

International Monetary Fund

[Republic of Madagascar](#) and the IMF

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

Press Release:
[IMF Executive Board Completes Fourth Review Under PRGF Arrangement with Madagascar. Increases Financial Assistance to Mitigate Impact of External Shocks, and Approves US\\$35.3 Million Disbursement](#)
July 2, 2008

June 17, 2008

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MADAGASCAR: LETTER OF INTENT

Antananarivo, Madagascar
June 17, 2008

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

Dear Mr. Strauss-Kahn,

1. 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 2006–08 and the activation of the Trade Integration Mechanism (TIM). On December 20, 2006 the Executive Board of the International Monetary Fund (IMF) completed the first review, and on January 30, 2008 it completed the second and third reviews under this arrangement.
2. The government of Madagascar requests an augmentation of access under the PRGF arrangement to cope with the external shocks resulting from a severe cyclone and the rise in world fuel and food prices. These shocks have raised import costs and limited reserve accumulation. The government requests an augmentation of access amounting to 15 percent of quota (SDR 18.33 million), of which SDR 13.75 million would be disbursed with the fourth review and SDR 4.58 million would be disbursed with the fifth review, bringing the total access under the PRGF arrangement to SDR 73.3 million (60 percent of quota).
3. The attached memorandum of economic and financial policies (MEFP) reviews the macroeconomic and financial performance and the implementation of economic policies through May 2008. It also updates the program of economic policies and structural reforms that the government of Madagascar will implement in 2008.
4. All quantitative performance criteria (PC) at the test date for the fourth review (end of January 2008) were met.
5. Two structural PCs were not observed through end-May 2008. The system of customs inspection for goods leaving the port was implemented with a 5-week delay owing to administrative delays. Given the limited length of the delay, we are requesting a waiver for the nonobservance of this PC. The consultations within government and with the private sector on the export promotion law took longer than expected; as a result, the structural PC for submitting to Parliament a draft export promotion law that would close the EPZ regime for new firms by end-May 2008 was not observed. We have reiterated our intention to undertake this measure in a recent communication to the Council of Government and are

committed to do so by end-October 2008, as the consultative process runs its course. We are requesting a waiver for the nonobservance of this PC.

6. We also recognize that the CBM had inadvertently created a multiple currency practice (MCP) and a related exchange restriction through its practice of offering foreign exchange at a discount to food importers, in an effort to contain the inflationary impact of rising international food prices. This practice was not recognized as an MCP at the time of the second and third reviews, as the deviation from the market rate was well below two percent. Although the practice was immediately halted when the problem was explained to us, the MCP and the exchange restriction caused the nonobservance of the continuous PCs against (i) the introduction or modification of an MCP and (ii) the imposition or intensification of restrictions on payments and transfers for current international transaction. The nonobservance of the PCs gave rise to two noncomplying disbursements in connection with the second and third reviews. We are therefore also requesting waivers for the nonobservance of these performance criteria.

7. 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 become 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.

8. To facilitate the attainment of the objectives and implementation of the policies described, the government of Madagascar hereby requests completion of the fourth review and disbursement of the fifth loan under the current arrangement, including augmentation, in an amount equivalent to SDR 21.606 million.

9. The government of Madagascar intends to carry out the fifth review by the end of December 2008 and the sixth review by end of June 2009. Inter alia, the fifth review will discuss the fiscal impact of reconstruction costs arising from the cyclone, the measures needed to eliminate the deficits of the civil servants' pension funds, priority measures to further strengthen public expenditure management, including the efficient use of the SIGFP system; and discussion of the future strategy for the state utility company JIRAMA.

10. 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 fourth review 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

MADAGASCAR: MEMORANDUM ON ECONOMIC AND FINANCIAL POLICIES FOR 2008**I. ECONOMIC TRENDS AND PROGRAM IMPLEMENTATION IN 2007
AND AS OF MAY 31, 2008**

