International Monetary Fund

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

January 7, 2008

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Republic of Madagascar and the IMF

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MADAGASCAR: LETTER OF INTENT

Antananarivo, Madagascar
January 7, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn,

1. On December 20, 2006, the Executive Board of the International Monetary Fund (IMF) completed the first review of Madagascar's economic performance under a three-year Poverty Reduction and Growth Facility (PRGF) arrangement. The Executive Board approved the three-year arrangement on July 21, 2006, for a total amount of SDR 55.0 million to support the government's economic program for 2006-2008 and the activation of the Trade Integration Mechanism (TIM).

2. The attached memorandum of economic and financial policies (MEFP) reviews the macroeconomic and financial performance and the implementation of economic policies through November 2007. It also updates the program of economic policies and structural reforms that the government of Madagascar will implement in 2008.

3. All quantitative performance criteria (PC) at the end of December 2006—the test date for the second review—were met, with the exception of the ceiling on domestic financing of the central government. This ceiling was missed owing to the obligatory expenditure which exceeded the budgeted amount in the 2006 Finance Law. In order to avoid a recurrence of such spending overage in 2007, the government has revised credit for these expenditure upwards and implementing offsetting cuts in nonpriority expenditure in its fiscal program.

4. One structural PC was also missed at end-December 2006. The continuous structural PC on no waivers of the established procedures for valuation and clearance of goods at customs was not respected in August 2006 and, as we had reported to the Executive Board that no such departures had occurred at the time of consideration of the first review, one case of misreporting has occurred, for which we have implemented remedial actions described in a separate letter.

5. All the quantitative PC at the end of June 30, 2007—the test date for the third review—have been met, except the floor on tax revenue. Tax receipts were lower than planned, because of the impact of the appreciation in the exchange rate on customs revenue

and a brief period of adjustment at the Tax Directorate until a new management team settled in. The government has taken drastic steps taken since then to modernize the tax code and the management of customs- and tax-revenue collection.

6. Two other PCs were missed in 2007: the central bank was recapitalized with one month delay because of supplementary groundwork which needed to be finalized with the support of the Fund's Monetary and Capital Markets (MCM) department; and the issuance of quarterly commitment ceilings was done with a three week delay owing to the need to consult with development partners regarding the additional budget transfers required to rehabilitate the public utility company JIRAMA.

7. Given the remedial measures already taken in response to three missed PCs, and in view of the limited delay after which the two last measures set as structural PCs have been met, the government of Madagascar requests a waiver for these five performance criteria.

8. The government of Madagascar believes that the policies and measures set forth in the attached memorandum are adequate to achieve its program objectives. However, it will 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 the Fund's policy in such consultation.

9. To facilitate the attainment of the objectives and implementation of the policies described, the government of Madagascar hereby requests completion of the second and third reviews and disbursement of the third and fourth loans under the current arrangement in an amount equivalent to SDR 15.712 million. At this time, an increase in access to Fund resources under the TIM's deviation feature is not justified.

10. The government of Madagascar undertakes to carry out the fourth review of the PRGF program by the end of June 2008, and the fifth review by the end of December 2008. Inter alia, The fourth review will discuss the measures needed to eliminate the deficits of the civil servants' pension funds, to be reflected in the 2009 Finance Law, and priority measures to further strengthen revenue collection by the customs administration following the conclusions of the recent private audit of import operations, and to collect unpaid taxes and duties identified by this audit.

11. 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 second and third reviews of the program.

Sincerely yours,

/s/

Haja Nirina Razafinjatovo
Minister of Finance and Budget

/s/

Frédéric Rasamoely
Governor
Central Bank of Madagascar

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

ATTACHMENT I

MADAGASCAR: MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2007–08

I. RECENT ECONOMIC DEVELOPMENTS AND PROGRAM IMPLEMENTATION

A. Recent Economic Developments

1. In 2007, the first year of the Madagascar Action Plan (MAP), there are signs of even stronger economic growth (6.3 percent) than in 2006 (5.0 percent), driven by a massive inflow of foreign direct investment (FDI) resulting from two major mining projects. Despite the impact of severe weather on food prices in early 2007, inflation fell to 8.5 percent in November 2007. The year-on-year appreciation of the MGA in real terms was in the region of 13 percent at end-October 2007. Despite good export performance, the current account of the balance of payments widened during the first semester owing to strong mining projects and Export Processing Zone (EPZ) imports. The overall balance of payment improved nonetheless owing to reduced external debt service, and FDI inflows. This improvement in the balance of payments paved the way for larger reserves at the Central Bank of Madagascar (BCM), which, at end-October 2007, amounted to 3.3 months of imports (excluding large mining projects). By end-September 2007, despite a shortfall in tax receipts, domestic financing of the budget (program definition, excluding recapitalization of the BCM) was below the program ceiling, owing to cuts in nonpriority expenditure and sluggishness in the execution of other expenditures. In June, the government decided to grant a tax amnesty on penalties due on tax arrears, the terms of which do not pose a threat to the government's revenue targets.

B. Performance Measured Against Performance Criteria and Structural Benchmarks up to November 2007

2. As of end-December 2006, all quantitative performance criteria were met, except the ceiling for the central government's domestic financing needs (Table 1). Net domestic financing as defined in the program[1] exceeded the program ceiling by MGA 54 billion (0.4 percent of GDP) as a result of overruns of: (i) MGA 14 billion on pensions; (ii) reimbursement of VAT credits for MGA 10 billion; and (iii) MGA 30 billion in interest outlays (resulting from the rise in interest rates and further auctioning of treasury bills prompted by the above-mentioned excess expenditures).

[1] See ¶¶11-16 of the Technical Memorandum of Understanding (TMU).

3. This overrun led to an upward adjustment of the central government's contribution to civil service pension funds and the reimbursement of VAT credits (¶2), and of the transfer to the water and electricity company, JIRAMA, as well as a reduction of MGA 63 billion (0.4 percent of GDP) in nonpriority expenditures in the revised 2007 budget programming (¶14-15). Considering these measures taken to avoid a further overrun of the domestic financing ceiling for 2007, the government requests a waiver for nonobservance of this performance criterion (PC).

4. In the structural area, contrary to the situation described in our letter of intent of November 25, 2006,[2] it has become clear that the continuous PC on no waivers of the requirement to present pre- and post-customs inspection reports for the import and clearance of goods (*Rapport d'inspection recevabilité* [RIR] and *Rapport d'inspection enlèvement* [RIE]), or on the use of the pre- and post inspection company *Société Générale de Surveillance* (SGS) valuation of goods was not observed (Table 2). In fact, one exemption from inspection by SGS was granted by the Minister of the Economy, Finance, and Budget in August 2006. This involved the filing of a submission (*soumission*), a procedure provided for under the customs regulation consisting in a commitment to produce a customs document after clearing the imported goods (Article 103.3 of the 2006 Customs Code). The authorization to file such a declaration was granted so that the RIR could be produced subsequently, given the size of the lot of goods concerned, the conditions of warehousing facilities at the port of Mahajanga, and the sensitivity of the product (sugar). It so happened that the importer did not choose to file a submission, thus rendering the ministry's authorization void. Given the corrective measures described in ¶¶ 29-31, the government requests a waiver for nonobservance of this PC.

5. Nevertheless, all the structural benchmarks at end-December 2006 were met, except one: the completion of the audit of at least 80 percent of outstanding VAT credits for the period ending end-June 2006 was delayed for three months, because of the importance attached to the preparation of a priority action plan to strengthen the tax administration.

6. As of June 30, 2007, all the quantitative performance criteria have been met, except the floor on tax revenue (Table 3). Tax receipts were lower than planned, because of the impact of the appreciation in the exchange rate on customs revenue and a brief period of adjustment at the Tax Directorate until a new management team settled in. Given the specific steps taken since then to modernize the management of customs- and tax-revenue collection (¶¶ 23-31), the government requests a waiver for nonobservance of this PC.

