stability. Madagascar reached the completion point under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative in October 2004 and satisfactorily completed its last three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in March 2005. In January 2006, Madagascar received debt relief from the IMF under the Multilateral Debt Relief Initiative (MDRI). Madagascar has also received considerable technical assistance from the IMF which we value greatly and have incorporated into our medium-term economic program.
2. Despite improved economic growth in recent years, the country remains poor, highly vulnerable to weather, price, and trade-related shocks, and is plagued with an extremely low tax revenue to GDP ratio. Given these challenges, the government is committed to raising economic growth and meeting the Millennium Development Goals. In this regard, the government is requesting a new three-year PRGF arrangement in an amount equivalent to SDR 54.99 million (45 percent of quota), to support its economic program for 2006-08.
3. Following a series of discussions in Antananarivo and Washington between the government and Fund staff, most recently in May 2006, understandings were reached on fiscal revenue and expenditure targets that could form the basis for a Fund-supported economic program for 2006. The government has presented its economic strategy in a Memorandum of Economic and Financial Policies (MEFP), and committed itself to a set of prior actions and structural and quantitative performance criteria for 2006 (attached). We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but the government stands ready to take any further measures that may become appropriate for this purpose. Madagascar will consult with the Fund on the adoption of such measures in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policy on such consultation.

4. Finally, the government is developing policies 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. In view of the possible effect on Madagascar of these changes, we hereby request activation of the Fund's Trade Integration Mechanism (TIM). Should the impact of the end of these agreements be greater than currently anticipated before policy adjustment, we would request an augmentation of the PRGF arrangement by up to 10 percent of quota, or SDR 12.2 million, under the TIM's deviation feature.

5. Reflecting the urgency in bringing the government's request for a three-year PRGF-supported program for consideration by the IMF Executive Board, the first review is expected to be conducted by end-November 2006 and the second review by end-April 2007, and will be based, respectively, on the end-July and end-December 2006 performance criteria as well as on the continuous PCs and the relevant structural conditions.

Sincerely yours,

/s/

/s/

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

Gaston Ravelojaona
Governor
Central Bank of Madagascar
Antananarivo, Madagascar

Attachments: Attachment I—Memorandum of Economic and Financial Policies
Attachement II—Technical Memorandum of Understanding

**ATTACHMENT I—MADAGASCAR: MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES
FOR 2006–08**

I. INTRODUCTION

1. Madagascar is doing its utmost to achieve the Millennium Development Goals aimed at reducing poverty by half by 2015. The policy strategy adopted for this purpose is set out in the Poverty Reduction Strategy Paper (PRSP), which was updated in June 2005. Since the programming period for implementation of the PRSP will come to an end on December 31, 2006, the Malagasy government is currently formulating a development policy to take over from the PRSP. This policy, known as the Madagascar Action Plan or MAP, is a five-year plan spanning the period 2007 to 2011. The MAP builds on the achievements of the PRSP and takes account of domestic and international developments in order to make a qualitative leap in development and achieve the objectives of both the MDGs and the long-term vision described in “*Madagascar Naturellement*.”

2. The updated PRSP confirms the country’s medium-term desire for strong and stable economic growth, founded on three pillars; (i) good governance; (ii) growth benefiting the entire population; and (iii) and better public services, especially in the education and health sectors. Economic policy to promote economic growth calls for a boost in aggregate supply and greater private and public sector investment, particularly in infrastructure. Thus, in an extension of the value chain, the subsistence economy is expected to evolve toward the market economy, the rural economy will expand into industry, and external openness will be reinforced by export growth.

3. Last year witnessed an inflationary upsurge which was brought under control in early March. The Malagasy economy was thus able to maintain the stability it had acquired in the second half of 2004 in respect of the exchange rate and inflation. However, government finance performed below expectation as a result of a 12 percent shortfall in tax revenues. This decline in earnings resulted in the imposition of two expenditure caps, which were only partially enforced, however, because of administrative weaknesses, with the result that the expenditure and domestic balance¹ targets were exceeded by around 1 percent of GDP. Real GDP growth for 2005 reached 4.6 percent and inflation declined to 11.4 percent by the end of the year. The financial problems facing the national water and electricity company (JIRAMA) resulted in power outages which disrupted economic activity and increased the cost of doing business. The current account deficit (including grants) widened to 10.8 percent of GDP owing to the increase in world oil prices and a drop in exports following the termination of the Agreement on Textiles and Clothing and the collapse of vanilla prices

¹ Total revenue minus expenditure, excluding foreign interest payments and foreign-financed capital expenditure.

4. In the first quarter of 2006, there appeared to be some slowing in the economy, partly coming from further increases in world oil prices and lower-than-expected rainfall impacting on hydroelectric and agricultural production. Consequently, the government was forced to borrow on the domestic financial markets, which pushed interest rates on treasury bills upward by about 3 percentage points over the quarter. The central bank maintained a restrictive monetary policy during the quarter and inflation—10 percent at end-March year-on-year—edged slightly lower than at end-2005.

5. The country's macroeconomic performance is supported by various measures reflecting its determination to forge ahead. Over the last few years, fiscal management reforms have been the most outstanding, in particular on the revenue front, as shown by the following reforms. In the customs sphere, the rates of import duties and taxes have been restructured and simplified, customs clearance has been streamlined, and the ASYCUDA++ software has been installed in the Toamasina customs offices. The rates of domestic taxes and levies have been lowered, and the tax base expanded by making inspection and oversight more effective. The SYGTAS program has been installed at the Large Enterprise Tax Office (DFGE). Efforts have also been made to achieve greater transparency and sound management of public expenditure. A new program budget system was introduced and laws governing government finance were approved in 2004 and implemented from 2005 onward, including: the organic law on the Budget Laws, the new Public Procurement Code and their respective implementing regulations, and the reorganization of the Council on Budgetary and Financial Discipline. Nevertheless, the difficulties experienced in 2005, both in terms of tax collection and expenditure control, point to the persistence of numerous underlying problems, which the government is committed to resolving in close association with development partners.

6. A new Foreign Exchange Code was drafted to resolve discrepancies among the existing laws and to gather the laws into a single document, to facilitate consultation by administrations and dealers. The main purpose of the revision was to make the Code consistent with the new orientations of the policy of economic openness, in which all current transfers are liberalized. However, capital movements still require prior authorization from the Finance Ministry.

7. Completion point under the enhanced HIPC Initiative was reached in October 2004. Further, Madagascar has qualified for additional debt relief under the Multilateral Debt Relief Initiative (MDRI) in 2006, leading to the cancellation of a significant amount of its external debt by its international partners. The total amount of debt relief provided by the IMF, the International Development Association (IDA), and the African Development Fund (AfDF) under the MDRI amounts to MGA 5,237 billion (US\$ 2,402 million, 44 percent of GDP, with the ratio of the net present value of debt to GDP declining from about 36 percent in 2005 to about 15 percent. The IMF debt relief, which became effective on January 6, 2006, amounts to US\$ 197 million. IDA debt relief, which will become effective in July 2006, amounts to US\$1,878 million. And the African Development Fund (AfDF) debt relief, which became effective on April 19, 2006, amounts to US\$327 million. Together, the MDRI relief

will free about MGA 73 billion (US\$ 36 million, 0.6 percent of GDP) for additional priority spending in 2006, and about double that amount on average each year over the next twenty years.

8. As the government remains convinced of the need to lay a sound foundation for sustainable and lasting growth in the medium term, it is seeking a new Poverty Reduction and Growth Facility (PRGF) arrangement to support implementation of the economic and financial policies contained in this memorandum. In parallel with this request, the government is requesting the activation of the IMF's Trade Integration Mechanism (TIM) in case the effect of the elimination of textiles quotas and the termination of the Africa Growth and Opportunity Act (AGOA) turn out to be greater than anticipated in this program. In this regard we plan to monitor the impact closely to assess whether a request for an augmentation of access under the deviation feature of the TIM would be warranted. This augmentation will be based on a comparison of TIM's baseline projection as defined by the current program projections for 2007 to 2008, with the actual outcomes.

II. MEDIUM-TERM ECONOMIC POLICY FRAMEWORK (2006–08)

9. In order to achieve the Millennium Development Goals to which Madagascar is committed, in particular halving the number of people living in extreme poverty by 2015, the government intends to implement economic policies in the medium term to promote strong and stable growth, fueled by a high level of investment.

10. In accordance with the guidelines adopted in the updated PRSP and the MAP, the strategies to be pursued will be based on: (i) the development of key sectors such as export-oriented manufacturing, mining, tourism, and particularly agriculture, where there will be special emphasis on improving infrastructure and restoring agricultural productivity. Support for this has already been obtained from financial partners, through projects and programs such as the Millennium Challenge Account (MCA) and the Integrated Growth Pole (PIC); (ii) implementation of a package providing incentives and security for private local and foreign investment (FDI); and (iii) development of human capital by improving the population's access to health, education, water, and sanitation services.

11. The government has established the following macroeconomic goals for the next three years: (i) achieve an average real GDP growth rate of about 5 ½ percent during 2006-2008; (ii) reduce consumer price inflation to 6 percent; (iii) increase the tax burden from 10.1 percent of GDP in 2005 to about 12 percent in 2008; (iv) improve the management and effectiveness of public expenditure; (v) reduce the domestic budget deficit and hold it at about 1 percent of GDP; (vi) maintain the sustainability of both domestic and external debt; (vii) stabilize the current account deficit around 10.5 percent of GDP; and (viii) maintain the level of gross foreign assets held by the central bank to the equivalent of at least three months of imports of goods and nonfactor services.