1. In 2007, economic growth proved to be more sustained (6.2 percent) than in 2006 (5 percent), owing to the good performance of exports and foreign direct investments (FDI) related to the start-up of two large mining projects. The deceleration in nonfood prices (particularly housing costs) brought inflation down from 10.8 percent in 2006 to 10.3 percent in 2007.
2. Growth in the money supply during the period was in line with the program's objectives. Base money also kept pace with the program, except for a temporary acceleration in December 2007. The impact of the increase in foreign exchange reserves on monetary growth was lessened by open market transactions. Recent prudential indicators show that the banking system remains sound, although the number of bad debts rose slightly at the end of 2007.
3. Tax revenue was significantly higher than the program target (by an amount equivalent to approximately 0.5 percent of GDP), owing to the progress made in tax and customs administration and to the income from VAT and property tax related to the construction of the large nickel exploitation project. Moreover, spending on domestic financing remained below the program target, owing largely to the favorable trend in interest rates. Consequently, net domestic debt (as defined by the program, excluding the recapitalization of the Central Bank of Madagascar) remained below the ceiling authorized by the program.
4. The overall balance of payments showed a surplus in 2007. The current account deficit was contained at 14 percent of GDP, well below the 19 percent initially projected. While construction delays in one of the large mining projects led to limited growth of imports, exports were dynamic, despite the rise in the value of the ariary. The current deficit was more than covered by capital inflows, which allowed accumulated reserves to reach SDR 148 million. At end-2007, official reserves covered 2.9 months of imports (3.3 months if imports for the large mining projects are excluded).
5. All the quantitative performance criteria at January 31, 2008 and all but two indicative monetary targets at March 31, 2008 were met (Tables 1 and 2). The central bank missed its foreign exchange reserves target owing to lower mining foreign direct investment inflows than programmed. And the central bank exceeded its ceiling on domestic assets because some banks had a temporary liquidity need, requiring use of the central bank refinancing window, and the BCM conducted less sterilization open market operations than programmed.

6. At the structural level, control of goods leaving the port of Toamasina, the country's main port and the only one where the Tradenet information system is operational, was enhanced five weeks later than required (structural performance criterion; PC, Table 3). This delay was caused by technical problems during installation of the Tradenet system. As the enhanced control has been implemented at the port of Toamasina, the government requires a waiver for not complying with this PC. The introduction of a draft export promotion law to Parliament eliminating the duty free zone and enterprise regime (*régime des zones et entreprises franches*) while grandfathering existing enterprises in the regime did not take place by end-May 2008, owing to the need to further consult with all stakeholders (¶35). As the Minister of Economy, Commerce and Industry has already sent a formal communication to the Council of government on how to proceed on the submission to parliament of the draft export promotion law by end-October 2008, the government requests a waiver for not complying with this PC. Two structural benchmarks have been met, although one, the production of treasury account balances with the budget information system SIGFIP, was delayed owing to technical problems (¶24).

7. The Central Bank of Madagascar sold foreign exchange to a trader at the minimum market rate for imports of essential goods (rice, wheat, and edible oils) in 2007 and during the early weeks of 2008, through the interbank foreign exchange market, without realizing that this would give rise to a multiple currency practice and a related exchange restriction. As soon as they became aware that this practice was in conflict with the commitments made within the context of the program, the monetary authorities put an end to this practice. In a note dated May 8, 2008, the Central Bank of Madagascar communicated to the banks participating to the interbank foreign exchange market that, in line with Madagascar's commitments under the Articles of Agreement of the International Monetary Fund (including Article VIII, Section 3), it would abstain from introducing multiple currency practices or imposing exchange restrictions. The MCP and the exchange restriction gave rise to the nonobservance of the PCs in the PRGF arrangement against the imposition of exchange restrictions and/or the introduction of MCPs in the context of the second and third reviews. The authorities are now requesting waivers for the nonobservance of these PCs.

II. 2008 PROGRAM UPDATE

A. Implementation of the Madagascar Action Plan

8. The Madagascar Action Plan (MAP) is the development plan for the period 2007–11, which serves as the reference for annual budget programming and the framework for medium-term expenditures. The framework for its implementation will henceforth include the following:

- the MAP, which describes the commitments, strategies, and actions;
- the sectoral programs, which indicate the strategies for the various sectors, the actions to be carried out each year, the unified monitoring and evaluation system, and the cost of the activities, as well as indicating the financing that has already been acquired and the additional financing that must be sought;

- programming at the regional level, including activities not included in the sectoral programs that will be funded from the regional budget;
- the annual program (or General State Policy), which will be drawn from the sectoral programs and will coincide with the budget process;
- establishing an assistance coordination entity that will be attached to the Prime Minister's Office.

9. In order to expand the dialogue on the resources to be brought into play, the government has decided to hold an annual conference and a number of sectoral meetings. The first Partners' Round Table, held in Madagascar on June 9 and 10 2008, provided a forum for dialogue and exchange of views on programs and resources to meet the challenges identified in the MAP.