7. In 2007, all structural performance criteria have been observed except the

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[2] IMF Country Report No. 07/7, Republic of Madagascar: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver and Modification of Performance Criteria, Table 2, p. 47 (http://www.imf.org/external/pubs/ft/scr/2007/cr0707.pdf).

recapitalization of the central bank (BCM) and the midterm update of the quarterly commitment plan, which were delayed two months and three weeks, respectively (Table 4). As far as the recapitalization of the BCM is concerned, these delays are a reflection of the need to fine-tune technical preparations with cooperation from Fund staff, and, as far as the quarterly commitment plan is concerned, the need to consult with development partners regarding the additional budget transfers needed to rehabilitate the public utility company JIRAMA (¶¶48-49). As these measures have been implemented, the government requests a waiver for nonobservance of these PC.

8. In 2007, three structural benchmarks have been observed, and it is proposed to postpone four benchmarks until 2008. New monetary policy instruments were created for the BCM, (¶41), the tax code was modernized (¶¶20-21), and priority actions were implemented to strengthen tax administration (¶23). However, the study on the appropriateness of a nonzero uniform customs tariff, its budgetary and economic impact, and other possible options within the framework of regional integration has been delayed owing to the unavailability of the World Customs Organization expert; the study will be finalized by end-January 2008. In addition, the difficulties encountered in implementing reforms of fiscal management and the electricity sector led to the postponement of three structural benchmarks initially established for the last quarter of 2007 to 2008 (Table 6).

II. PROGRAM IN 2007–08

A. Implementation of the MAP

9. The MAP (Madagascar Action Plan)[3] is the development plan for the period 2007-11, which serves as a reference for annual budget programming and the medium-term expenditure framework. The task of preparing the Implementation Plan (PMO) for the MAP was carried out with the collaboration of all ministries. The PMO will be refined, augmented, and supplemented with summaries of sectoral policies and strategies to make it more responsive and coherent, especially in terms of intersectoral linkages. To this end, Technical Working Groups (GTT) made up of sectoral representatives and technical and financial partners were set up to carry out the process. These GTTs will also serve as a platform for discussing issues related to implementation of the National Integrated Monitoring/Assessment System (SNISE), refining the costing, and, finally, accurately assessing the MAP financing gap.

10. In terms of mobilizing international support for implementation of the MAP, the technical and advocacy documents to be presented to the partners are being prepared. A task force bringing together the government and partners was set up to identify strategic

[3] Country Report No. 07/59, Republic of Madagascar: Poverty Reduction Strategy Paper—Madagascar Action Plan. (http://www.imf.org/external/country/MDG/index.htm)

approaches to preparing for the conference, planned for early 2008. This conference will also be an opportunity to launch the joint government/partners platform (Friends of Madagascar Club) for dialogue on improving aid effectiveness. Moreover, all the activities involved in steering the MAP process take into account all the aspects and concepts related to implementation of the Paris Declaration (alignment, appropriation, harmonization, results-based management, and shared responsibilities).

B. Macroeconomic Framework

Macroeconomic framework revised in 2007

11. The 2007 macroeconomic framework has been revised to take account of the impact of massive inflows of foreign direct investment linked to the implementation of two major mining projects (ilmenite and nickel mining) totaling an estimated USD 4 billion (54 percent of GDP) in the period 2006 to 2010. Inasmuch as the local component of these projects is about 20 percent during the construction phase, they are generating a net inflow of foreign exchange, which leads to a real appreciation of the exchange rate and creates increased demand for currency.

12. Therefore, the economic growth rate in 2007 was revised upward from 5.6 percent to 6.3 percent. The end-period inflation rate was revised upward from 8.0 percent to 8.4 percent because of the rise in oil prices. This appreciation also negatively affected customs revenues and the domestic currency value of external aid, requiring a reduction in expenditures to curb the growth of net domestic financing compared with the programmed level.

Macroeconomic framework in 2008

13. The 2008 macroeconomic framework is based on the MAP priorities. The economic growth rate is projected to be 7.3 percent, owing to the impact of major mining investments on the tertiary sector (notably the construction and public works sectors—BTP). These investments should push investment to 34 percent of GDP and explain the deterioration in the current account, where the deficit is expected to exceed 23.4 percent of GDP. Export volumes should increase by 8 percent due especially to efforts to diversify, the strong performance of the textile sector, Madagascar's membership in the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC), and the continuation of programs such as the Integrated Growth Poles and projects financed by the Millennium Challenge Account. The tertiary sector is being driven both by increased construction and the tourism sector, the development of which is being fostered by the implementation of new legal provisions on real estate ownership, the law on investment, and the implementation of major hotel construction projects. Despite rising international fuel prices and increases in the prices of other forms of energy, inflation by end-2008 should remain at about 7.2 percent, thanks to a prudent monetary and fiscal policies.

C. Economic and Financial Policies

Fiscal policy

Fiscal policy adjustments in 2007

14. During the midterm budget execution review, it was deemed necessary to revise the target for tax revenue and current grants downward to a total of MGA 80 billion (0.6 percent of GDP) and the amount of expenditure upward to MGA 214 billion (1.5 percent of GDP). The downward revision of tax revenue is a reflection of the effect of the 15 percent appreciation of the MGA over and above the projection in the 2007 budget law. The upward revision of expenditure is due in large part to the recapitalization of the BCM, the specific details of which were unknown at the time the 2007 budget law was drafted, and, for the rest, to the underestimation of certain expenditures (reimbursement of VAT credits, civil service pensions, transfer to JIRAMA) in the budget law. On the other hand, new estimation allowed a downward revision of the external debt service by MGA 42 billion (0.3 percent of GDP).

15. In keeping with its commitments under the program, the government lowered the ceiling on nonpriority expenditure commitments by MGA 63 billion (0.5 percent of GDP) vis-à-vis the 2007 budget law, with a view to curbing its reliance on domestic financing. As a result of these expenditure cuts, it should be possible to keep the government's reliance on domestic financing as defined in the program to less than 0.5 percent of GDP, not including the impact of recapitalization of the BCM.[4]

16. Accordingly, the government requests an upward revision of the ceiling on domestic financing by MGA 44,1 billion (0.3 percent of GDP) and a downward revision of the tax revenue floor by MGA 31 billion (0.3 percent of GDP) for 2007.

Fiscal policy in 2008

17. The draft 2008 budget law submitted to Parliament reflects the government's will to increase tax revenue by 0.7 percent of GDP, match expenditures with MAP priorities, and involve the regions closely in defining and implementing fiscal policy. The increase in tax revenue and external aid contributed by the development partners enabled the government to allocate a fiscal expenditure envelope of 20.9 percent of GDP, of which a mere 0.8 percent of GDP will be financed with domestic debt. In order to improve the effectiveness of spending, regional heads will be responsible for executing 306 investment projects costing a total of MGA 106 billion (0.6 percent of GDP) in close collaboration with the officials in charge of the deconcentrated entities of the ministries and those reporting to the Ministry of Finance

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[4] See TMU, ¶12.

and the Budget. To avoid having to cut outlays midstream in the fiscal year to deal with tax revenue shortfalls or surplus expenditures, the government decided to allocate MGA 45 billion (0.3 percent of GDP) to a reserve account, which could be allocated to the departments and ministries in the second half of the year, depending on revenue and expenditure performance.

18. In addition to earmarking expenditures of MGA 1825,9 billion (11.5 percent of GDP) for the priority ministries of education, health, agriculture, public works and transport, justice, the environment, and energy (of which MGA 54 billion or 0.3 percent of GDP for the restructuring of JIRAMA), the draft budget law is focused in particular on the on the rehabilitation of civil service retirement funds (MGA 85 billion or 0.5 percent of GDP), and on the regularization of those arrears outstanding prior to the start of the program in July 2006 and now being audited by a private firm (MGA 39 billion or 0.3 percent of GDP).