12. During the period 2006-2008 real GDP growth will essentially be fueled by a high and sustained level of investment (averaging 22.2 percent of GDP), with an initial strong

increase of government investment in 2006, particularly externally-funded investment projects, followed by a rise in private sector investment. The strongest growth is expected to come from the secondary and tertiary sectors, owing to the effects of increased investment activity. The reduction of inflation to 6 percent during the period will be achieved through prudent fiscal and monetary policies and expanded domestic production. This will lead to an increase the population's purchasing power and progress in the poverty reduction process.

13. To attain the macroeconomic goals described above, the government has defined an appropriate set of measures and is implementing the corresponding reform programs (Annex). These measures and reforms include those that underpin strong economic growth sustained by high levels of public and private investment. Against this backdrop, the government is determined to implement suitable macroeconomic and structural policies, with the following objectives: (i) ensure macroeconomic stability; (ii) reduce the country's vulnerability to shocks; and (iii) sustain high levels of growth. To achieve these objectives, the government intends to: (i) maintain political stability; (ii) establish a favorable legal and regulatory framework creating a more attractive and secure climate for investors; (iii) establish the rule of law, guaranteeing respect for property rights; protection of property; individuals and production activities and continuation of the fight against corruption; (iv) strengthen civil service reform to guarantee high-quality public administration and transparent governance; (v) streamline administrative procedures and improve the clarity and predictability of government actions; (vi) persevere with the policy of external openness; (vii) facilitate access to basic infrastructures that act as vectors of development (roads, transport, communications, energy, etc.); and (viii) adjust energy prices continuously in line with oil prices so as to mitigate the impact on the external accounts.

14. Fiscal consolidation will continue over the medium-term. Accordingly, the authorities will redouble efforts to bring the budget into line with the priorities defined in the PRSP, and to maintain the dynamism acquired thus far as a result of reforms already undertaken. The resources freed up by the debt relief granted under the MDRI will be allocated to priority expenditure in line with the PRSP and the MAP. On the revenue side, the key measures will aim to: (i) provide better tax service to economic agents and easier access to related services, in the hope that better understood taxation would be more readily accepted; (ii) set up a comprehensive national record of the entire taxpaying population to ensure better monitoring of taxpayers; (iii) increase the level of nontax receipts (mining and/or fishing royalties, and the agriculture sector particularly). On the public expenditure side, steps will be taken to: (iv) consolidate the link between fiscal policy and poverty reduction; (v) improve budget formulation, execution and monitoring; and (vi) strengthen oversight bodies. Lastly, an effort will be made to improve domestic and external debt management.

15. During 2006-2008, the central bank will continue to implement monetary policy aimed at controlling inflation in a flexible exchange rate environment. The central bank will only intervene in the foreign exchange market to avoid excessive exchange rate volatility. The bank will reinforce its operational framework in line with recent Fund recommendations in the framework of technical assistance. The government will make consistent efforts to

gradually reduce borrowing from the central bank to below 10 percent of total revenues by 2008. In addition, efforts to develop the country's financial sector and strengthen its stability, thus better mobilizing savings and channeling them into productive investments, will be continued. Particular attention will also be paid to reducing the cost of doing business, monitoring the soundness of the banking sector and developing microfinance institutions.

16. To reduce the current account deficit, the government will take steps to apply the following measures: (i) increase the supply of exportable goods and services by improving the economic environment needed to make exports more competitive and by diversifying the goods and services to be exported; and (ii) further streamline the tariff structure over the medium term. The government will step up efforts to attract foreign direct investment.

17. In addition, in order to keep external debt at a sustainable level, the government will give priority to seeking external funding in the form of grants and will not contract any additional external debt except on concessional terms as stipulated in the technical memorandum of understanding (TMU) (Attachment II, para. 3). The government will also keep the more expensive domestic debt at a low level, as well as identify and control contingent liabilities.

18. Apart from the consolidation of actions taken in the field of investment, the government is convinced of the overarching role of education in development and poverty reduction, and has therefore decided to implement the education-for-all policy. Education policy has an important role to play in strengthening Madagascar's competitiveness and making it possible to form a skilled labor force. Efforts to improve infrastructures will be continued (particularly school building and refurbishment), along with the promotion of informal education in order to optimize human capital. As with education, improvements in the health sector are also essential in the fight against poverty. Measures to promote mother and child health, combat malnutrition and disease, and improve healthcare infrastructures will be maintained over the next three years.

19. Implementing this program will help attenuate vulnerability to the main risks facing the Malagasy economy, namely further deterioration in the terms of trade and cyclones. Continuous adjustment of energy prices to keep pace with oil prices will soften the impact on the external accounts. Implementation of a flexible exchange rate policy will make it easier for the exposed sector to adjust to the change in relative prices. A resolute policy of external openness of the Malagasy economy will serve to consolidate and diversify the economic fabric. And further fiscal consolidation and control will facilitate the build up of financial reserves, identification of nonpriority expenditure and securing of development partner confidence needed to fund expenditure in the wake of a natural disaster.

III. PROGRAM FOR 2006

20. In keeping with the medium-term policy framework, the main macroeconomic goals for 2006 are as follows: (i) keep the real GDP growth rate at about 4.7 percent; (ii) reduce

average inflation to 11.2 percent; (iii) increase the tax burden to 11 percent of GDP, compared to 10.1 percent in 2005; (iv) hold the domestic budget deficit to no more than 0.9 percent of GDP; (v) restrict the external current account deficit to 10.5 percent; and (vi) keep the gross foreign assets of the central bank to at least 2.9 months of imports of goods and nonfactor services. To achieve these objectives, the government intends to implement the fiscal, monetary, trade policy, institutional, public enterprise policy and social policy measures described below. The government has set up a follow-up committee to monitor implementation of these measures. The follow-up committee comprises representatives of the Presidency the Prime Minister's Office, the Ministry of Economy, Finance and Budget, the Ministry of Industry, Commerce and Private Sector Development and the Central Bank. The Committee will facilitate information flow and coordinate the activities of the institutions concerned.

A. Fiscal Policy and Reforms

Fiscal policy

21. In 2006, tax revenue is now expected to reach a level of MGA 1,295.8 billion, representing a tax burden of 11 percent of GDP. Given this level of tax revenue and the expected grants and loans under concessional terms, total public expenditure is expected to rise to MGA 2,580.5 billion (21.9 percent of GDP) in 2006. Operating expenses, excluding interest and wages, and payroll costs are set to reach MGA 371.7 billion (3.2 percent of GDP), and MGA 599.8 billion (5.1 percent of GDP) respectively. Public investments will rise to MGA 1,359.2 billion (11.5 percent of GDP). Consequently, the overall deficit (on a cash basis, excluding capital transfers under the MDRI) will stand at MGA 602.5 billion (5.1 percent of GDP).

22. To reach this objective, the government will introduce a supplementary budget to parliament which will reduce current expenditure, excluding interest and payroll costs, and domestically financed capital expenditure by a total amount of about MGA 127 billion² (1.1 percent of GDP) compared to the to level approved in the 2006 budget. Cuts in an amount of MGA 200 billion (1.7 percent of GDP) are necessary to offset tax revenue shortfalls of MGA 45.6 billion (0.3 percent of GDP) compared to the 2006 budget, reductions in budgetary support provided by development partners in an amount of MGA 80.6 billion (0.7 percent of GDP), and inadequately budgeted items in the 2006 budget in an amount of MGA 60.5 billion (0.5 percent of GDP), as well as to eliminate excessive spending in an amount of MGA 13.3 billion (0.1 percent of GDP). But the MDRI relief will free about MGA 73.4 billion (0.6 percent of GDP), which will be allocated to poverty reducing spending in the supplementary budget, and limit the size of the reduction in expenditure to MGA 127 billion. The government will cut non-priority spending more than

² Under the assumption of African Development Bank budget support of SDR 17.5 million in 2006, and subject to an adjuster for any change in budget support compared to the program scenario, as described in the TMU (Attachment II, paras. 25-27).

priority spending (i.e. education, health, justice, agriculture, environment protection and infrastructure).

23. In the near term, the government regards the key target of fiscal policy to be net domestic financing (NDF)³ of the budget, which will be limited to a reduction of MGA 55.6 billion (0.5 percent of GDP) in 2006. This will serve to maintain domestic debt sustainability. Should domestic revenue for this year not be in line with forecasts, any under/over performance in revenues (not offset by increased foreign inflows) will be compensated by an adjustment in domestically financed expenditures in order to meet the net domestic financing target. Any surplus revenues will be used to increase the allocations to priority ministries using the procedure of advances by decree. In the case of a revenue shortfall, the following contingency spending reduction will be implemented: expenditure will be reduced by adjusting mainly the commitments for non-priority spending established in the circular from the Ministry of the Economy, Finance and Budget.

Tax administration

24. Given the structural and organizational difficulties encountered in collecting tax revenues, both in 2006 and in previous years, the government is determined to implement the priority measures described in the annexed document (Annex).