B. Macroeconomic Framework

10. The acceleration of growth from 6.1 percent in 2007 to 7 percent in 2008 can be explained by the increased investments made by mining companies, and takes into account the impact of the cyclones at the beginning of the year. The inflation rate has been revised upward (from 8 to 9.7 percent), reflecting the increase in the price of rice and oil on the international markets. These developments, along with the slowdown in the world economy, will lead to an increase in the current deficit, which is expected to reach 23 percent of GDP. Despite the expected inflows of foreign direct investment, gross international reserves cover is projected to decline markedly to 3.1 months of imports (net of large mining project imports).

C. Economic and Financial Policies

Fiscal policy and reforms

a. Fiscal policy

11. The government has decided to allocate MGA 30 billion out of the MGA 45 billion budgetary reserve approved in the 2008 budget¹ to the reconstruction costs caused by the cyclones.

12. The good tax revenue performance in 2007, the upward revision of imports, and the continued implementation of tax and customs administration reforms have led the government to increase its tax revenue target (by about 0.3 percent of GDP) compared to the one announced in the 2008 budget, in spite of the temporary VAT exemption on rice and the VAT exemption on lighting fuel contemplated to alleviate the oil and food price shock for

¹ MEFP of January 7, 2008, ¶17.

the poorest. In addition, nontax revenue were also revised upwards owing to proceeds from the public auction of illegally logged rose wood (about 0.1 percent of GDP) during the first quarter. Moreover, the update of donor commitments revealed an increase of budget grants (by about 0.3 percent of GDP) and of budget loans (by about 0.3 percent of GDP) compared to the 2008 budget, to address the food and oil price shocks. In addition, the lower net domestic borrowing in 2007 and the lower level of interest rates during the first quarter of 2008 have led the government to revise the interest payment downwards (by about 0.3 percent of GDP) compared to the 2008 budget.

13. In light of these developments, the government will propose the following measures in a supplementary budget to be introduced to parliament:

- temporary VAT exemption on rice from July 1, 2008 to alleviate the impact of higher international prices on the poorest citizens (budgetary cost : MGA 30 billion or 0.2 percent of GDP); the government will adopt additional measures to increase domestic rice production and therefore reduce reliance on imports;
- VAT exemption on oil for lamps, to alleviate the impact of higher international prices on the poorest citizens (maximum budgetary cost: MGA 12 billion or 0.1 percent of GDP);
- targeted measures to alleviate the food price shock for the poorest (budgetary cost: MGA 40 billion, or 0.2 percent of GDP): countercyclical rice production (MGA 15 billion); urban transport subsidies (MGA 10 billion); cash for work (MGA 5 billion); and school nutrition program in poor neighborhoods (MGA 10 billion);
- increase of the budgetary credits for current expenditure, in order to pay overdue electricity bills of ministries and universities to JIRAMA (¶34) and cope with rise in oil prices (budgetary cost of, respectively, MGA 32 billion and 3.6 billion, or about 0.2 percent of GDP);
- increase of domestically financed capital expenditure (MGA 51.5 billion, or 0.3 percent of GDP), mainly in the agriculture and energy sectors, as well as in infrastructure, including VAT on externally financed capital expenditure;
- increase of the payment of accumulated arrears to the telecom company (TELMA) before July 1, 2006 (budgetary cost: MGA 38.5 billion or 0.2 percent of GDP); and
- other expenditures: recapitalization of the state airline company Air Madagascar

(MGA 16.2 billion, or 0.1 percent of GDP); increase in transfers to communes (MGA 10 billion); preparation of the African Union Summit that will be held in Madagascar in July 2009 (MGA 5 billion); increase in the wage bill of civil servants (MGA 5 billion); increase in credits for goods and services for the National Assembly (MGA 3.1 billion); and increase in credits for embassies in Ethiopia, India and the United Nations (MGA 1 billion)..

14. It is the government's priority to avoid accumulating any new arrears and to pay off the arrears accumulated by the State before the start of the program. To this end, the government will give priority to executing the appropriations entered in the 2008 budget law to pay the VAT due on externally financed capital expenditure, and to paying these expenditures within 60 days of the date on which the required documents are received. The Ministry of Finance and Budget will monitor the execution of these payments through the recording of operators' invoices on its website. Moreover, as indicate above (¶13), the government will include MGA 38 billion of supplementary appropriations in the supplementary budget law to pay off the arrears accumulated before the start of the program.

b. Tax policy

15. Tax policy remains shaped by the implementation of the major simplification of the Tax Code adopted in the 2008 budget law, which establishes a simple and equitable tax system that encourages growth.² In the 2009 budget law, the government will introduce changes in the Tax Code so that taxes due by taxpayers whose turnover is less than MGA 20 million (\$12,000) will also be based on self assessment.