19. The payment of VAT on externally financed capital expenditures is another priority for 2008. Accordingly, the government has committed to the priority execution of appropriations of MGA 132 billion in the draft 2008 budget law to pay the VAT on externally financed capital expenditures. Furthermore, to ensure that the commitment and payment of this category of expenditures takes place without delay, the government announced in the press that entrepreneurs must submit to the Ministry of Finance and the Budget a copy of the request for payment addressed to the other ministries and institutions. Based on this information, the Ministry of Finance and Budget will contact relevant spending ministries to ensure payment of the counterpart expenditures fewer than 60 days after receipt of the appropriate documents.

Tax policy

20. In 2008, the government decided to modernize the Tax Code with a view to increasing tax revenue and creating a growth-friendly climate. To promote a simple, fair, and growth-friendly tax system, the aim of the modernization of the Tax Code is to :

- create an attractive income tax regime, and
- reduce the number of taxes from 28 to 14 by eliminating the taxes that are low in yield and heavy in administrative costs.

21. By applying these principles, the government decided to implement a reform of the General Tax Code with a positive effect on revenue by introducing the following changes in the Code within the framework of the 2008 budget law approved by Parliament:

- merge the Corporate Income Tax (IBS) and the Nonwage Income Tax (IRNS) of natural persons into a single tax to be known as “Income Tax,” with a single proportional rate 25 percent as well as a simplification of the Tax on Wage and

Similar Income (IRSA) by applying a single tax rate of 25 percent above a monthly income of MGA 180,000 (US$100);

- increase of tax rate of the Tax on Income from Capital (IRCM) from 15 to 20 percent and introduce an exemption on dividends ;

- reduce the list of products subject to excise duty by eliminating the excise duty on sugar, flour, perfume and beauty products, pay-TV reception, semi-processed mining products, mineral water, and carbonated waters with added sugar or other sweeteners;

- Increase the VAT rate from 18 to 20 percent and the tax liability threshold from MGA 50 to MGA 200 million (US$ 28,000 to 110,000) in annual turnover and eliminate the Transaction Tax; and

- Eliminate the Business Tax (*Taxe Professionnelle* or TP), the Transfer Tax (*Taxe forfaitaire sur les transferts* or TFT, and the transaction tax (*Taxe sur les transactions* or TST).

22. In 2008, the government will review the competitiveness of the tax regime applied to major mining investments in light of the results of a study being conducted in collaboration with the World Bank.

Reform of the tax and customs administrations

Tax administration

23. The emphasis in 2007 has been on improving the management of the tax operations of the Large Enterprises Directorate, which saw a change-out of its entire staff complement following a comprehensive reorganization of its services and administrative procedures. This has involved significant improvements in case management, the enhancement of employees' technical skills to boost performance in tax auditing and collection, closer involvement of managers and executives in the implementation of reforms, and the upgrading of services offered to enterprises.

24. In keeping with the strategy paper and action plan for tax administration reform (2007–11), initiatives to overhaul tax case management will be expanded to other tax centers with high yield potential. The related actions planned for 2008 cover:

- an overhaul of operations in the Regional Business Bureaus managing small and medium-sized enterprises, in line with the reforms under way at the Large Enterprises Directorate (archiving and effective monitoring of cases, reactivation of inactive cases, documentary audits, and follow up of outstanding collections);

- implementation of bank transfers as a mode of tax payment at the level of the regional business bureaus; and

- further strengthening of the effective monitoring of cases and scheduling of on site inspections based on the rehabilitation work begun in 2007 at the Large Enterprises Directorate.

25. Another priority will be to improve the functioning of the VAT. To this end, the government has pledged to reimburse, within 60 days of the correct filing of the application with the Directorate General of Taxes or the Directorate General of Customs, VAT credits to exporters and tax credits on petroleum products (TPP) and VAT on petroleum products (TVAPP) to oil distributors for refueling of international airline and shipping companies.

Customs administration

26. The government reiterates its commitment to abolishing all "ad hoc" tax or customs duty exemptions or suspensions (i.e., those not provided for by law, in the General Tax Code, in the General Customs Code, in international treaties or conventions), except for those expressly adopted by the Council of Government in exceptional circumstances (disasters, public interest, or reasons of State) (proposed PC, Table 6). Such decisions on granting exemptions will be systematically published in the press, including the name of the beneficiary enterprises and the amount of exempted duties and taxes, and posted in all customs bureaus and tax centers throughout the country.

27. The installation of the Tradenet electronic platform linking all economic agents involved in external trade is the main priority of the customs administration in 2007-08. This platform will simultaneously complete the computerization of customs clearance procedures and make them faster and more secure. The installation will complete the transition from the system of pre-shipment inspection carried out with private inspection companies to a system of inspections at destination performed by the customs administration, based on the requirement to generate a cargo tracking slip (BSC) for imported goods shipped since April 1, 2007. The customs administration has redoubled its efforts to ensure that this new system will be fully operational by end-December 2007 at the Toamasina port. Tradenet is due to be deployed in all the other ports by end- 2008. Given the priority placed on installing Tradenet, the automatic transfer of data on revenue collection by the Directorate General of Taxes and the Directorate General of Customs to the Directorate General of the Treasury via SIGFIP will need to be postponed to June 30, 2008 (proposed benchmark, Table 6).

28. Another priority has been the deployment of the ASYCUDA++ software in three additional bureaus in 2007, over and above the eight high-volume bureaus where it was installed at end-2006. In addition, the customs administration will develop additional features for the basic modules in 2008, with technical assistance from the United Nations Conference for Trade and Development (UNCTAD). Other priorities will include the reorganization and strengthening of the Anti-Fraud Unit, the optimal use of management and selectivity tools in

audit operations, and additional training for customs agents.

29. Despite the fact that, from March 2003 to March 2007, all imports of goods were subject to the presentation of an import inspection report (RIR) and a clearance inspection report (RIE), the statistics of the inspection company SGS show that, since July 2006, about 20 percent of the imports recorded had an RIR but no RIE. The government entrusted the Independent Anti-Corruption Bureau (BIANCO) with the task of conducting an audit of all such imports between July 1, 2006 and March 31, 2007to verify the payment of duties and taxes and, where necessary, to collect them. A task force composed of members of the Customs Administration and SGS was formed to provide BIANCO with all the assistance necessary for the purpose. An initial phase of the audit identified 2,278 import operations with an RIR but no RIE between July 2006 and March 2007. The government then ordered an audit by a private audit firm to identify which of those operations had been granted an exemption from the requirement of presenting an RIE or valuation of the goods by SGS. The auditors' task also included determining the reasons for the lack of an RIE and, in applicable cases, why a valuation other than the SGS valuation was used. This audit revealed no additional waiver from SGS inspection, beyond the one that came to the surface in March 2007 (¶4) and produced many recommendations to strengthen tax collection by the Customs administration.

30. Consequently, to further ensure the payment of import duties and taxes, the government decided to:

- establish within each customs bureau a section responsible for reviewing declarations, particularly for cargo tracking notes (BSC) for shipments on or after April 1, 2007, for consistency between the documents, and the relevant customs regime codes;

- put in place a system to entrust the release of goods leaving the ports exclusively to a team headed by a customs inspector and made up of members of the Directorate General of Customs (DGD) and the private firm GasyNet in charge of Tradenet (proposed PC, Table 6), subject to the following conditions: (i) the head of the team will report directly to the Director of External Services at DGD headquarters and will receive no instructions from local DGD officials; (ii) the work of the team will be formally described in terms of reference, which will include verification that the customs declaration corresponds to the cargo tracking note (BSC) and corresponds with the tariff line in the ASYCUDA++ system; and (iii) the head of the team will have the authority to prohibit the departure of goods, based on transparent procedures;

- tighten customs control by installing an automatic gate and surveillance cameras at the entrance and exit of port or airport customs enclosures;

- entrust to a private company with expertise in customs inspections the task of ongoing audits of 5–10 percent of import declarations to verify, each month in 2008, the value determined by the Customs Administration, the calculation of import duties and taxes, and the payment of said duties and taxes; and

- have a specialized firm conduct an independent annual audit of the Customs Administration's enforcement of the Customs Code and applicable procedures.

