International Monetary Fund

Republic of Madagascar and the IMF

Press Release:
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December 21, 2006

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

November 25, 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.

MADAGASCAR: LETTER OF INTENT

Antananarivo, Madagascar
November 25, 2006

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

Dear Mr. de Rato,

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

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

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

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

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

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

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

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

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

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

Sincerely yours,

/s/ /s/

Benjamin Radavidson
Minister of Economy, Finance and Budget

Gaston Ravelojaona
Governor
Central Bank of Madagascar

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

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

I. MEDIUM-TERM PERSPECTIVES

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

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

II. RECENT ECONOMIC DEVELOPMENTS AND STATUS OF PROGRAM IMPLEMENTATION

A. Recent Economic Developments

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

III. Program for the Remainder of 2006 and for 2007

A. Macroeconomic Framework

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

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

B. Fiscal Reform Policy

1. Fiscal policy

20. Efforts to stabilize public finance will continue through 2006 and into the medium term. In 2004, the Government embarked on an ambitious fiscal reform project designed to help it get a better grip on public expenditure, match resource allocations with national priorities, and better control the use of public funds. In the short term the principal fiscal policy target is to reduce net domestic financing of the budget[1] by MGA 55.7 billion (0.5 percent of GDP) in 2006. That will make it possible to keep domestic indebtedness sustainable. Should this year's domestic revenue turn out to differ from the programmed amounts, additional revenue or shortfall that is not offset by external flows will be offset by adjusting the expenditures financed by domestic resources to observe the domestic financing target. Additional receipts will boost the allocations to priority ministries via the advances decree procedure. If there is a shortfall, the Ministry of Economy, Finance, and Budget will issue a circular to adjust spending by regulating commitments mainly in nonpriority sectors.

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

[1] As defined in the Technical Memorandum of Understanding (Attachment II).

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

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

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

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

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

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

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

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

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

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

2. Tax policy

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

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

3. Reform of tax and customs administrations

Tax administration

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

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

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

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

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

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

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

Customs administration

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

31. Customs policy priorities for 2007 are to

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

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

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

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

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

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

4. Public financial management

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

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

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

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

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

- enhancement of SIGFP capabilities in the six provinces;

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

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

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

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

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

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

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

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

C. Monetary Policy and Financial Sector Development

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

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

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

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

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

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

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

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

E. Trade Policy

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

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

F. Foreign Debt and Support

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

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

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

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

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

G. Reform of Public Enterprises

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

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

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

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

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

H. Governance

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

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

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

I. Social Policies and Poverty Reduction

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

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

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

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

IV. Program Monitoring

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

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

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

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

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

Sources: Malagasy authorities and Fund staff estimates and projections.

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

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

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

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

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

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

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

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

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

ATTACHMENT II

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

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

I. QUANTITATIVE CRITERIA

A. Ceiling on External Payments Arrears

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

B. Ceiling on Nonconcessional External Borrowing

Definition

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

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

Calculation

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

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

Definition

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

Calculation

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

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

Definition

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

Calculation

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

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

Definition

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

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

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

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

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

d. domestic or foreign receipts from privatization operations, plus

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

f. the variation in identified domestic arrears.

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

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

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

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

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

Calculation

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

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

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

F. Floor on Tax Revenue

Definition

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

G. Ceiling on Accumulation of New Domestic Payments Arrears

Definition

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

II. Monitoring Variables and Memorandum Items

A. Balance of Payments Assistance

Definition

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

Calculation

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

B. Cash Debt Service

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

C. Program Exchange Rate

Definition

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

III. Exchange Rate and Net Balance of Payments Assistance Adjusters

A. Differences Between Program and Actual Exchange Rate

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

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

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

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

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

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

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

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

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

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

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

IV. Information and Data to be Supplied to Fund Staff

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

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

Monthly

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

Quarterly

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

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

Monthly

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

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

Quarterly

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

Every four months

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

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

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

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

Source: Malagasy authorities and Fund staff estimates and projections.

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

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

[3] Includes STABEX and PASA.

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

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

Source: Malagasy authorities and Fund staff estimates and projections.

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

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

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

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

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