16. The government reiterates its commitment not to grant any exemption or suspension of taxes and/or customs duties other than those provided for in the Customs Code, international treaties or agreements, and those explicitly determined by the Government Council in exceptional circumstances such as disasters, the public interest, or reasons of state (continuous PC, Table 3). In order to be completely transparent in applying this policy, the government is committed to publish each month on the website of the Ministry of Finance and Budget, a list of the firms that benefited from an exemption or suspension decided by the Government Council since the beginning of the year, the reason for these exemptions and/or suspensions, and the corresponding loss of revenue to the Treasury (new structural benchmark proposed, Table 3). The monthly list will be published beginning on June 15, 2008 and will cover the period from January 1, 2008 to the end of April 2008. Subsequent lists will be published within 30 days after the end of the reported month.

² See paragraphs 20 & 21 of the Memorandum on Economic and Financial Policies (MEFP) dated January 7, 2008.

c. Reform of the tax and customs administrations

Tax administration

17. According to the strategy for reform of the tax administration (2007–11), the measures for rehabilitating the management of tax files will be extended from the Large Enterprises Department to the other high-potential tax centers, beginning with the Regional Enterprise Services in Antananarivo and Toamasina.¹

18. Another priority will be to improve the performance of the VAT. To this end, the government will reimburse, within a maximum of 60 days of the date on which the duly completed request is received by the Directorate General of Taxes or the Directorate General of Customs, the VAT credits to exporters, and both the petroleum tax credits and the VAT credits on oil products to distributors of oil for refueling for international shipping and airline travel. The Directorate General of Taxes (DGI) will treat the requests for reimbursement differently based on a risk analysis: it will process the refunds within 15 days for enterprises that have a good tax payment track record, and limit ex ante controls to credits that present an important risk of fraud.

Customs administration

19. Introduction of the Tradenet electronic platform linking all the economic actors involved in foreign trade is a customs administration priority for 2008.

20. In addition, the Directorate General of Customs (DGD) is committed to reforming the customs regulations that authorize the suspension of import duties and taxes. To this end, it will review the scope of suspended tax payments in light of best international practices and will propose a revision of their scope if needed. The DGD is developing an additional functionality for the SYDONIA++ software in order to automate monitoring of the payment of duties and taxes benefiting from suspension. The target is to have this functionality operational at the port of Toamasina beginning on January 1, 2009 and at all the other ports during 2009.

21. The DGD will attach particular importance to implementing the recommendations on strengthening the collection of duties and taxes by the customs administration, issued by the audit firm that reviewed customs operations during the last quarter of 2007:²

- Of the unpaid duties and taxes revealed by the audit amounting to MGA 8.047 billion (\$4.8 million), MGA 2.725 billion (\$1.6 million) had been collected as at March 31, 2008. The balance will be, as far as possible, collected in full by July

¹ See paragraph 24 of the MEFP dated January 7, 2008.

² See paragraphs 29 & 30 of the MEFP dated January 7, 2008.

31, 2008.

- The control of outgoing merchandise at ports was strengthened at Toamasina (¶7). Similar improvements will be made in Ivato beginning on June 1, 2008, and in Mahajanga, Diego Suarez, and Tulear beginning on September 1, 2008.
- No later than June 1, 2008, the GasyNet company will begin checking on a continuous basis 10 percent of the import declarations (8 percent chosen on the basis of a risk analysis and 2 percent chosen randomly) in order to verify the value determined by the customs administration, the calculation of import duties and taxes, and the payment of these duties and taxes.
- Beginning in January 2009, a specialized firm will conduct the first annual independent audit of the enforcement of the customs code and the procedures in force by the customs administration.

22. In order to effectively combat fraud, the DGD and DGI will intensify their exchange of information.

Fiscal management reform

23. The third independent evaluation mission under the Public Expenditure and Financial Accountability (PEFA) framework, carried out in February 2008, noted the tangible progress made by Madagascar in improving tax performance thanks to the fundamental reforms implemented by the DGD and DGI. On the other hand, the mission noted that there were still some problems with the monitoring of expenditure, particularly the reporting of budget execution, as well as the internal and external mechanisms for monitoring budget execution.