31. Moreover, the government commits to using the recommendations of the audit (¶29) to further strengthen tax collection by the customs administration, and collecting the unpaid tax and duties identified by the audit. To that end, the government will discuss the audit recommendations with IMF staff and agree on additional priority measures to improve customs reforms on the occasion of the next review under the arrangement under the PRGF (¶56).

Public financial management reform

32. The government will continue to place emphasis on achieving a marked improvement in budget preparation and in the monitoring of budget execution. The government proposes to postpone the adoption of a simplified budget classification until the 2009 Budget Law, because of the need for more time to consult with the spending ministries (proposed benchmark, Table 6). With technical assistance from the IMF Fiscal Affairs Department and the support of external partners, the government will improve its cash management by continuing to fine-tune the cash flow plan and strengthen procedures for updating it in conjunction with the quarterly commitment regulation.

33. In 2008, the government will give priority attention to the deployment and use of the automated fiscal management information system (SIGFP). Accordingly, it will implement the following priority measures:

- production via SIGFP of monthly expenditure commitment reports, including the number of and reasons for rejections by the Directorate General of Financial Supervision (proposed benchmark, Table 6) ; and
- Monthly production of the trial balances of all treasuries linked to SIGFP, which are used to prepare the Treasury general operations table (OGT) (proposed benchmark, Table 6).

34. A reform aimed at eliminating the structural deficit of the civil service retirement system, which a recent actuarial study estimated at 0.8 percent of GDP, will be implemented under the 2009 Budget Law. First, however, in 2008 the government will review the system's parameters, take stock of the existing legislation, organize workshops for stakeholders, and explore the possibility of creating a pensions directorate within the Ministry of Finance and the Budget.

35. In 2009 the government will enhance the transparency and step up the financial supervision of government agencies that collect royalties not included in the central government budget (including the mining agency OMNIS, the port, airport, and telecommunications authorities). The government will use the results of ongoing financial audits for that purpose.

Monetary and exchange policy

36. The central bank reiterates its resolve to conduct a monetary policy aimed at keeping inflation in the single digits and, along with the government, confirms its commitment to the floating exchange rate policy. Under this policy, the BCM intervenes on the exchange market to avoid excessive day-to-day exchange rate volatility, occasionally "lean against the wind" to avoid potential overshooting of the exchange rate, and achieve its objective of accumulating foreign exchange reserves.

37. In response to the expected surge in the demand for money caused by FDI flows and the deepening of financial intermediation, the BCM decided to revise upward its growth objective for base money relative to the initial program in 2007, and to generate additional liquidity primarily by accumulating more exchange reserves than initially planned (Table 3). The objectives of the monetary program in 2008 were based on the assumption that these developments would continue (Table 5).

38. The government believes that the appreciation of the MGA on the foreign exchange market since mid-2006 can be attributed to the increased demand for local currency resulting from FDI flows and solid export performance. The government is aware that preserving the competitiveness of the Malagasy economy in the context of currency appreciation will require an improvement in business productivity and implementation of the structural reforms outlined in the MAP aimed at reducing the production costs of enterprises, including: rehabilitation of road and port infrastructures, increase in the supply of electricity, improvement of the training and health of the workforce, strengthening of the financial system, and the simplification of administrative procedures.

39. The government also adopted the following measures to ease the pressure on the MGA to appreciate:

- in May 2007, the time limit for repatriating export receipts was extended from90 days to 180 days for non-EPZ enterprises; and

- in June 2007, the ceiling on the foreign exchange position of credit institutions was raised from 10 percent to 20 percent.

40. The BCM will also consider the advisability of creating an interbank forward exchange market and will review the exchange reserves management guidelines to ensure

that reserves are managed optimally while remaining usable.

Financial sector development policy

41. The key component of the financial sector reform in 2007-08 consists of strengthening the financial independence of the BCM by recapitalizing it and implementing new monetary policy instruments. In line with the technical assistance recommendations of the IMF Monetary and Capital Markets Department, the government recapitalized the BCM by issuing securities. To maintain the BCM's equity at an adequate level, profits available for distribution will be allocated to the legal reserve until the sum of the capital and the legal reserve reaches 10 percent of the central bank's monetary liabilities. The government's consolidated debt to the BCM was restructured as negotiable securities, which bear market interest rates and provide the central bank with a new tool to manage liquidity on the money market. To protect the BCM's financial position, the government will reimburse the sterilization costs generated by BCM interventions on the foreign exchange market, estimated at MGA 19 billion (0.1 percent of GDP). The government will also review the central bank law to adapt it to the SADC requirements.

42. To further enhance financial stability, the BCM will prepare a plan by mid-2008 to bring its operating cost under control, based on the recommendations of the IMF Monetary and Capital Markets Department. Specifically, this plan will include:

- a study on the possibility of reducing the costs of currency circulation by replacing small denominations banknotes with coins; and
- a review of the staffing level, organization, and compensation system at the BCM.

43. To promote financial intermediation, the government is preparing a financial sector development strategy in close cooperation with the staff of the IMF, the World Bank, and other partners. In 2008, the main components of the strategy include:

- assessing implementation of the new real-time payments system;
- establishing a central credit register to improve the quality of financial system data; and
- expanding microfinance institutions and stepping up their supervision by the Banking and Finance Supervisory Commission (CSBF). A new regulation governing this sector will be issued.

New initiatives are also being launched:

- the government is considering the advisability of creating a development bank, possibly to be financed and managed by the private sector;

- the possibility to set up of a securities exchange is being considered; and.
- the public savings institution (*Caisse d'Épargne de Madagascar*) has requested a change in status in order to become a bank.

Trade policy

44. Trade liberalization will continue. Madagascar is furthering its integration into the South African Development Community (SADC). In this connection, in December 2006 Madagascar signed a protocol with South Africa designed to promote investment between the two countries. In addition, Madagascar began reducing customs duties on products from the SADC countries in October 2007. Almost all such duties will be eliminated by 2012. The government is currently undertaking a study on the impact of that tariff reduction. In the medium term, the structure of customs tariffs will be simplified in order to eliminate certain distortions. Madagascar reached an interim agreement with the European Commission that covers market access, fisheries and development issues of the Economic Partnership Agreement (EPA). This agreement secures Madagascar favorable market access to the European Union (EU) and Madagascar will phase out customs tariffs for about 80 percent of its imports from the EU over 15 years. Negotiations on other aspects of the EPA will continue in 2008.

Debt management

45. External debt management continues to be based primarily on the maintenance of a sustainable level of debt. The actions already taken to achieve this objective are the limitation of external debt to concessional loans. The institutional structure of debt management has remained unchanged since the completion point of the HIPC Initiative. However, the installation of the DMFAS system has improved the efficiency of debt management. The Malagasy government is currently seeking financing to obtain the latest version of DMFAS, activate the DSM+ debt sustainability analysis tool, and provide training for staff.

46. The government is also working to finalize bilateral agreements on external debt cancellation. In 2006, agreements on full debt cancellation were signed with two members of the Paris Club (Sweden and Israel). In 2007, an agreement was concluded with Japan concerning a number of loans. The agreements on a recent Japanese loan and with the Russian Federation are in process of finalization. As regards countries that are not Paris Club members, agreements were concluded in 2007 with the Abu Dhabi Fund and the People's Republic of China. Negotiations are currently under way with Libya and Iraq. Despite requests by the Malagasy government, no draft agreements have been received from Algeria.