25. With regard to customs, and thanks to the implementation of the Administration's new strategy prepared in 2005, the government is carrying out a program of priority reforms to improve the functioning of the administration and boost revenues, based on the following:

- No granting of ad hoc tax and/or tariff exemptions outside those specified in the Customs Code, international treaties and conventions.
- No granting of exemptions from the requirement to present a post-customs inspection report (RIE) for the import and clearance of goods, nor on the use of SGS valuation of goods.
- Strengthening of the unit responsible for coordinating, monitoring, and evaluating customs actions with a view to piloting measures for implementation of the new strategy and taking steps to improve the collection of customs revenues.
- Improvement of the quality of customs services introduced in Toamasina in 2005, by extending installation of the ASYCUDA++ system to the five largest customs bureaus (including Antananarivo, Majunga, Antsiranana and Tuléar), as well as developing and implementing a service standard in customs offices using this software. These measures should make it possible not only

³ As defined in the TMU (Attachment II, para. 10).

to strengthen the operational effectiveness of the services but also to step up the fight against fraud.

- Strengthening of monitoring and oversight by using modern control tools during the customs clearance process in collaboration with the SGS (scanner and Profiler, Valuenet and Resus software at Toamasina and Ivato).
- Improvement of the communications network among all stakeholders involved in customs clearance (customs, port, shipping companies, freight forwarders, banks, etc.), through use of the TRADENET system, in order to minimize the risk of using false customs documents and facilitate more effective merchandise targeting even before the vessels in question have arrived.
- Tightening of eligibility conditions for economic regimes (temporary admission, customs warehouse, transit, etc.).
- Improving integration of customs manifests in the ASYCUDA++ information system using the converter.
- Stepping up of ex post controls by creating mobile surveillance units in the six provinces.
- Strict application of the requirement to pay customs duties either by guaranteed bills or by bank transfer, to make customs receipts more secure.
- Simplification of the tariff structure for imports by reducing the number of rate categories to three and eliminating excise duties on all products except tobacco, alcohol, petroleum and mining products and cosmetics.

26. With respect to domestic taxation, the government is continuing its program of modernizing management tools and reorganizing structures, simplifying, and pursuing a more coherent tax system, with a view to significantly increasing the level of tax revenues. To this end, steps will be taken to (i) review all existing tax and tariff exemptions and waivers, with a view to eliminating them where necessary; (ii) review provisions of the 2007 Budget Law that allow the Ministry of Finance to negotiate preferential tax treatment with potential investors on an ad hoc basis; and (iii) simplify the number of goods subject to indirect taxes and rationalize their rates.

27. Collection of VAT has been severely undermined by: (i) the accumulation of arrears of VAT payments by the government on externally funded capital expenditure (currently estimated at MGA 9.8 billion, or 0.1 percent of GDP in 2005); (ii) the accumulation of arrears on VAT refunds to free zone enterprises and exporters (MGA 10.8 billion or 0.1 percent of GDP at end-2005); and (iii) the build up of outstanding VAT credits (MGA 45.2 billion, or 0.4 percent of GDP at December 31, 2005). With a view to bringing the

proceeds and management of VAT under control once and for all, the government undertakes to: (i) conduct an audit of the government's VAT arrears on capital expenditure by end-September 2006; (ii) reimburse VAT owed to exporters and export processing enterprises for business conducted in 2006 within 60 days starting April 1, 2006; and (iii) conduct a verification of at least 80 percent of outstanding VAT credits at end-June 2006 before end-December 2006. With a view to reducing the build up of VAT arrears, the government will include additional credits amounting to MGA 36 billion in the 2006 Supplementary Budget Law, which will be submitted to Parliament in July, and will ensure that all ministries receive sufficient credits to pay VAT on externally-funded capital expenditures included in the 2007 Budget Law.

28. The actions to be taken to enhance tax system effectiveness with a view to attaining the government's domestic tax revenue target require the mobilization of efforts and resources to give priority to the management of taxpayers with high fiscal potential. To achieve this, the Tax Office (DGI) intends to: (i) strengthen the tax administration management of medium-sized taxpayers (annual turnover of between MGA 0.5 and 2 billion), while continuing to improve management of taxation of large enterprises (turnover of over MGA 2 billion); (ii) develop and implement a selective audit program covering all categories of taxpayers (with priority given to large and medium-sized enterprises) and combine different audit methods ; and (iii) establish monthly activity and performance indicators for all revenue collection services, including the DFGE (Large Enterprise Tax Office) and the regional services. In addition, DGI will implement the following activities: (i) exchange of information and, over time, placement of data held by customs, the Treasury, and the tax administration on a network to optimize the use of such data for tax control purposes; (ii) continuation of tax audits underway in the tourism, construction, and transport sectors; and (iii) expansion of the tax base to encompass the informal sector, supported by systematic taxation made possible by computerized cross checks.

29. As was done for custom duties, the government intends to develop a clear strategy and implement priority reforms to improve the collection of domestic taxes. Building on the IMF Fiscal Affairs Department 2003 and 2006 technical assistance recommendations, the government will develop a priority action plan by end-December 2006.

Public financial management

30. On the public expenditure side, the authorities will implement the priority public financial management (PFM) action plans designed in cooperation with development partners aimed at improving the management and effectiveness of public expenditure, and strengthening control over budget execution and cash management.

31. The objective of the new budget framework is to consolidate integration of the PRSP priorities (specifically the government's programs in the context of poverty reduction) in the budget law preparation process as from 2007 by using a functional and sub-functional classification regarding poverty reduction, preparing a correspondence table between the MAP and the functional classification of the budget with technical assistance, continuing to

eliminate redundancies and establishing fewer but better-defined, measurable indicators, which will facilitate strict management and improved monitoring of budget execution. Simplification of the budget classification by retaining only three programming levels (mission, program, and objective) is also essential and will be rolled over in the 2007 Budget Law, which will be submitted to Parliament in October 2006.

32. For the 2007 budget law, the budget preparation process will be consolidated and the quality of program budgets improved. Budgetary forecasting will be based on more realistic assumptions on both the revenue and expenditure sides, and the budget preparation process started with the establishment of initial guidelines followed by notification of ministries of the preparation of the medium-term expenditure framework (MTEF). The areas covered by the financial data that accompany the draft budget laws will be broadened, and data on payroll expenses will be remodeled. Departments with budget responsibilities will undergo structural reorganization to give them the expertise needed to aid government decision-making and monitor public investments more effectively. Guidelines for improving the MTEF of the various ministries and institutions have also been discussed.

33. In terms of expenditure management, the government will strive to achieve a significant improvement in budget execution and to that end will implement a series of measures that should make it possible to remedy deficiencies in controlling commitments. These measures include: (i) issuance of instructions by Ministry of Finance to the other ministries to submit monthly plans for expenditure commitments in accordance with the quarterly budget appropriations; these monthly plans will serve as tools for monitoring compliance with expenditure ceilings as part of overall control of committed expenditure (Financial Control); (ii) issuance in September 2006 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; (iii) an external analytical and organizational audit of Financial Control with a view to taking concrete steps to improve monitoring of commitments before year-end; (iv) reform of the expenditure chain by disseminating the voucher classification, installing information systems software, thereby making it easier to monitor the rate of rejection by Financial Control and the Treasury, and studying the merits of merging the functions of the secondary payment authorizing officer (*ordonnateur secondaire*) and the activities manager (*gestionnaire d'activités*); (v) improvement of government cash management by strengthening the unit responsible for cash flow forecasting and the coordination of liquidity management, training staff of the principal treasuries in the use of the cash management guide, development of a mechanism to improve data centralization through the internet for principal treasuries that do not have the fiscal management system (SIGFP), regular reconciliation of the government's bank accounts and accounts held by the Treasury; (vi) production of four-month budget execution reports by all line ministries, based on an economic classification, in the four weeks following the end of the reference period; and (vii) monitoring of MDRI-financed expenditure. This should result in more effective monitoring of budget execution both in the sectoral ministries and in the MEFB. With regard to the computerization of fiscal management, the SIGFP development

process will begin with the preparation of a blueprint and proceed towards exhaustive coverage of all government expenditure.

34. Reform strategies will also be implemented to strengthen the monitoring and oversight of budget execution, based essentially on the following: (i) management oversight to compensate for difficulties beyond the scope of internal control; (ii) less ex ante control, and, as a corollary, more ex post and on-site controls, to more effectively verify certification of the service provided and foster a culture of performance and effectiveness; (iii) implementation of the action plan contained in the recommendations of the Financial Control audit to be conducted by an independent firm; (iv) enforcement of sanctions against persons responsible for serious irregularities; (v) extension of the scope of oversight activities; (vi) strengthening of external controls and implementation of recommendations made by oversight and inspection bodies; and (vii) timely production of final accounts (budget review laws, end-year treasury accounts) in keeping with the scheduled timeframes (Annex). The capacities (human, material, and training) of oversight bodies such as the Treasury control and internal audit units will be strengthened, and their field of intervention expanded to cover other government areas (account officers of government administrative agencies, diplomatic posts, territorial governments, etc.). Steps will be taken to become involved in implementation of the SIGFP, in order to oversee developments in the computerized fiscal management system and incorporate alert indicators and accounts analysis tools.

35. Audit and budget control functions will also be strengthened by actuating the Inspectorate General of Finance (IGF), appointing its members, and making the necessary resources available. A draft manual of internal control procedures will be prepared, as well as a clarification of its field of competence compared to that of the Inspectorate General of State (IGE) and its positioning relative to the issues involved in decentralization and external financing.