24. To resolve these problems, the government will use the potential offered by the fiscal management information system (SIGFP) to enhance the monitoring of budget execution:

- production of monthly reports on committed expenses with the help of the SIGFP, including the number of rejections and reasons for these rejections by the Directorate General of Financial Supervision;
- monthly production of the account balances of all the treasury divisions linked to the SIGFP, which are used to prepare the Treasury general operations table (this benchmark was postponed by three months because of technical problems, Table 3); and
- monthly publication on the website of the Ministry of Finance and Budget beginning in June 2008 of a table showing all commitments, payment orders, and payments since the beginning of the year, by budget headings, for all the ministries

where the SIGFP is operational.

25. Finally, the Ministry of Finance and Budget will develop an action plan and schedule of priority measures to fundamentally enhance the effectiveness of the Financial Control Department, modeled on the strategies that are beginning to bear fruit at the DGD and DGI. This strategy will be developed in close cooperation with the development partners who coordinate to provide budgetary assistance (World Bank, European Commission, African Development Bank, France, and Germany) by September 30, 2008.

26. The reform of the pension system for government employees will start to be implemented in the 2009 Budget Law in order to reduce its structural deficit estimated at 0.8 percent of GDP by a recent actuarial study. On the basis of this study, which has been approved by human resources management and the staff representatives of the ministries, public establishments, and decentralized local governments, the Minister of Finance and Budget will submit a proposal for revising the parameters of the system to the Government Council. Management of the civil service pension system will be turned over to a new Pension Department at the Ministry of Finance and Budget beginning on January 1, 2010.

Monetary and exchange policy

27. The Central Bank (BCM) reaffirms its determination to adopt a monetary policy designed to contain inflation under the bar of 10 percent, reduce volatility and prevent an excessive appreciation of the exchange rate, and achieve its goal for accumulating foreign exchange reserves. To meet these goals, the BCM will continue its policy of sterilization in the money market. To enhance the management of its foreign exchange reserves, the BCM will develop a strategic investment plan with technical assistance from MCM.

28. In addition, if it becomes necessary to exceed the net foreign asset position anticipated in the program, the BCM will carry out additional sterilization operations aimed at maintaining the targeted level for base money. The government agreed to cover the cost of sterilization operations, beginning in 2008, by means of quarterly transfers to the BCM. In order to minimize monetary financing of the State, the government has decided to reduce statutory advances of the BCM to the Treasury from 15 to 5 percent of the Treasury's budget revenues, and the Treasury has decided to use this facility only in case of absolute necessity.

Policy on financial sector development

29. The government will finalize a national financial strategy with the assistance of the World Bank, the IMF, and other partners by September 2008. On the basis of this strategy and a new financial services project conducted by the World Bank (in progress), the government's objective will be to enhance the legal framework and structure of the financial sector and the supervision of nonbank financial institutions, while increasing access to financing for small and medium enterprises and enhancing the diversity of financial instruments.

30. The authorities envisage creating a development bank with the assistance of the South African Development Bank and the German development bank KfW; this bank could draw on the private sector for its management and financing.

Trade policy

31. Madagascar's trade policy continues to be guided by the principles stated in the MEFP of January 7, 2008.³ In light of the study on the appropriateness of a uniform nonzero tariff, the authorities have concluded that such a system would go against the country's international commitments and would be inconsistent with ongoing trade negotiations.

32. The authorities are pursuing trade liberalization at the regional level. Implementation of the plan to reduce tariffs within the framework of the Southern African Development Community (SADC), in effect since October 2007, has been continued in 2008 and the initial problems concerning the rules of origin, which affected certain exporting firms, are in the process of being resolved. Negotiations with the European Commission and other countries in the region are being held in order to reach an agreement on the aspects of the Economic Partnership Agreement (EPA) that were not covered by the interim agreement signed in 2007.

Debt management

33. The government's policy remains focused on maintaining a sustainable level of debt, and only concessional loans are being considered. These principles are all the more important given that an increase in loans, particularly bilateral loans, is envisaged to help finance the MAP. In 2008, no bilateral debt cancellation agreement has been signed to date, but negotiations continue, particularly with the bilateral creditors that are not members of the Paris Club.