Reform of public enterprises

47. Electricity generation and distribution are essential for the country's economic and social development. Given the serious financial and production problems facing the national company JIRAMA, which have resulted in power cuts and poor quality service, the government has received technical assistance from the World Bank and the French government for the rehabilitation and reform of JIRAMA, and has commissioned the IFC to provide advice on the implementation of a leasing contract. On the basis of this assistance, and following the conclusions of a joint mission of the World Bank, the French Development Agency (AFD) and the European Investment Bank (EIB), the government commits to continue to carry on JIRAMA's restructuring.

48. To improve JIRAMA's financial position in the near term, and aware of the sociopolitical constraints that a sudden, appreciable increase in rates would entail, the government plans to raise electricity prices by 45 percent in nominal terms: it raised electricity prices by 15 percent, effective October 1, 2007 and plans to implement two more 15 percent price increases effective, respectively, April 1 and October 1, 2008. In 2009, the government will put in place a price indexing formula that will cover operating costs, take account of future rehabilitation investment needs, and eliminate budgetary operating subsidies.

49. In light of the decision to raise prices gradually, the government decided to increase budgetary transfers to JIRAMA from MGA 25 to 43 billion in 2007 to cover losses and urgent investments. This additional investment assistance is being disbursed pursuant to a protocol between the Ministry of Finance and Budget, the Ministry of Energy, and JIRAMA, as validated by the World Bank and the IFC. The government will transfer MGA 54 billion to JIRAMA under the 2008 Budget Law. A memorandum of understanding on capital expenditure, similar to the one on expenditure in 2007, will be drawn up.

50. To carry on JIRAMA's restructuring, the government will renew the contract of the current management team until end-March 2009 and strengthen the team with a few additional experts. At the end of that period, the government will sign a new management contract for a period of five (5) years with clear and measurable performance indicators. This management contract will be subject to an open bidding process that will be prepared in 2008 (proposed benchmark, Table 6). At the end of this management contract, and when all the conditions will be met, the government commits to maintaining the improved performance within the framework of a strengthened partnership with the private sector, with the aim of receiving private financing and eliminating all budgetary transfers.

Policies conducive to private sector development

51. The government has presented to Parliament a new investment law designed to provide a secure, practical, and transparent framework for all investment activities in Madagascar. The law is based on the following principles: (i) the establishment of a secure and attractive legal framework for all private investments in Madagascar, without favoring any given category of investors; (ii) streamlining of a large number of administrative procedures; (iii) access to commercial property for companies incorporated under Malagasy law, whether or not controlled by foreign interests; (iv) establishment of the Economic Development Board of Madagascar (EDBM), with the task of facilitating investment projects as well as promoting and developing investment in Madagascar.

52. The government will propose a draft law to promote exports to Parliament by end-May 2008 (proposed PC, Table 6). It will be elaborated in close cooperation with the private sector. Exports are critical for economic development. Export promotion should help boosting output and fighting poverty through improved income distribution and effective use of Madagascar's untapped potential. In the context of this law, the government will propose measures to promote exports by all sectors and companies without relying on tax exemptions. As a result, the duty free zone and enterprise regime will be eliminated, while grandfathering existing enterprises in the regime. (proposed PC, Table 6). During the elaboration of the law, the Ministry of Budget and Finance and the Ministry of Economy, Trade and Industry will closely collaborate with the EDBM to avoid granting new duty free zone or enterprise agreement for legal or fiscal arbitrage purposes.

Governance

53. Given the country's significant oil and mineral resources, as well as the authorities' commitment to good governance and fiscal transparency, in March 2007 the government officially confirmed its membership in the Extractive Industries Transparency Initiative (EITI) at the EITI conference in Oslo. In August 2007, the government publicly announced its resolve to include civil society in the process, as well as companies operating in the extractive industry. A committee was set up, composed of representatives of the government, the mining and oil companies, and civil society, and including the press and nongovernmental organizations. In December, these representatives drew up a work plan to ensure transparency of the collection and allocation of revenue from mining and petroleum extraction. The government will launch an information campaign to raise awareness in the country concerning the activities of the extractive industry, regulation, and the responsibilities of corporations and citizens in those activities. With support from the Norwegian government and international institutions, the government wishes to obtain appropriate instruments to prevent the adverse effects of the flow of extractive industry investment ("Dutch disease": i.e., local currency appreciation, inflation, and other induced macroeconomic effects). The government also intends to create a "fund for future generations," so that a portion of the revenue that the country's oil and mineral resources are

expected to generate can be invested abroad. As these instruments and the details of the fund have yet to be determined, the government is requesting IMF technical assistance to help in assessing the best method of implementation.

54. Madagascar intends to combat money laundering and major financial crimes. For this purpose, it has decided to set up a Financial Intelligence Unit (SAMFIN). This independent administrative authority will receive a budget appropriation of MGA 1.1 billion (US$600,000) in 2008. Operational in the first quarter of 2008, it will analyze and process the declarations to be filed by entities that conduct, advise on, and control capital movement transactions. The unit will participate in international cooperation and in networks of agencies that combat money laundering.

Statistics

55. In accordance with the MAP, the government intends to improve its statistical system and to make data more easily accessible by the public. The BCM and the Ministry of Finance and Budget will publish statistical data on the Internet. In 2008, the National Statistics Institute (INSTAT) plans to produce a quarterly industrial production index and quarterly national accounts. It also plans to change the base year of the national accounts to 2005 (instead of 1984, currently) as well as modify the reference basket of the consumer price index to better reflect the current consumption of Malagasy households and expand the geographic coverage of the index.

III. PROGRAM MONITORING

56. The program supported by the IMF under the PRGF will be monitored through half-yearly reviews and by applying quantitative and structural performance criteria and benchmarks, as well as the indicative targets mentioned in Tables 5 and 6. The fourth review will include a discussion of the reform of civil service pension funds, to be implemented upon the entry into force of the 2009 Budget Law, and on priority measures to strengthen duty and tax collection by the Customs administration as a follow up to the conclusions of the recent private audit of import operations (¶29), and to collect unpaid taxes and duties identified by this audit.

Table 1. Madagascar: Quantitative Performance Criteria and Indicative Targets for the PRGF Arrangement, 2006 [1]
(Billions of ariary, cumulative change 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 [3]	Actual	Actual Adjusted	Status
I. Quantitative performance criteria													
External													
(a) Ceiling on accumulation of new external arrears (millions of SDRs) [4]	0.0	…	0.0	Met	0.0	…	0.0	Met	0.0	0.0	0.0	…	Met
(b) Ceiling on contracting or guaranteeing of new external debt on nonconcessional terms [4]	0.0	…	0.0	Met	0.0	…	0.0	Met	0.0	0.0	0.0	…	Met
Central Bank													
(c) Floor on net foreign assets (NFA) of the BCM [5]	-24.1	-18.2	31.9	Met	62.7	61.6	148.1	Met	77.5	77.5	127.4	198.0	Met
(d) Ceiling on net domestic assets (NDA) of the BCM [5]	16.8	8.7	-47.5	Met	-35.6	-36.7	-102.4	Met	36.9	36.9	-2.2	-72.9	Met
Fiscal													
(e) Ceiling on domestic financing of the central government [5]	133.9	133.9	-8.2	Met	62.1	66.4	-62.6	Met	-55.7	-55.7	47.6	-2.0	Not Met
(f) Floor on tax revenue	695.1	…	722.0	Met	907.8	…	906.5	Not Met	1,295.8	1,259.3	1,260.8	…	Met
(g) Ceiling on accumulation of new domestic arrears [4]	0.0	…	0.0	Met	0.0	…	0.0	Met	0.0	0.0	0.0	…	Met
II. Memorandum items:													
Floor on net foreign assets (NFA) of the BCM NFA (SDR millions) [5,6]	-7.7	-7.7	10.1		20.0	20.0	47.0		47.7	19.9	47.7	62.5	Met
Net external budget (program) support (SDR millions)	-1.1	…	-7.7		30.4	…	46.4		46.5	59.0	44.2	…	
Budget support grants and loans (SDR millions)	16.6	…	15.2		48.6	…	69.4		73.6	84.0	79.2	…	
External cash debt service (SDR millions)	17.7	…	22.9		18.2	…	22.9		27.1	25.0	35.0	…	
Exchange rate (MGA/SDR)	3,134.7	…	3,172.1		3,134.7	…	3,153.3		3,134.7	3,167.3	3,027.3	…	

Sources: Malagasy authorities and IMF staff estimates and projections.