36. In terms of the external oversight exercised by Parliament, the Audit Office, the Financial Tribunals, and the Budgetary and Financial Discipline Council (CDBF), the following measures will be taken: (i) training for members of parliament in fiscal management; (ii) systematic inclusion in the Audit Office annual work plan of thematic studies analyzing the work of payment authorizing officers; and (iii) establishment of financial tribunals in the provinces as well as the CDBF, in order to apply financial sanctions, as promptly as possible, for fiscal mismanagement.

37. The government is currently working to activate the new public procurement system through: (i) establishment of a new legal and institutional framework, by preparing and approving implementing regulations for the new Public Procurement Code; (ii) establishment of the Public Procurement Regulatory Authority; and (iii) strengthening of the capacities of participants in the public procurement system (PRMP, UGPM, secondary payment authorizing officers), with special emphasis on capacity building in the priority ministries.

38. The government undertakes to use the lessons of the current public expenditure analysis with the World Bank to improve the preparation, implementation and monitoring of public investments.

B. Monetary and Financial Policy

39. The central bank monetary program for 2006 will focus on attaining the targets for inflation and level of foreign reserves, and allowing for an adequate expansion of credit to the economy sufficient to achieve the GDP growth target while meeting the financing requirements of the government. To attain the target for inflation, the BCM is currently using indirect monetary policy instruments such as the bank rate, the reserve requirement, and money market liquidity injection and mop up operations. The bank is also improving the operational framework of liquidity forecasting and management, as well as strengthening coordination with the Treasury. BCM will give priority to achieving the foreign reserves target in the second half of the year as the government will benefit from multilateral debt relief under the MDRI and plans to only intervene in the foreign exchange market to smooth exchange rate volatility.

40. The monetary authorities intend to strengthen the effectiveness of the monetary policy instruments available to them, by: (i) fine tuning indirect monetary policy instruments; (ii) improving the operational framework of liquidity forecasting and management, as well as strengthening coordination with the Treasury; and (iii) putting in place the mechanisms necessary to facilitate transactions on the domestic money market. The key measures that have already been taken or are currently under study are as follows: (i) expansion of access to Treasury bill auctions, by lowering the minimum denomination from MGA 40 million to MGA 20 million and extending auctions to other large towns; (ii) broadening of the range of monetary instruments by gradually converting securitized public debt held by the central bank into negotiable securities; to that end, a bill modifying certain provisions of the Central Bank Charter will be submitted to Parliament by year-end; (iii) better coordination of work with the Treasury, in order to forecast and manage liquidity more effectively; (iv) establishment of mechanisms to cover counterparty risks on the interbank money market, with technical assistance from the IMF; and (v) reduction of the time required for the settlement of interbank transactions at the BCM, the diagnostic study for which will be financed by the Millennium Challenge Account (MCA). BCM will work with the Treasury to issue public debt securities at market rates with longer maturity dates than Treasury bills.

41. The government is taking steps to strengthen the financial viability of the Central Bank through a recapitalization of the BCM to provide it with the resources it needs to manage money market liquidity effectively. A recapitalization plan will be included in the 2007 Budget Law to be submitted to Parliament in October 2006. Additionally, the Governor of the Central Bank approved a time-bound action plan for strengthening the central bank's control, accounting, reporting and auditing systems, in line with the main recommendations of the March 2006 Safeguards Assessment. The BCM will strengthen the internal audit department and verify coherence with the data on net domestic and external

assets provided to the IMF to monitor the program. The government commits to limit transactions between the government and the central bank to only those permitted by the Central Bank Act. The annual report by the external auditor will include a separate report on transactions between the central bank and the government and their compliance with the Central Bank Charter.

42. The development of the country's financial infrastructure is a priority, in order to reduce the financial cost of loans to the private sector and to expand the capacity for financing the government through the private sector. To help mobilize domestic saving while ensuring the soundness of the financial system, the authorities have adopted a microfinance law and strengthened staffing at the General Secretariat of the Banking and Financial Supervision Commission (CSBF). New measures to be implemented shortly include: (i) strengthening the training capacity of the CSBF General Secretariat and increasing equipment availability; and (ii) defining a legal and regulatory framework conducive to the development of microfinance institutions. Additionally, the following measures will also be programmed: (i) reform of the regulatory framework with the support of the FSAP mission, to enhance competition in the banking sector; (ii) building judiciary capacity in the area of commercial law; (iii) facilitating the development of micro credit institutions through the training of heads of micro credit institutions with assistance from the World Bank and the MCA, the promotion of new agricultural financing instruments, and by extending the services of the risk-rating agency; (iv) establishment of a legal and regulatory framework to create a capital market; and (v) promotion of access to bank loans by modernizing the property registration system to facilitate the use of land as collateral. The authorities also recognize the importance of expanding private sector financing of the government, and will look at the potential for realignment of taxes on interest income and Treasury bill returns, to encourage saving.

43. The interbank foreign exchange market (MID) has worked well in allowing the foreign exchange rate to fluctuate and respond to market conditions, additional actions are, however, needed to improve its efficiency. To this end, the BCM will (i) ensure that it implements its operational framework more rigorously; (ii) recommend that all bids and offers are brought to market; and (iii) ensure the publication on a real time basis of more data on the volume and price of transactions.

C. External Relations and Regional Integration

44. The current account deficit (including grants) should start to trend downward in 2006 (narrowing from 10.8 percent of GDP in 2005 to 10.5 percent in 2006). This will mainly result from a slackening of imports, which should make itself felt from 2006 onward, supported by a robust export performance, with the situation starting to show improvement thanks to the implementation of various measures such as: (i) creation of a favorable environment for lowering production costs and developing the productive sectors, partly thanks to improved regulatory policies, the growth and diversification of financing instruments, and the strengthening of economic and social infrastructures; and

(ii) diversification of the goods and services export basket as a result of efforts to expand both traditional and nontraditional exports, as well as expansion into new export products (essential oils, mining products, etc.). Efforts to attract foreign capital flows, particularly private flows, will also be continued, in order to make up for shortfalls in official capital transfers or other external funding.

45. Efforts to increase external openness will also be continued, particularly through regional integration processes and the implementation of an effective trade policy. Madagascar's recent admission to the Southern African Development Community (SADC) sends a strong signal to investors seeking new market opportunities, especially since member countries are relying on the country to act as the region's "bread basket." Although further streamlining of the tariff structure is envisaged in the medium term, more immediately the government intends to eliminate duties on certain imported goods (dairy products, wheat, and sugar), and other persistent distortions that could be acting as hidden taxes. In June 2006, the government will launch a study on the tariff rate required to offset the impact of implementation of a single tariff of which the findings will be published by latest June 2007.

46. Policies on external debt management for 2006 will mainly aim to maintain a sustainable level of debt. To achieve this, all new external debt will be contracted at concessional rates. With a view to improving public debt management, the following actions are proposed: (i) implementation of the SYGADE software, which will replace the previous program, thereby making it possible to update the debt file in real time; (ii) staff training in the use of this software; and (iii) establishment of a link between the central bank and the Treasury.

47. In order to achieve the development goals set out in the PRSP, the World Bank, France, the European Union, and the African Development Bank have decided to increase the budgetary support they provide to Madagascar, through a new partnership framework. The aim here is to strengthen cooperation between the government and its partners, in order to make more efficient use of foreign budgetary assistance through: (i) harmonization of partners' processes and procedures; (ii) consolidation of the dialogue between the government and its partners; (iii) greater predictability of flows of budgetary assistance from partners (in terms of scheduling and amount); (iv) closer alignment between budgetary support programs and national processes; and (v) coordinated support for capacity building. A joint performance monitoring framework based on predetermined criteria has been defined, along with a review process to keep it up to date.

D. Institutional Reforms

48. In 2006, institutional and structural reforms will also be implemented to support economic policy measures. They will target the following areas: the fight against corruption; respect for democracy; establishment of the rule of law; and bringing government closer to the citizenry through civil service reform, decentralization and deconcentration.

49. In the fight against corruption, where the superior integrity council (CSI) and BIANCO are already active, steps taken in the first year of this work will be intensified in 2006, through the following actions: (i) a public opinion survey to assess the impact of activities undertaken in the first year of BIANCO operations; (ii) establishment of an anticorruption unit in each ministry as well as the effective application of enforcement measures; and (iii) focusing of research in 2006-2007 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.

50. In the justice sector, the aim is to convince the public in general, and local and foreign investors in particular, of the judiciary's effectiveness and impartiality. Measures to be taken in this regard will consist of: (i) strengthening the anticorruption mechanism within the judiciary; (ii) ongoing implementation of the judicial units provided for in the Constitution; (iii) continued strengthening of existing units; (iv) streamlining of procedures related to the adoption of laws and the handling of cases; and (v) establishment of a plan of action for closely monitoring the effective application of laws and regulations.

51. To guarantee security, additional law enforcement officers (police, gendarmes) will be deployed in both urban and rural areas, particularly in high risk ("red") zones, where the number of security operations will be increased. The authorities will also take steps to improve collaboration between the police and the judiciary on this issue.

52. With regard to the civil service reform, the "Voy Rindra" operation, which the authorities are currently implementing, should result in a new classification of civil service jobs and positions. The resulting database will be used as a basis to rationalize the civil service wage scale, introduce merit-based pay increases, identify capacity building needs, and ensure transparency in recruitment, while remaining within the limits of the total wage bill allocation specified in the program.