Reform of the electricity sector

34. Rising oil prices reinforce the need to improve the management of the electricity sector. However, in order to alleviate the oil price shock for the population, the government has decided to delay electricity price increases until October 2008. According to the overall strategy described in the MEFP of January 7, 2008,⁴ the government is taking the following priority measures:

- a 15 percent average increase in electricity prices in October 2008 (with a smaller increase for the first bracket in order to reduce the impact on the poor), and

³ Paragraph 44 of the MEFP dated January 7, 2008.

⁴ See paragraphs 47–50 of the MEFP dated January 7, 2008.

another increase in April 2009 to fully align prices with costs;

- implementation of a price indexing mechanism adjusting prices to cost and allowing a profit margin for investments, beginning in May 2009;
- a budget transfer of MGA 54 billion to cover operational losses and finance the priority investments approved in the 2008 budget law, supplemented by a transfer of MGA 32 billion, to pay arrears owed by the public administration and universities (¶13), in the revised draft supplementary budget law, and to cover losses flowing from the decision not to increase prices in April in an adversarial oil price environment; and
- an international call in September 2008 for tenders for a new five-year management contract, beginning on April 1, 2009; a consultant will be hired soon to prepare the international call.

Policies to facilitate private sector development

35. The government decided to postpone the submission to Parliament of a draft law for promoting exports from the spring to the fall of 2008 (by end-October 2008), owing to a slower than anticipated consultation process (PC, Table 3). Within the framework of this law, measures will be taken to stimulate all export-oriented enterprises and activities, irrespective of sector or type of activity, without granting any tariff or tax exemptions. As a result, the system of free zones and enterprises will be eliminated for new firms, while the enterprises already benefiting from the system will be grandfathered.

Governance

36. The government is committed to taking measures to ensure compliance with the Extractive Industries Transparency Initiative (EITI).

37. Madagascar intends to combat money laundering and large-scale financial crime. To this end, the Financial Information Service (SAMIFIN) is operational since May 22, 2008.

Statistics

38. In accordance with the MAP, the government intends to enhance its statistical apparatus and make data more easily accessible to the general public. In 2008, the BCM and the Ministry of Finance and Budget will begin publishing statistical data on their websites. Also beginning in 2008, the National Statistics Institute (INSTAT) expects to update the base year for the national accounts from 1984 to 2007. In 2008, within the framework of implementing the National Statistics Development Strategy (SNDS), the government prepared a draft law governing the national statistics system, which will be submitted to

Parliament during the current year. Finally, in 2009, INSTAT expects to produce a quarterly index of industrial production.

III. PROGRAM MONITORING

39. The program supported by the IMF under the Poverty Reduction and Growth Facility (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 2 and 3.

Table 1. 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				June 30, 2007				September 30, 2007				December 31, 2007				Jan. 31, 2008			
	Indicative Targets			Status	Performance Criteria			Status	Indicative Targets			Status	Indicative Targets			Status	Perf. Criteria			Status
	Prog. ²	Actual	Actual Adjusted		Prog. ²	Actual	Actual Adjusted		Prog. ²	Actual	Actual Adjusted		Prog. ²	Actual	Actual Adjusted		Prel.	Prog. ³	Actual	
I. Quantitative performance criteria																				
External																				
(a) Ceiling on accumulation of new external arrears (SDR millions) ⁴	0.0	0.0	...	Met	0.0	0.0	...	Met	0.0	0.0	...	Met	0.0	0.0	...	Met	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	...	Met	0.0	0.0	...	Met	0.0	0.0	...	Met
Central Bank																				
(c) Floor on net foreign assets (NFA) of BCM (SDR millions, excluding MDRI)	-40.6	25.8	39.1	Met	-19.0	88.1	95.5	Met	5.7	112.5	112.5	Met	15.3	152.5	...	Met	108.3	149.4	154.1	Met
(d) Ceiling on net domestic assets (NDA) of the BCM (MGA bn)	15.8	-53.2	-222.7	Met	-6.6	-32.8	-299.3	Met	-39.3	-129.5	-329.6	Met	33.3	-6.6	...	Met	-26.4	-112.0	-147.3	Met
Fiscal																				
(e) Ceiling on domestic financing of the central government	86.9	10.1	-33.1	Met	-16.8	-6.0	-41.3	Met	-53.8	-82.1	-103.0	Met	10.8	-54.1	...	Met	80.0	-131.5	-144.4	Met
(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	1,573.1	...	Met	1,624.9	1,738.9	...	Met
(g) Ceiling on accumulation of new domestic arrears ⁴	0.0	0.0	...	Met	0.0	0.0	...	Met	0.0	0.0	...	Met	0.0	0.0	...	Met	0.0	0.0	...	Met
II. Memorandum items:																				
Net external budget (program) support (SDR millions)	-3.5	-1.8	...		19.3	12.0	...		42.1	46.8	...		47.2	...			48.6	42.4	...	
Budget support grants and loans (SDR millions)	0.0	0.7	...		33.5	16.7	...		60.4	54.7	...		76.3	...			61.3	56.9	...	
External cash debt service (SDR millions)	3.5	2.4	...		14.2	4.7	...		18.3	7.9	...		29.1	...			12.7	14.5	...	
Average exchange rate (MGA/SDR) ⁵	3350	3015			3350	2810			3350	2816			3350	2824			2790	2821		
End-period exchange rate (MGA/SDR) ⁵	3350	2953			3350	2794			3350	2854			3350	2800			2790	2834		