[1] See Technical Memorandum of Understanding (TMU) in IMF Country Report No. 07/7 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] IMF Country Report No. 07/7, Republic of Madgascar: First Review under the Three-Year Arrangement under the PRGF.
[4] To be observed on a continuous basis.
[5] Excluding capital transfer flowing from MDRI assistance from IMF via central bank.
[6] 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-custor reports for the import and clearance of goods (*Rapport d'inspe recevabilité* [RIR] and *Rapport d'inspection enlèvement* [RIE], the pre- and post inspection company SGS valuation of goods	Continuous	Not 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	Not met[1] Implemented on October 24, 2006
Benchmarks		
▪ Extension of the new ASYCUDA++ software to the five largest customs bureaus.	September 30, 2006	Not met Implemented in December 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	Met
▪ Install the expenditure tracking information system SIGFP in 13 ministries.	December 31, 2006	Met
▪ Completion of the verification of at least 80 percent of outstanding VAT credits at end-June 2006.	December 31, 2006	Not met Implemented on March 20, 2007

[1] Waived on the occasion of the first review (IMF Country Report No. 07/7, Republic of Madagascar—First Review Under the Three-Year Arrangement Under the Poverty and Growth Facility and Request for Waiver and Modification of Performance Criteria, Staff Report, ¶43)

Table 3. Madagascar: Quantitative Performance Criteria and Indicative Targets for the PRGF Arrangement, 2007-January 2008 [1]
(Billions of ariary, cumulative change from January 1, 2007, unless otherwise indicated)

	March 31, 2007 Indicative Targets				June 30, 2007 Performance Criteria				September 30, 2007 Indicative Targets				Dec. 31, 2007 Indicative Targets		Jan. 31, 2008 Perf. Criteria
	Prog. [2]	Est. Actual	Actual Adjusted	Status	Prog. [2]	Est. Actual	Actual Adjusted	Status Prel.	Prog. [2]	Est.	Actual Adjusted	Status Prel.	Prog. [2]	Proj.	Prog.
I. Quantitative performance criteria															
External															
(a) Ceiling on accumulation of new external arrears (SDR millions) [3]	0.0	0.0	...	Met	0.0	0.0	...	Met	0.0	0.0	…	Met	0.0	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	…	Met	0.0	0.0	0.0
Central Bank															
(c) Floor on net foreign assets (NFA) of BCM (SDR millions, excluding MDRI)	-40.6	25.8	23.2	Met	-19.0	88.1	95.8	Met	5.7	112.5	112.5	Met	15.3	106.8	108.3
(d) Ceiling on net domestic assets (NDA) of the BCM (MGA bn)	15.8	-53.2	-168.3	Met	-6.6	-32.8	-295.8	Met	-39.3	-130.3	-340.0	Met	33.3	2.9	-26.4
Fiscal															
(e) Ceiling on domestic financing of the central government	86.9	10.1	20.1	Met	-16.8	-6.0	-42.4	Met	-53.8	-83.5	-106.0	Met	10.8	58.7	80.0
(f) Floor on tax revenue	339.7	292.2	...	Not met	761.3	718.8	...	Not met	1136.9	1,088.5	…	Not met	1523.8	1,492.8	1,624.9
(g) Ceiling on accumulation of new domestic arrears [3]	0.0	0.0	...	Met	0.0	0.0	...	Met	0.0	0.0	…	Met	0.0	0.0	0.0
II. Memorandum items:															
Net external budget (program) support (SDR millions)	-3.5	14.1	...		19.3	11.6	...		42.1	46.1	...		47.2	45.6	48.6
Budget support grants and loans (SDR millions)	0.0	16.5	...		33.5	16.5	...		60.4	54.6	...		76.3	60.0	61.3
External cash debt service (SDR millions)	3.5	2.4	...		14.2	4.9	...		18.3	8.6	...		29.1	14.3	12.7

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

[1] See Technical Memorandum of Understanding (TMU) for definition of variables and adjustments.
[2] Country Report No. 07/7, Republic of Madagascar: First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver and Modification of Performance Criteria.
[3] To be observed on a continuous basis.

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

	Timing	Status
Performance criteria		
• No granting of ad hoc tax or tariff exemptions outside those specified in the Customs Code and international treaties or conventions, and in exceptional cases decided by the Council of government (natural disasters, public good, reasons of state).	Continuous	Met
• 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 all imported goods shipped up until March 31, 2007. .	Continuous	Met
• No waiver of the requirement to generate a cargo tracking slip (BSC) for all imported goods shipped up from April 1, 2007 .	Continuous	Met
• 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	Not met Implemented on May 30, 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	Met
• 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	Not met Implemented on July 18, 2007
Benchmarks		
• Provide the BCM with new instruments (securities) through the securitization of government debt to help it better manage liquidity.	January 31, 2007	Met
• 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	Not met Delayed to January 31, 2008
• 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	Met
• 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	Not met Delayed to October 31, 2008

	Timing	Status
• 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	Not met Delayed to June 30, 2008
• 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	Met
• Issue an international tender for the transfer of JIRAMA's management to a private operator under a lease (*affermage*).	December 31, 2007	Not met Modified and delayed to September 30, 2008

Table 5. Madagascar: Quantitative Performance Criteria and Indicative Targets for the PRGF Arrangement, 2008 [1]
(Billions of ariary, cumulative change from the beginning of the year, unless otherwise indicated)

	March 31, 2008 Indicative Targets	June 30, 2008 Performance Criteria	September 30, 2008 Indicative Targets	December 31, 2008 Indicative Targets
I. Quantitative performance criteria				
External				
(a) Ceiling on accumulation of new external arrears (SDR millions) [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 (SDR millions, excluding MDRI)	1.6	43.0	81.7	114.4
(d) Ceiling on net domestic assets (NDA) of the BCM (MGA bn)	-56.1	-19.0	-33.6	3.4
Fiscal				
(e) Ceiling on domestic financing of the central government	72.5	-9.8	-33.0	65.6
(f) Floor on tax revenue	396.5	910.9	1,338.3	1,827.1
(g) Ceiling on accumulation of new domestic arrears [2]	0.0	0.0	0.0	0.0
II. Memorandum items:				
Net external budget support (SDR millions)	-2.9	31.0	53.3	49.4
Budget support grants and loans (SDR millions)	1.4	43.0	69.9	74.4
External cash debt service (SDR millions)	4.3	12.0	16.6	25.0

Sources: Malagasy authorities; and IMF 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 6. Madagascar: Structural Performance Criteria and Benchmarks for the PRGF Arrangement, 2008