53. At the local level, the chief aim of decentralization/deconcentration is to facilitate the production of high-quality local services by including communes and regions in the development process. Actions in 2006 could be aimed towards: (i) consolidation of knowledge acquired by local authorities (mayors, municipal councilors, etc.) regarding measures to boost local government resources; (ii) strengthening of synergy between the various regional structures (regions, communes); and (iii) an increase in the number of district administrative representatives to ensure government presence throughout the national territory. For this purpose, the intervention and advisory support capacities of the decentralized services will be reinforced. In addition, the regions will be better integrated into regional dialogue structures to enable them to participate fully in the coordination, planning, monitoring, and evaluation of programs and projects relevant to their constituency. The same applies to the laws and regulations governing decentralized bodies, through the correction of inconsistencies.

E. Reform of Public Enterprises

54. The government has launched an ambitious plan to restore the profitability of the state electricity and water company JIRAMA. In April 2005 it transferred management of the company to a private company under a two-year management contract, and over the course of 2005 year implemented two tariff increases raising electricity prices by 76 percent. It also contracted with financial experts to review JIRAMA's financial situation and prepare a financial restructuring plan for the utility, which resulted in a conference of development partners held in Paris from January 10-12, 2006 at which the plan was presented to the donor community. The government has increased water and electricity prices by a further 20 and 15 percent, respectively, in 2006, and will contribute MGA 50 billion to capital increases of the company in 2006. The government will include an appropriation of MGA 7 billion in the 2007 Budget Law with a view to repaying the loan contracted by the Treasury with the National Social Security Fund (CNAPS) to fund a transfer to JIRAMA in 2005. In September 2007, the government will grant a concession to a private party regarding the management and operation of JIRAMA when the current private management contract expires. On the basis of these commitments, donors have committed to provide financial support for JIRAMA's restructuring.

55. Reforms aimed at reducing government involvement and liquidating public enterprises will be continued. The schedule for 2006–07 envisages, with the financial support of development partners, liquidation through the divestiture of assets of 22 public enterprises, including principally: ROSO (distribution), FIMA (transport), SIB (wood), COROI (distribution), RNCFM SUD (transport) and Port de Manakara (transport). A timetable and estimates of net proceeds from the sales will be drawn up before October 2006.

F. Social Policies and Poverty Reduction

56. Within the framework of improving the welfare of the population and reducing poverty, specific measures will be continued and strengthened in the fields of education, health, access to drinking water, and sanitation. Educational actions will target the following: (i) improvement of access to education by building new classrooms in rural areas, particularly for primary schools; (ii) more precise identification of intervention sites by improving the distribution of schools; (iii) recruitment, training, and rational distribution of new teachers, including at the primary school level; and (iv) procurement of basic teaching materials and essential equipment. To ensure a significant reduction in the repetition rate, more multigrade classes are needed in rural areas, especially in isolated localities, as well as more full-cycle schools.

57. Actions in the health sector will focus on: (i) improvement of public access to quality services by building and refurbishing basic health centers (CSBs), and raising the technical level of reference hospitals through the rehabilitation and provision of technical equipment and materials; (ii) development of human resources by recruiting medical and paramedical staff, along with support personnel and specialists; (iii) budgetary prioritization for new

structures and remote areas; and (iv) studying of a system of incentives for doctors in remote areas.

IV. PROGRAM PERFORMANCE CRITERIA AND MONITORING

58. The program supported by the IMF under the PRGF will be monitored through semiannual reviews and through quantitative and structural performance criteria and benchmarks, and indicative targets (Tables 1 and 2).

59. The Government of Madagascar will also observe the standard performance criteria against imposing or intensifying exchange restrictions, introducing or modifying multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, and imposing or intensifying import restrictions for balance of payments reasons.

Table 1. Madagascar: Quantitative Performance Criteria for the 2006 PRGF Arrangement ¹
(Billions of Ariary, cumulative from 1st January, 2006, unless otherwise indicated)

	July 31 <u>Performance Criteria</u> Proposed Program	September 30 <u>Benchmark</u> Proposed Program	December 31 <u>Performance Criteria</u> Proposed Program
I. Quantitative performance criteria			
External			
(a) Ceiling on accumulation of new external arrears (in millions of SDRs) ²	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
Central Bank			
(c) Floor on net foreign assets (NFA) of the BCM	-24.1	62.7	77.5
(d) Ceiling on net domestic assets (NDA) of the BCM	16.8	-35.6	36.9
Fiscal			
(e) Ceiling on domestic financing of the central government	133.9	62.1	-55.7
(f) Floor on tax revenue	695.1	907.8	1,295.8
(g) Ceiling on accumulation of new domestic arrears ²	0.0	0.0	0.0
II. Memorandum items:			
(h) Budget support grants and loans (in millions of SDRs)	16.6	48.6	73.6
(i) External cash debt service (in millions of SDRs)	17.7	18.2	27.1
(j) Program exchange rate (MGA/US dollar)	3,134.7	3,134.7	3,134.7

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 2. Prior Actions, Structural Performance Criteria and Benchmarks

	Timing
Prior Actions for Board Consideration of a New-PRGF Supported Program	
<ul style="list-style-type: none"> • Verification of expenditure and tax revenue performance during the first quarter of 2006 in line with the target discussed with staff. 	Implemented
<ul style="list-style-type: none"> • Publication, in the press and on the government website and via posters in customs offices and tax centers, of the elimination of: (i) ad hoc tax and/or tariff exemptions except in cases provided in the Customs Code, international treaties or conventions and in exceptional cases decided by the Council of Government (natural disaster, public interest, reasons of State); (ii) waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (<i>Rapport d'inspection recevabilité</i> RIR and <i>Rapport d'inspection enlèvement</i> RIE), or on the use of the pre-/post inspection company SGS valuation of goods. 	Implemented
<ul style="list-style-type: none"> • Adoption of a medium-term PFM action plan that will address deficiencies in the control of the budget commitment and monitoring process. 	Implemented
<ul style="list-style-type: none"> • Finalization of a satisfactory action plan for JIRAMA. 	Implemented
<ul style="list-style-type: none"> • Approval by the central bank Governor of an action plan for implementing the main recommendations of the March 2006 Safeguards Assessment. 	Implemented
<ul style="list-style-type: none"> • Submission to Parliament of a supplementary budget which increases the share of PRSP priority spending in total domestically financed spending compared to the 2006 budget, and is in line with the 2006 fiscal program. 	
<ul style="list-style-type: none"> • Issuance of instructions by Ministry of Finance to all ministries to submit monthly plans for expenditure commitments in accordance with the quarterly budget appropriations. 	
Performance Criteria	
<ul style="list-style-type: none"> • No waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (<i>Rapport d'inspection recevabilité</i> (RIR) and <i>Rapport d'inspection enlèvement</i> (RIE), or on the use of the pre and post inspection company SGS valuation of goods. 	Continuous
<ul style="list-style-type: none"> • No granting of ad hoc tax and/or tariff exemptions outside those specified in the. the Customs Code, international treaties or conventions. 	Continuous
<ul style="list-style-type: none"> • Finalization of an audit of the VAT arrears owed by the government on capital expenditure. 	September 30, 2006
<ul style="list-style-type: none"> • No Transactions shall be carried out between the government and the central bank that are contrary to the provisions of the Central Bank Charter. 	Continuous
<ul style="list-style-type: none"> • 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
Benchmarks	
<ul style="list-style-type: none"> • Extension of the new ASYCUDA++ software to the five largest customs bureaus. 	September 30, 2006
<ul style="list-style-type: none"> • Inclusion of a recapitalization plan for the BCM in the 2007 Budget Law. 	October 31, 2006
<ul style="list-style-type: none"> • Development of a comprehensive time bound action plan translating the 2003 and 2006 IMF FAD tax administration recommendations in operational terms. 	December 31, 2006
<ul style="list-style-type: none"> • Install the expenditure tracking information system SIGFP in 13 ministries 	December 31, 2006
<ul style="list-style-type: none"> • Completion of the verification of at least 80 percent of outstanding VAT credits at end-June 2006. 	December 31, 2006