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

¹ See Technical Memorandum of Understanding (TMU) for definition of variables and adjustments.

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.

³ IMF Country Report No. 08/6, Republic of Madagascar-Staff Report for the Second and Third Reviews Under the PRGF.

⁴ To be observed on a continuous basis.

⁵ Program exchange rate for accounting purposes, used to monitor performance criteria and indicative targets.

Table 2. Madagascar: Quantitative Performance Criteria and Indicative Targets for the PRGF Arrangement, 2008¹
(Billions of ariary, cumulative change from the beginning of the year, unless otherwise indicated)

	March 31, 2008				June 30, 2008		September 30, 2008		December 31, 2008	
	Indicative Targets			Status	Performance Criteria		Indicative Targets		Performance Criteria	
	Prog. ²	Estimated Actual	Adjusted Actual		Prog. ²	Rev. Prog.	Prog. ²	Rev. Prog.	Prog. ²	Rev. 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	0.0	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	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	-30.0	-30.0	Not Met	43.0	-24.2	81.7	36.5	114.4	50.5
(d) Ceiling on net domestic assets (NDA) of the BCM (MGA billions) ⁴	-56.1	51.4	78.8	Not Met	-19.0	183.0	-33.6	81.7	3.4	193.3
Fiscal										
(e) Ceiling on domestic financing of the central government	72.5	-144.9	...	Met	-9.8	-116.5	-33.0	-86.9	65.6	31.5
(f) Floor on tax revenue	396.5	462.0	...	Met	910.9	963.4	1338.3	1,416.8	1827.1	1,931.5
(g) Ceiling on accumulation of new domestic arrears ³	0.0	0.0	...	Met	0.0	0.0	0.0	0.0	0.0	0.0
II. Memorandum items:										
Net external budget support (SDR millions)	-2.9	1.6			31.0	19.3	53.3	66.6	49.4	95.8
Budget support grants and loans (SDR millions)	1.4	5.9			43.0	30.3	69.9	82.1	74.4	118.4
External cash debt service (SDR millions)	4.3	4.3			12.0	11.0	16.6	15.4	25.0	22.6

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

¹ See Technical Memorandum of Understanding (TMU) for full description of variables and adjustments.

² IMF Country Report No. 08/66, Republic of Madagascar-Staff Report for the Second and Third Reviews Under the PRGF.

³ To be observed on a continuous basis.

⁴ Excluding transfers from government.

Table 3. Madagascar: Structural Performance Criteria and Benchmarks for the PRGF Arrangement, 2008

	Timeline	Status
Performance criteria		
<ul style="list-style-type: none"> 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	Met.
<ul style="list-style-type: none"> 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	Not met. Implemented on March 11, 2008
<ul style="list-style-type: none"> Introduce a draft export promotion law to Parliament eliminating the duty free zone and enterprise regime (<i>régime des zones et entreprises franches</i>) while grandfathering existing enterprises in the regime. 	May 31, 2008	Not Met. Postponed to October 31, 2008
<ul style="list-style-type: none"> 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		
<ul style="list-style-type: none"> 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	Met.
<ul style="list-style-type: none"> 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	Met.
<ul style="list-style-type: none"> Production of the accounts balances of all treasuries linked to SIGFP, which are used to prepare the Treasury general operations table (<i>Opérations Générales du Trésor</i>) 	April 30, 2008	Not met. Postponed to July 31, 2008
<ul style="list-style-type: none"> 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	
<ul style="list-style-type: none"> Review of BCM guidelines on management of foreign exchange reserves 	June 30, 2008	
<ul style="list-style-type: none"> Publish a table on the external web site of the Ministry of finance and budget presenting the list of enterprises that benefited from ad hoc tax or tariff exemptions or suspensions in exceptional cases decided by the Council of Government, the reason for each exoneration and suspension, and the revenue loss for the Treasury caused by each exoneration or exemption, from the beginning of 2008 to end-June 2008. 	July 31, 2008	
<ul style="list-style-type: none"> Publish an international call for tenders for the transfer of JIRAMA's management to a private operator under a management contract. 	September 30, 2008	
<ul style="list-style-type: none"> 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	