	Timeline
Performance criteria	
• No granting of ad hoc tax or tariff exemptions or suspensions outside those specified in the Customs Code and international treaties or conventions, and in exceptional cases decided by the Council of government (natural disasters, public good, reasons of state).	Continuous
• Put in place a system to entrust the inspection of goods leaving ports exclusively to a team made up of representatives of the customs administration and GasyNet in all ports where Tradenet is in use, headed by a customs inspector reporting directly to the Director of External Services at Directorate General of Customs headquarters.	January 31, 2008
• Introduce a draft export promotion law to Parliament eliminating the duty free zone and enterprise regime (*régime des zones et enterprises franches*) while grandfathering existing enterprises in the regime.	May 31, 2008
• Update by the Ministry of Finance and Budget of quarterly commitment ceilings for all ministries up to the end of 2008 taking into account the most recent outlook for external and internal resources and expenditure.	July 31, 2008
Benchmarks	
• 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.	January 31, 2008
• Production with the public finance information system SIGFP of an expenditure commitment report at end-March, including the number of, and reasons for, rejections by the Directorate General of Financial Control.	April 30, 2008
• Production of the accounts balances of all treasuries linked to SIGFP, which are used to prepare the Treasury general operations table (*Opérations Générales du Trésor*)	April 30, 2008
• Automatic transfer of data on revenue collection by the Directorate General of Taxation and the Directorate General of Customs to the Directorate General of the Treasury via SIGFP	June 30, 2008
• Review of BCM guidelines on exchange reserves management	June 30, 2008
• Publish an international call for tenders for the transfer of JIRAMA's management to a private operator under a management contract.	September 30, 2008
• Adoption of a simplified budget classification in the 2009 budget to: (i) establish a clear link between the objectives assigned to each ministry and the programs it implements; and (ii) clearly identify poverty reduction expenditure in the budget.	October 31, 2008

ATTACHMENT II

MADAGASCAR: TECHNICAL MEMORANDUM OF UNDERSTANDING ON MONITORING THE PERFORMANCE CRITERIA AND TARGETS FOR THE PROGRAM SUPPORTED BY THE ARRANGEMENT UNDER THE POVERTY REDUCTION AND GROWTH FACILITY (PRGF) IN 2008

1. This technical memorandum of understanding (TMU) 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. The quantitative objectives for January 31, 2008 and June 30, 2008, are performance criteria; those for March 31, 2008, September 30, 2008 and December 31, 2008 are indicative targets. Unless otherwise indicated, flow variables are measured as cumulative from the beginning of the year. However, the quantitative PCs for January 31, 2008 are measured as cumulative from the beginning of 2007.

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 contract or guarantee by the central government (CG) of Madagascar (defined in paragraph 9), 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, discussions with IMF staff should take place in advance to consider including the request in the program.

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 of 15 years or more and the six-month average CIRR for loans maturing in less than 15 years.

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

Definition

5. The net foreign assets (NFA) of the central bank of Madagascar (BCM) are defined as the difference between its gross foreign assets and total foreign liabilities, including debt to the IMF.

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 of the Central Bank of Madagascar

Definition

7. The net domestic assets (NDA) of the BCM are defined as 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 open market operations), and other items net.

Calculation

8. The outturn for NDA will be adjusted for the variation of the actual versus the quarterly program exchange rates, applied to the stock of NFA of the BCM and the foreign exchange deposits held by the CG, as explained in Section III below.

9. The outturn for NDA will also be adjusted for the excess or shortfall in the net external budget support , as explained in Section III below.

10. The outturn for NDA will be adjusted for changes in the required reserve ratio, if the new reserve requirement has been in effect for at least one full calendar month.

a. For an increase in the reserve ratio, the NDA outturn would be adjusted downward by an amount equal to the percentage point change in the reserve requirement ratio times the average level of deposits held by the public with commercial banks for the month of the target.

b. For a decrease in the reserve ratio, the NDA outturn would be adjusted upward by an amount equal to the percentage point change in the reserve requirement ratio times the average level of deposits held by the public with commercial banks for the month of the target.

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

11. The coverage of the CG, for the purposes of the program, corresponds to the scope of operations of the treasury, as shown in the o*pérations globales du Trésor* (or OGT) (see Table 1 for quarterly breakdown).

12. The net domestic financing of the CG is the sum of the components below.

a. the variation in net bank claims on the CG, 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 domestic arrears, <u>minus</u>

g. government transfers in 2007 to recapitalize the BCM, interest paid by the government on BCM recapitalization bond in 2007, and government transfers to the BCM in 2008 to defray the cost of sterilization operations.

13. The amount of CG domestic payments float is the difference between committed and paid expenditure (*dépenses engagées et payées*).

14. Domestic arrears are defined in paragraph 21 below.

15. 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 authorities will inform Fund staff of any substantive changes in CG accounts with the banking system, which may affect the calculation of bank claims.

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

Calculation

17. The net domestic financing outturn of the CG will be adjusted for the variation of the actual versus the quarterly program exchange rates, applied to the net external budget support and to the foreign exchange deposits held by the CG, as explained in Section III below.

18. For nonbank borrowing, the value of BTAs and other government securities should be recorded as the value received at time of issue (sale), that is, face value less discount.

19. Net domestic financing is subject to adjustment for the excess or shortfall in net external budget support, as described in Section III.

F. Floor on Tax Revenue

Definition

20. Tax revenue includes all domestic taxes and taxes on foreign trade received by the treasury.

G. Ceiling on Accumulation of New Domestic Payments Arrears

Definition

21. Domestic 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*); (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); and (iii) VAT and Tax on Petroleum Products (TPP) credit to oil distributors for VAT and TPP paid on petroleum supplied to airline and shipping companies for international transport (*avitaillement*), that are not reimbursed within 60 days of the receipt of a valid request by the Customs Directorate (Direction Générale des Douanes, DGD). This performance criterion will be observed on a continuous basis.

II. Monitoring Variables and Memorandum Items

A. Net External Budget Support

Definition

22. Net external budget support is defined as external budget support less cash debt service (Tables 2 and 3).

23. External budget support is defined as cash budget (i.e., not linked to projects) loans and grants, excluding debt relief under the enhanced Initiative for Heavily Indebted Poor Countries (HIPC), that are provided as financing and result in funds available to the treasury . 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.

24. Cash debt service is defined as the amount of external debt service the CG pays in cash.

Calculation

25. Programmed net external budget support is recorded in SDRs and converted into MGA at the quarterly program exchange rates. The outturn of the CG of net external budget support will be adjusted for the variation of the actual versus the program exchange rates and net external budget support as explained in section III below. Counterpart funds to assistance in kind are posted as budget support when deposited with the treasury.

B. Program Exchange Rate

Definition

26. For accounting purposes, program exchange rates have been set (previous MEFP, Table 3 for 2007 [1] and Table 2 for 2008). Foreign exchange stocks and flows that affect performance criteria and benchmarks have been converted to MGA at the MGA/SDR program exchange rates. Original amounts denominated in U.S. dollars and in euros have been converted into SDRs by applying the program rates of 1 SDR = 1.520 US$ and 1 SDR = 1.172 € for 2007; and 1 SDR = 1.538 US$ and 1 SDR = 1.126 € for 2008.

[1] IMF Country Report No. 07/7, Republic of Madagascar: First Review under the Three-Year Arrangement under the PRGF, Memorandum of economic and financial policies, Table 3.

III. Exchange Rate and Net External Budget Support Adjusters

A. Exchange Rate

27. In the fiscal and monetary tables, outturns for program variables in foreign currency are converted to MGA at the exchange rate occurring on the day of assessment for stocks and on the day of transaction for flows.

28. To compare actual outturns to program targets, outturns for program variables in foreign currency are converted to MGA at the program exchange rate.

B. Net External budget support

29. If there is a shortfall in net external budget support versus the programmed amount on any test date, the actual outturns of the following PCs and indicative targets will be adjusted by the amount of the year-to-date 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 that will be converted into MGA at the programmed exchange rate; and

c. the CG net domestic financing outturn will be adjusted downward by an equal amount up to a cumulative maximum of SDR 15 million that will be converted into MGA at the programmed exchange rate.