ANNEX: MADAGASCAR: ECONOMIC AND FINANCIAL POLICY MEASURES FOR 2006–08

Area	Measures	Timing
Tax Policy	<p>Objective: Generate sufficient internal resources to achieve the MDGs and improve the business climate by:</p> <ul style="list-style-type: none"> ➤ Streamlining the taxation system, and ➤ Strengthening its implementation. 	
	<ul style="list-style-type: none"> • No ad hoc tax or tariff exemptions outside those specified in the Customs Code, international treaties or conventions. 	Continuous
	<ul style="list-style-type: none"> • Disseminate notice of exceptional exemptions decided by the Council of Government (natural disasters, public good, reasons of State) in the press, on the government website and via posters in customs offices and tax centers. 	Continuous
	<ul style="list-style-type: none"> • Report to Fund staff any decision on exemptions made by the Council of Government as quickly as possible. 	Continuous
	<ul style="list-style-type: none"> • Restrict the status of export processing zones to existing sectors. 	Continuous
	<ul style="list-style-type: none"> • Restrict excise duties to alcohol, cigarettes, petroleum products, mining products, and cosmetics. 	January 2006
	<ul style="list-style-type: none"> • Simplify evaluation modalities of excise duties on beverages, alcohol and cigarettes. 	January 2006
	<ul style="list-style-type: none"> • Increase excise duties on gasoline by 66 percent and on diesel by 178 percent. 	January 2006
	<ul style="list-style-type: none"> • Maintain the single VAT rate (non-zero) for both local and imported goods. 	January 2006
	<ul style="list-style-type: none"> • Reduce the number of goods subjected to excise duties and fees. 	January 2006
	<ul style="list-style-type: none"> • Through internal memoranda of the Minister of Economy, Finance, and Budget instruct all officials to apply only those exemptions provided in the Customs Code, international treaties or conventions and those decided by the Council of Government in exceptional cases (natural disasters, public good, reasons of State). 	May 2006
	<ul style="list-style-type: none"> • Transmit to the IMF the audit report on import fees and rice distribution justifying a rebate on customs duties in 2005. 	May 2006
	<ul style="list-style-type: none"> • Publish, in the press and on the government website and via posters in customs offices and tax centers, the elimination of: (i) ad hoc tax and tariff exemptions except in cases provided in the Customs Code, international treaties or conventions and in exceptional cases decided by the Council of Government (natural disaster, public good, reasons of State); (ii) waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (RIR and RIE), or on the use of SGS valuation of goods. 	June 2006
	<ul style="list-style-type: none"> • Complete a study of possible restrictions to the scope of excise duties. 	December 2006
	<ul style="list-style-type: none"> • Reduce the length of the holiday period (currently 5-7 years depending on the sectors) for corporate income tax for new export processing zone (EPZ) enterprises, while maintaining the privileges of existing EPZ enterprises. 	2007 Budget

Area	Measures	Timing
	<ul style="list-style-type: none"> Eliminate exemptions on corporate income tax, including for export processing zone enterprises, while maintaining the privileges of existing enterprises. 	2008 Budget
	<ul style="list-style-type: none"> Generalize VAT repayment on petroleum products to all sectors subject to VAT. 	January 2007
	<ul style="list-style-type: none"> Eliminate excise duties and fees on sugar and flour. 	January 2008
	<ul style="list-style-type: none"> Reduce the number of rates of excise duties and fees. 	2008
Customs Administration	Objective: improve customs duties collection and streamline procedures.	
	<ul style="list-style-type: none"> No waivers of the requirement to present pre and post-customs inspection reports for the import and clearance of goods (RIR and RIE), or on the use of SGS valuation of goods. 	Continuous
	<ul style="list-style-type: none"> Tighten eligibility for economic regimes (temporary admission, customs warehouse, transit, etc.). 	January 2006
	<ul style="list-style-type: none"> Verify post-customs inspection reports (RIE) not returned to SGS to determine whether duties and taxes were actually paid. 	May 2006
	<ul style="list-style-type: none"> Update exemption arrangements in the ASYCUDA system. 	May 2006
	<ul style="list-style-type: none"> Implement the CIVIO system by SGS to verify the value of used vehicles. 	July 2006
	<ul style="list-style-type: none"> Publish monthly table in the press and on the government website presenting all duty and tax exemptions (name of beneficiary, nature of goods, reason for exemption, amount of forgone revenues) prepared using the ASYCUDA computer system. 	June 2006 onward
	<ul style="list-style-type: none"> Issue a monthly table of goods not inspected by the PSI company (SGS). 	June 2006 onward
	<ul style="list-style-type: none"> Deploy the new ASYCUDA++ software in the next five largest customs bureaus. 	September 2006
	<ul style="list-style-type: none"> Use a "watermark" securing system to minimize risks of counterfeit customs documents (Council of Government decisions granting duty-free treatment, inspection reports, etc.). 	September 2006
	<ul style="list-style-type: none"> Establish of the TRADENET electronic information platform at Tamatave Port. 	December 2006
	<ul style="list-style-type: none"> Implement strictly the requirement on bank transfers for duty and tax payment. 	January 2007
Tax Administration	Objective: Broaden tax base.	
	<ul style="list-style-type: none"> Strengthen coverage of, and compliance with tax obligations by, medium-sized taxpayers (annual turnover of between 0.5 and two billion Ariary), while continuing to improve the tax management of large enterprises (turnover above two billion Ariary). 	2006
	<ul style="list-style-type: none"> Design and implement a selective audit program covering all categories of taxpayers (giving priority to large and medium-sized enterprises) and combine different audit methods. 	2006

Area	Measures	Timing
	<ul style="list-style-type: none"> • Provide for 36 billion additional credits in budget for paying counterpart funds (VAT, RPI). 	2006 Supplementary Budget Law
	<ul style="list-style-type: none"> • Reduce to two months the time limit required for VAT refunds. 	March 2006 onward
	<ul style="list-style-type: none"> • Establish monthly activity and performance <i>indicators</i> for all tax collection entities, including the DFGE (large taxpayer directorate) and the regional services. 	May 2006
	<ul style="list-style-type: none"> • Establish monthly activity and performance reports for all tax collection entities, including the DFGE (large taxpayer directorate) and the regional services. 	2006
	<ul style="list-style-type: none"> • Publish a monthly table in the press and on the government website presenting all tax and duty exemptions (name of beneficiary, nature of goods, reason for exemption, amount of forgone revenues) prepared using the SYGTAS and SURF computer systems. 	As of June 2006
	<ul style="list-style-type: none"> • Establish an action plan for better taxation on mining and tourism sectors. 	June 2006
	<ul style="list-style-type: none"> • Start implementing these action plans in line with the timetable approved. 	September 2006
	<ul style="list-style-type: none"> • Rotate tax inspectors in the DFGE (large taxpayer directorate). 	December 2006
	<ul style="list-style-type: none"> • Audit the management of the various DFGE units. 	December 2006
	<ul style="list-style-type: none"> • Draw up a comprehensive time bound action plan translating the 2003 and 2006 IMF FAD tax administration recommendations in operational terms. 	December 2006
	<ul style="list-style-type: none"> • Implement that action plan. 	2007-08
	<ul style="list-style-type: none"> • Establish a computerized communication network between the Tax Directorate, Customs, and Treasury to enable rigorous checks on tax revenues. 	January 2007
	<ul style="list-style-type: none"> • Establish payment of taxes and duties through commercial banks. 	January 2007
Public Finance Management	Objective: Improve contribution of public expenditures to growth and poverty reduction by strengthening budget preparation and execution and the control of budget execution.	
	<ul style="list-style-type: none"> • Improve the ratings of at least 5 out of the 28 criteria between 2006 and 2008 for performance of public finance management under the PEFA program. <p>Madagascar is associated with the donor community under the joint annual ratings for performance of public finance management under PEFA program. The first PEFA exercise (May 2006) will make it possible to build a medium term action program (3 years) for improving PFM.</p>	2006-08
	<ul style="list-style-type: none"> • Start implementing 2006 priority action plan of public finance management, including namely: <ul style="list-style-type: none"> ➢ adoption and implementation, for the 2007 budget, of a new schedule for budget preparation that starts in June. ➢ action plan that will address deficiencies in the control of budget commitment. 	March 2006
		June 2006
		May 2006

Area	Measures	Timing
	➤ transmission of 2004 -management accounts (June 2006) and 2005-(December 2006) to the Auditor General (Cour des comptes) and.	Before end 2006
	➤ transmission of 2002 and 2003 draft reports on budget execution (Lois de Règlement) (June 2006) and 2004-(December 2006) to Parliament.	June 2006 December 2006
	➤ setting up the new legal public procurement framework (enforcement texts and standard documents).	By Jan 1st 2007
	➤ enforcing new legal public procurement framework.	2007-08
	• Send to IMF the audit report prepared by IGE on exceptional expenditures in 2003-04.	February 2006
	• Adopt a medium-term PFM action plan that will address deficiencies in the monitoring and control of budget commitments.	May 2006
	• Issue instructions (Ministry of Finance to spending ministries to submit monthly plans for expenditure commitments in accordance with the quarterly budget appropriations.	June 2006
	• The Ministry of Finance issues monthly commitment ceilings for the last quarter of 2006 to all ministries on the basis of the latest cash flow plan prepared by the Treasury. • Limit commitments to the monthly expenditure ceilings specified in the ministries' monthly commitment plans.	September 2006 onward
	• Present expenditures according to a three-level classification (mission, program, objectives) in the 2007 Budget Law submitted to Parliament.	October 2006
	• Create a Budget Directorate integrating recurrent and capital expenditures so as to strengthen consistency in the preparation and execution of both types of expenditures.	December 2006
	• Complete verification of at least 80 percent of VAT credits outstanding as of June 30, 2006.	December 2006
	• Identify, audit, and settle all VAT payment arrears owed on externally-funded capital expenditure:	December 2006
	➤ Establish the modalities.	March 2006
	➤ Make a public appeal to identify arrears.	April 2006
	➤ Complete the audit of the government's VAT arrears on capital expenditure.	July 2006
	➤ Check the arrears.	September 2006
	➤ Implement the modalities of a multi-year plan for settlement of arrears in the 2007 Budget Law.	October 2006
	• Establish the modalities for settlement of other government arrears.	January 2007
Monetary Policy	Objectives: (i) Improve effectiveness of monetary policy; (ii) reduce financial intermediation costs; and (iii) broaden the range of monetary policy instruments, including use of indirect instruments for managing liquidity.	
	• Introduce a bill modifying the provisions of the Central Bank Charter governing the securitization of government debt held by the Central Bank in negotiable securities.	December 2006
	• Use open market operations as the primary means of managing money market	Continuous from

Area	Measures	Timing
	liquidity and avoiding overly frequent changes in the required reserve ratio.	January 2007 onward
	<ul style="list-style-type: none"> Define the mechanism for implementing the conversion of State securitized debt held by BCM in exchangeable securities. 	June 2006
	<ul style="list-style-type: none"> Limit transactions between the government and the central bank to only those permitted by the Central Bank Act, as certified by the external auditor in its report on the annual audit of the central bank accounts. 	July 2006
	<ul style="list-style-type: none"> Reduce gradually the monetary financing of Treasury (« statutory advances ») to below 10 percent of the previous year's revenues. 	2008
	<ul style="list-style-type: none"> Improve liquidity management and coordination between the Central Bank and the Treasury regarding Treasury bill issuance. 	Continuous
Exchange Rate Policy	Objective: Make the exchange market more efficient.	
	<ul style="list-style-type: none"> Implement the operational guide for BCM interventions on the interbank foreign exchange market (MID). 	Continuous
	<ul style="list-style-type: none"> Make sure that MID screens are updated on a regular basis. 	Continuous
	<ul style="list-style-type: none"> Make sure that all sale and purchase orders go through MID. 	Continuous
	<ul style="list-style-type: none"> Publish every day in the official media and newspapers and on BCM website, for the attention of the wider public, the quantity transacted, weighted average, and minimum and maximum rates by currency for currencies exchanged on the MID. 	Continuous
	<ul style="list-style-type: none"> Remind banks to observe the MID market rules (Convention de Place du MID). 	Continuous
	<ul style="list-style-type: none"> Submit a bill to Parliament proposing a new foreign exchange code. 	October 2006
Financial Sector Reforms	Objective: Increase the size and effectiveness of financial markets and reduce transaction costs.	
	<ul style="list-style-type: none"> Draw up a priority action timeline to strengthen the financial system following the Financial System Assessment Program (FSAP). 	September 2006
	<ul style="list-style-type: none"> Complete actuarial surveys in the two public pension funds and make any required parameter changes. 	June 2007
	<ul style="list-style-type: none"> Implement priority action timeline to strengthen the financial system. 	2006-08
	<ul style="list-style-type: none"> Extend access to public auctions of treasury bills to other major cities. 	2006
	<ul style="list-style-type: none"> Reduce minimum denomination of treasury bills to below MGA 20 million 	2007
	<ul style="list-style-type: none"> Define a schedule for resolving the problems of the distressed insurance company. 	October 2006
Payment System Reforms	Objective: Reduce transaction fees with MCA assistance.	

Area	Measures	Timing
	<ul style="list-style-type: none"> • Launch an exhaustive reform program for payment systems. 	2006-08
	<ul style="list-style-type: none"> • Reduce to maximum 5-10 days the time limit for cashing off site checks, the diagnostic survey for which will be financed by MCA. 	2006-08
	<ul style="list-style-type: none"> • Computerize the keyboarding of checks and the calculation of trade-off balances. 	2006-08
	<ul style="list-style-type: none"> • Amend the law to enable electronic means of payment. 	2006-08
	<ul style="list-style-type: none"> • Set up a steering committee to implement reform of payment systems. 	2006-08
Strengthening the Financial System Supervision	Objective: Strengthen the financial system.	
	<ul style="list-style-type: none"> • Strengthen supervision of the banking system by increasing the Banking and Financial Supervision Commission's (CSBF) resources. 	June 2006
	<ul style="list-style-type: none"> • Include a recapitalization plan for the central bank in the 2007 Budget Law. 	October 2006
	<ul style="list-style-type: none"> • Strengthen the supervisory agency for insurance companies (training, staff and additional financial resources). 	June 2007
	<ul style="list-style-type: none"> • Issue implementing decrees for the Law on Microfinance. 	December 2006
	<ul style="list-style-type: none"> • Define prudential and management standards for the Law on Microfinance 	December 2006
	<ul style="list-style-type: none"> • Define a plan to remedy current weaknesses in supervision of nonbank financial institutions and insurance companies (e.g. , private pension funds, post office saving banks, financial services by post). 	December 2007
	<ul style="list-style-type: none"> • Strengthen training of central bank staff who specialize in supervising microfinance institutions. 	December 2007
	<ul style="list-style-type: none"> • In the new Banking Law, make CSBF responsible for authorizing and controlling foreign exchange bureaus. 	December 2007
Statistics	Objective: Improve information supporting economic policy.	
	<ul style="list-style-type: none"> • Produce revised national accounts based on the new estimates for 2001 compiled with IMF technical assistance. 	2007
	<ul style="list-style-type: none"> • Increase the number of skilled staff in INSTAT and enhance their training. 	2006-08
	<ul style="list-style-type: none"> • Adopt a law for the compilation and distribution of statistics required for establishing national accounts. 	2006-07
Improving the Financial System Environment	Objective: Improve financial system contribution to financing the development of the economy.	
Legal and Judiciary Framework	<ul style="list-style-type: none"> • Set up a regular schedule of meetings between the Minister of Justice and financial sector professionals to raise awareness of problems and push reforms of the financial sector. 	

Area	Measures	Timing
	<ul style="list-style-type: none"> • Ensure the independence of the “Conseil Supérieur de la Magistrature” and transparency in appointments, promotion and sanctions of judges. 	
	<ul style="list-style-type: none"> • Launch medium- and long-term plans to reform the judiciary based on existing diagnoses and provide sufficient funding. 	
	<ul style="list-style-type: none"> • Improve theoretical and practical training (particularly by increasing the resources provided to ENMG--the Institute for Magistrates and Clerks of Court). 	
	<ul style="list-style-type: none"> • Make legal information more accessible: through the official gazette, then CD ROMs, and finally through the Internet). 	
	<ul style="list-style-type: none"> • Build capacity for drafting texts and the strengthening of the independence and capacity of the Business Law Reform Committee (Commission de réforme du droit des affaires). 	
	<ul style="list-style-type: none"> • Reform land legislation to ease land titling and mortgaging. 	
	<ul style="list-style-type: none"> • Streamline the law governing the use of securities as collateral for credit. 	
Improving Financial Information Quality	<ul style="list-style-type: none"> • Set up a data base on enterprises balance sheets. 	
	<ul style="list-style-type: none"> • Launch an incentive and assistance program to foster the use of reliable accounting documents by enterprises so as to broaden the pool of bankable enterprises. 	
Financial Taxation	<ul style="list-style-type: none"> • Revise the taxation of financial products to eliminate distortions. 	January 2006
	<ul style="list-style-type: none"> • Implement the reform. 	January 2007
Assessing BCM safeguard procedures	Objective: Ensure the financial transparency of the central bank by adopting fiduciary procedures that observe best international practices.	
	<ul style="list-style-type: none"> • Analyze the source of central bank losses, and set up a program to enhance its financial independence. 	August 2006
	<ul style="list-style-type: none"> • Publish the 2005 BCM audited accounts. 	August 2006
	<ul style="list-style-type: none"> • Have the central bank governor approve a satisfactory time-bound action plan for implementing the main recommendations of the March 2006 IMF Safeguards Assessment, including an assignment of responsibilities. 	June 2006
	<ul style="list-style-type: none"> • Include a recapitalization plan for the central bank in the 2007 Budget Law. 	October 2006
	<ul style="list-style-type: none"> • Recapitalize the central bank. 	2007
	<ul style="list-style-type: none"> • Secure executive board approval of an action plan for total adoption of IFRS standards, starting with the 2007 financial statements. 	June 2006
	<ul style="list-style-type: none"> • Correct the presentation of balances relative to Madagascar’s status as an IMF member, as well as to its obligations: (i) report the SDR 11.3 million disbursement in the PRGF as part of obligations to the IMF; (ii) report the 	June 2006 December 2006

Area	Measures	Timing
	quota subscription in the Securities Account in the balance sheet.	
	<ul style="list-style-type: none"> Conduct quarterly reviews of data relative to net foreign assets and to net domestic assets and communicate the results to the IMF to ensure that they are consistent with the technical memorandum of understanding (for the PRGF modality envisaged), as well as accounting data and financial statements. 	Ongoing during program
	<ul style="list-style-type: none"> Appoint an international auditor working according to international audit standards (ISA) and having IFRS expertise in the bidding process for the 2006 external audit. So as to facilitate transition to IFRS standards, make sure the external auditor selected is associated with a professional audit firm from an international financial center that will countersign the audit opinion report. 	June 2006
	<ul style="list-style-type: none"> Adjust the book entry transfers from the special exchange account that offset central bank cumulated losses and increased non-distributed revenues. 	August 2006
	<ul style="list-style-type: none"> The BCM sets up, in its accounting system, a system which identifies realized and unrealized foreign exchanges gains or losses. 	June 2006
	<ul style="list-style-type: none"> Have the internal audit department (IAD) acquire a database in which it can list and monitor implementation of the recommendations of the audit. 	December 2006
Foreign Trade Policy	Objective: Strengthen growth potential by increasing its integration into the world economy.	
	<ul style="list-style-type: none"> Reduce the number of tariffs on foreign trade (non-zero tariff band) from four to three, with the ultimate goal of a single, non-zero tariff. 	January 2006
	<ul style="list-style-type: none"> Announce and start a study on the tariff level required to neutralize the tax impact of the uniform tariff. 	June 2006
	<ul style="list-style-type: none"> Publish the results of the study. 	June 2007
	<ul style="list-style-type: none"> Reduce clearance time at the main port to two days for an importer presenting the required documents. 	
Foreign Indebtedness	Objective: Maintain a sustainable level of foreign indebtedness.	
	<ul style="list-style-type: none"> Do not accumulate foreign arrears. 	Continuous
	<ul style="list-style-type: none"> Do not contract or guarantee foreign debt on nonconcessional conditions. 	Continuous
RAMA	Objective: Strengthen the growth potential of the economy by ensuring a continuous and competitive energy supply.	
	<ul style="list-style-type: none"> Finalize a satisfactory action plan for JIRAMA. 	May 2006
Civil service Reforms	Objective: Strengthen potential for growth and poverty reduction by ensuring an economical supply of first quality public services.	
	<ul style="list-style-type: none"> Adopt (Council of Ministers) measures for reforming the civil service, including a new classification of assignments and positions, decompression of the salary 	2007-08