30. If there is a cumulative excess of more than SDR 30 million in net external budget support on any test date, the actual outturns of following PCs and indicative targets will be adjusted by the amount of the year-to-date excess (above SDR 30 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 that will be converted into MGA at the programmed exchange rate; and

c. the CG net domestic financing outturn will be adjusted upward for the excess that will be converted into MGA at the programmed exchange rate.

IV. Information and Data to be Supplied to Fund Staff

31. In addition to the information already specified in the previous Technical Memorandum[2] the authorities will provide the following information:

transfers from the government to the BCM to defray the cost of sterilization operations.

[2] IMF Country Report No. 07/7, Technical Memorandum ¶¶ 28-29.

Table 1. Madagascar: Quarterly Government Financial Operations, 2008
(Billions of ariary, cumulated since the beginning of the year)

	January Prog.	March Prog.	June Prog.	September Prog.	December Prog.
Total revenue and grants	184.5	548.4	1,288.6	1,885.0	2,569.7
Total revenue	133.7	401.0	924.8	1,362.6	1,862.1
Tax revenue	132.2	396.5	910.9	1,338.3	1,827.1
Domestic taxes	62.9	188.8	467.3	681.2	921.9
Taxes on foreign trade	69.2	207.7	443.6	657.2	905.2
Nontax revenue	1.5	4.5	13.9	24.3	35.0
Grants	50.9	147.4	363.8	522.4	707.6
Current grants	4.3	7.6	87.5	93.6	111.0
Capital grants	46.6	139.8	276.3	428.7	596.6
Total expenditure	252.5	759.2	1,566.0	2,333.9	3,303.8
Current expenditure	134.5	405.2	847.0	1,253.9	1,718.0
Personnel	67.5	202.6	405.3	607.9	810.6
Interest expenditure	15.1	46.9	100.7	135.2	192.9
Foreign interest obligations	1.6	6.3	15.3	22.5	32.2
Domestic interest obligations	13.5	40.6	85.4	112.7	160.7
Other	48.9	146.6	312.0	465.2	642.0
Of which : transfer to central bank	1.3	4.3	8.7	13.4	19.4
Treasury operations (net) [1]	3.0	9.0	29.0	45.6	72.5
Capital expenditure	118.0	354.0	719.0	1,080.0	1,585.7
Domestically financed	24.8	74.5	187.8	272.5	416.6
Foreign financed	93.2	279.5	531.3	807.5	1,169.1
Overall balance (commitment basis)					
Excluding grants	-118.9	-358.2	-641.3	-971.3	-1,441.6
Including grants	-68.0	-210.8	-277.4	-448.9	-734.0
Including grants, excluding central bank recapitalization	-68.0	-210.8	-276.4	-446.9	-717.7
Domestic balance (commitment basis) [2]	-24.1	-72.4	-94.7	-141.3	-240.3
Float [3]	-4.8	-14.4	25.6	35.6	0.0
Variation of domestic arrears	-12.8	-38.5	-38.5	-38.5	-38.5
Overall balance (cash basis)					
Excluding grants	-136.5	-411.1	-654.2	-974.1	-1,480.1
Including grants	-85.6	-263.6	-290.3	-451.8	-772.5
Financing	85.6	263.6	290.3	451.8	772.5
Foreign (net)	45.3	134.0	278.6	468.6	649.1
Drawings	46.5	139.6	296.5	492.2	686.0
Budget	0.0	0.0	41.6	113.4	113.4
Projects	46.5	139.6	254.9	378.7	572.5
Amortization	-1.2	-5.6	-18.0	-23.6	-36.9
Domestic (net)	40.3	129.6	11.8	-16.8	123.4
Banking system	16.2	41.8	8.5	-64.8	21.7
Central bank	-17.1	-58.2	-16.5	-14.8	46.7
Of which: MDRI account	8.1	8.1	16.3	24.4	32.6
Commercial banks & OPCA	33.3	100.0	25.0	-50.0	-25.0
Nonbanking system	24.1	87.8	3.2	48.0	101.7
Treasury correspondent accounts (net)	0.0	0.0	0.0	0.0	0.0
Memorandum items:					
Net domestic financing [4]	21.3	72.5	-9.8	-33.0	65.6

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

[1] See Staff Report Table 4a, footnote 4.

[2] See Staff Report Table 4a, footnote 5.

[3] See Staff Report Table 4a, footnote 6.

[4] See Staff Report Table 4a, footnote 7.

Table 2. Madagascar: Programmed Net External Budget Support, 2007-January 2008
(in Millions of SDRs, cumulative from January 1, 2007)

	2007								2008
	30-Mar		30-Jun		30-Sep		31-Dec		31-Jan
	Prog.[2]	Actual	Prog.[2]	Actual	Prog.[2]	Est.	Prog.[2]	Proj.	Rev. Prog.
Budget grants	0.0	16.5	23.0	16.5	23.0	17.8	38.9	23.1	24.5
European Union	0.0	15.9	9.5	15.9	9.5	15.9	18.9	21.2	21.2
STABEX and PASA	0.0	0.7	6.5	0.7	6.5	1.9	12.9	1.9	3.3
UNDP grants	0.0	0.0	7.1	0.0	7.1	0.0	7.1	0.0	0.0
Budget loans	0.0	0.0	10.5	0.0	37.4	36.8	37.4	36.8	36.8
World Bank	0.0	0.0	0.0	0.0	26.9	26.3	26.9	26.3	26.3
African Development Bank	0.0	0.0	10.5	0.0	10.5	10.5	10.5	10.5	10.5
Total program grants and loans	0.0	16.5	33.5	16.5	60.4	54.6	76.3	60.0	61.3
External debt service (budget, cash basis) [1]	3.5	2.4	14.2	4.9	18.3	8.6	29.1	14.3	12.7
Interest	0.6	1.0	3.7	1.4	4.1	3.1	7.0	6.2	6.8
Amortization	2.9	1.4	10.5	3.5	14.2	5.5	22.1	8.1	5.9
Net external budget support	-3.5	14.1	19.3	11.6	42.1	46.1	47.2	45.6	48.6
Memorandum item:									
Program exchange rate (MGA/SDR) [3]	3350	3015	3350	2810	3350	2816	3350	2817	2790

Source: Malagasy authorities and Fund staff estimates and projections.

[1] Net of HIPC and MDRI debt relief.

[2] IMF Country Report No. 07/7, Republic of Madagascar: First Review under the Three-Year Arrangement under the PRGF.

[3] Rate used only for accounting purposes to set and monitor indicative targets and performance criteria.

Table 3. Madagascar: Programmed Net External Budget Support, 2008
(in Millions of SDRs, cumulative since January 1, 2008, unless otherwise indicated)

	31-Jan [2]	31-Mar	30-Jun	30-Sep	31-Dec
Budget grants	24.5	1.4	28.0	28.9	33.3
European Union	24.5	1.4	28.0	28.9	33.3
STABEX and PASA	3.3	1.4	1.4	2.3	6.8
Other	21.2	0.0	26.5	26.5	26.5
Budget loans	36.8	0.0	15.0	41.0	41.0
World Bank	26.3	0.0	0.0	26.0	26.0
African Development Bank	10.5	0.0	15.0	15.0	15.0
Total program grants and loans	61.3	1.4	43.0	69.9	74.4
External debt service (budget, cash basis) [1]	12.7	4.3	12.0	16.6	25.0
Interest	6.8	2.3	5.5	8.1	11.6
Amortization	5.9	2.0	6.5	8.5	13.3
Net external budget support	48.6	-2.9	31.0	53.3	49.4
Memorandum item:					
Program exchange rate (MGA/SDR) [3]	2790	2790	2775	2760	2745

Source: Malagasy authorities and Fund staff estimates and projections.

[1] Net of HIPC and MDRI debt relief.

[2] Cumulative since January 1, 2007.

[3] Rate used only for accounting purposes to set and monitor indicative targets and performance criteria.