Area	Measures	Timing
	gap among civil servants, and introduction of merit-based salary increases.	
	<ul style="list-style-type: none">• Computerize the civil servant database to better match individual qualifications with job requirements.	2007-08

**ATTACHMENT II—MADAGASCAR: TECHNICAL MEMORANDUM ON MONITORING THE 2006
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 indicative targets for the program, how they are calculated, and any adjustments deemed 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, all variables are measured as the cumulative change from their January 1, 2006 level. The objectives for end-September are indicative targets; those for end-July and end-December are performance criteria. **Program and benchmark targets must be adjusted (as explained below) for comparison to actual outturns.**

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Ceiling on Accumulation of New External Payments Arrears

2. These arrears will consist of overdue debt-service obligations (i.e., payments of principal and interest) in respect of 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 within the contractual due date or within a grace period agreed with, or unilaterally granted by, each creditor prior to the contractual due date. They will 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 the Contracting or Guaranteeing of Nonconcessional External Debt

Definition

3. 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 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, the 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/Adjustment method

4. Calculation of the degree of concessionality of new external debt is based on the ten-year average of the OECD's commercial interest reference rate (CIRR) for loans or leases with maturities greater than 15 years and the six-month average CIRR for loans or leases 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 gross foreign assets and total foreign liabilities of the BCM, including debt to the IMF.

Calculation/Adjustment method

6. The program target of NFA must be adjusted in Ariary (MGA) for the difference between the actual and program exchange rate, for comparison with the actual outturn. The target is also subject to adjustment for the shortfall/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 central bank deposit auctions—*appels d'offres négatifs*), and other items net.

Calculation/Adjustment method

8. The target for NDA will be adjusted for the variation of the actual versus the program exchange rate, applied to the level of foreign exchange deposits held by the government. The target is adjusted for the excess/shortfall in the net external balance of payments support as explained below. Finally, the target 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 the commercial banks.

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

Definition

9. The central government (CG) corresponds to the scope of operations of the treasury shown in the *opérations globales du Trésor* (or OGT).
10. The net domestic financing of the CG is the sum of:
 - a. the variation in the stock of net bank claims on the CG, plus
 - b. the change in CG's debt to the nonbank system (domestic and non-resident), 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 level of central government domestic payments float (*paiements en instance*), plus
 - f. the payment of outstanding arrears.
11. The amount of central government domestic payments float is the difference between committed and paid expenditure.
12. The payment of outstanding arrears refers to the MGA 20 billion of unpaid bills (prior to 2006) to JIRAMA and TELMA.
13. Net bank claims on the government are measured by the change in net credit to government in the monetary survey; and 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.
14. Nonbank claims consist of BTAs and other treasury bills (BTs) and bonds placed with nonbank institutions (domestic and non-resident) and the public.

Calculation/Adjustment method

15. The amount for net bank claims on the CG should be adjusted for foreign exchange deposits of the government valued at the actual exchange rate. 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 initial issue—not at their redemption value.
17. Net domestic financing is subject to adjustment for excess/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 revenues received by the treasury, including suspense items and those related to the public investment program.

G. Ceiling on Accumulation of New Domestic Payments Arrears

Definition

19. Payments arrears consist of all Treasury expenditures for which payment orders have been issued but have not been paid by the Treasury within three months (*dépenses ordonnancées mais non-payées*). This performance criterion should be observed on a continuous basis.

II. MONITORING VARIABLES AND MEMORANDUM ITEMS

H. Balance of Payments Assistance

Definition

20. External balance of payments assistance is defined as cash nonproject loans and grants provided as financing and resulting in funds available to the treasury (budget support). It does not include the stock of International Development Association (IDA) and African Development Fund (AfDF) debt cancellation under MDRI. It excludes any disbursement of loans by the IMF and assistance that gives rise to counterpart funds for the treasury with a delay of longer than one year. (See TMU Table 1, attached, for specification of flows.)

Calculation method

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

I. Cash Debt Service

22. Amount of external debt service expected to be paid in cash by the central government, net of HIPC and MDRI debt relief. (See TMU Table 1, attached, for specification of flows).

J. Program Exchange Rate

Definition

23. For program purposes, all foreign exchange stocks and flows that affect performance criteria have been converted to Ariary at the program exchange rate of 1 SDR = MGA 3,134.7. (Amounts denominated in U.S. dollars and in euros are converted to SDRs by applying the program rates of US\$1.44=SDR 1, and €1.20=SDR 1).

III. EXCHANGE RATE AND NET BALANCE OF PAYMENTS ASSISTANCE ADJUSTERS

A. Differences Between Program and Actual Exchange Rate

24. To compare program targets to actual outturns, those foreign exchange stocks and flows that affect program targets will be adjusted for the difference between the actual and programmed SDR exchange rate.

B. Excess/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 (paragraph 20 above) less external cash debt service (paragraph 22).

26. **In the event of a shortfall** in net external balance of payments assistance at end-July 2006, end-September 2006, or end-December 2006 versus the programmed amount for the corresponding period, the floors and ceilings will be adjusted by the amount of the shortfall up to a cumulative maximum of SDR 15 million, on an as needed basis and according to the following method:

- a. the floor on the BCM's NFA target will be adjusted downward by an equal amount up to a cumulative maximum of SDR 15 million (the adjustment will be converted at the actual exchange rate);
- b. the ceiling on the BCM's NDA target will be adjusted upward by an equal amount up to a cumulative maximum of SDR 15 million (the adjustment will be converted into MGA at the actual exchange rate); and
- c. the ceiling on the central government's net domestic financing target will be adjusted upward by an equal amount up to a cumulative maximum of SDR 15 million (the adjustment will be converted into Ariary at the actual exchange rate).

27. **In the event of a cumulative excess** in net external balance of payments assistance of more than SDR 17.5 million, the following adjustments will be made:¹

- a. the floor on the BCM's NFA target will be adjusted upward by the excess (the adjustment will be converted into Ariary at the actual exchange rate);
- b. the ceiling on the BCM's NDA target will be adjusted downward by the excess (the adjustment will be converted into Ariary at the actual exchange rate); and
- c. the ceiling on net domestic financing target of the central government will be adjusted downward for the excess (the adjustment will be converted into Ariary at the actual exchange rate).

IV. CONSULTATIONS WITH FUND STAFF ON THE PERFORMANCE CRITERION

28. In the event that a major shift in monetary policy or exchange rate policy is required, or if monetary outturns exhibit substantial variation from their targets, the authorities will consult Fund staff on measures to be taken in the context of exchange and monetary policy management.

29. In the event of substantial unexpected fiscal expenditures, for example, concerning JIRAMA or privatizations, the authorities will inform Fund staff to discuss corrective actions.

V. INFORMATION AND DATA TO BE SUPPLIED TO FUND STAFF

30. The Malagasy authorities will provide Fund staff with information and data by email or facsimile according to the schedule provided; the Fund's resident mission will be copied on all such exchange of information.

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 for treasury bills and other government securities;

¹ The amount of SDR 17.5 million was used because it is equal to the second tranche from the ADB, which is not programmed to be disbursed in 2006 but could be disbursed. In the event of disbursement, this adjuster would allow the authorities to spend this tranche according to the contingent expenditure plan that has been identified.

- information on monetary developments, as required by the Statistics Department of the International Monetary Fund (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 monthly foreign exchange cash flow table, including foreign debt operations;
- the table of interbank foreign exchange operations on the MID, including the amount of non-satisfied bids for sales and purchases;
- banking sector prudential ratios; and
- data on foreign trade (exports and imports).

Quarterly

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

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 reform;
- 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; and
- indicators of sectoral economic activity.

Quarterly

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

Every four months

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

31. 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 should be reported to Fund staff on a timely basis for consultation or information, as appropriate.

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

	July 31	September 30	December 31
Budget support	16.6	48.6	73.6
Grants	16.6	20.8	28.3
European Union	16.6	20.8	28.3
Loans	0.0	27.8	45.3
World Bank	0.0	27.8	27.8
African Development Bank	0.0	0.0	17.5
External debt service (cash basis) ¹	17.7	18.2	27.1
Interest	12.1	12.3	16.1
Amortization	5.6	5.9	11.0
Net balance of payment assistance	-1.1	30.4	46.5

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

¹ Net of HIPC and MDRI debt relief.