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 (PRGF)

1. This technical memorandum of understanding (TMU) defines the variables used to establish the quantitative performance criteria (PCs) and indicative targets for the 2008 program, how they are calculated, and any adjustments that may be necessary. The quantitative objectives for June 30, 2008 and December 31, 2008 are performance criteria; those for September 30, 2008 are indicative targets. Unless otherwise indicated, flow variables are measured as cumulative from the beginning of the year. The measurement of the quantitative PCs for January 31, 2008 are measured as cumulative from the beginning of 2007 and explained in the previous TMU.¹

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 12), 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,

¹ Country Report No. 08/66, Republic of Madagascar-Staff Report for the Second and Third Reviews Under the PRGF; Appendix I, Attachment II.

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. The program values for NDA exclude transfers from the government to the BCM to cover the cost of sterilization operations.

Calculation

8. The outturn for NDA will be adjusted for the variation of the actual versus the program exchange rate, 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 be adjusted by removing transfers from government to the BCM to cover the cost of sterilization operations.

10. 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.

11. 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

12. The coverage of the CG, for the purposes of the program, corresponds to the scope of operations of the treasury, as shown in the *opérations globales du Trésor* (or OGT).
13. 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, minus
 - g. government transfers to the BCM to defray the cost of sterilization operations.
14. The amount of CG domestic payments float is the difference between committed and paid expenditure (*dépenses engagées et payées*).
15. Domestic arrears are defined in paragraph 22 below.
16. Net bank claims on the government are measured by net credit to government in the monetary survey, which consists 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.

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

Calculation

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

19. 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.

20. 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

21. 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

22. 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

23. Net external budget support is defined as external budget support less cash debt service (Table 1).

24. 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.

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

Calculation

26. Programmed net external budget support is recorded in SDRs and converted into MGA at the program exchange rate. The outturn of the CG for 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

27. For accounting purposes, program exchange rates have been set. Foreign exchange stocks and flows that affect performance criteria and benchmarks have been converted to MGA at the MGA/SDR program exchange rate (Table 1). Original amounts denominated in U.S. dollars and in euros have been converted into SDRs by applying the program rates of 1 SDR = 1.505 US\$ and 1 SDR = 1.023 € for 2008.

III. Exchange Rate and NET EXTERNAL BUDGET SUPPORT Adjusters

A. Exchange Rate

28. 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.

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

B. Net External budget support

30. 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 program 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 program exchange rate.

31. 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

32. In addition to the information already specified in the Technical Memorandum of the first review ¹ the authorities will provide the following information:

- Transfers from the government to the BCM to defray the cost of sterilization operations.

¹ IMF Country Report No. 07/7, Technical Memorandum ¶¶ 28-29.

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

	31-Jan ¹		31-Mar		30-Jun		30-Sep			31-Dec			
	Prog. ²	Est.	Prog. ²	Est.	Prog. ²	Rev.	Prog.	Prog. ²	Rev.	Prog.	Prog. ²	Rev.	Prog.
Budget grants	24.5	20.1	1.4	5.9	28.0	30.3	28.9	33.8	33.3	55.1			
European Union	24.5	20.1	1.4	5.9	28.0	30.3	28.9	33.8	33.3	45.1			
STABEX and PASA	3.3	...	1.4	0.0	1.4	0.8	2.3	1.6	6.8	7.4			
Other	21.2	...	0.0	5.9	26.5	29.5	26.5	32.3	26.5	37.6			
World Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.6			
Germany	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.4			
Budget loans	36.8	36.8	0.0	0.0	15.0	0.0	41.0	48.2	41.0	63.2			
World Bank	26.3	26.3	0.0	0.0	0.0	0.0	26.0	33.2	26.0	33.2			
African Development Bank	10.5	10.5	0.0	0.0	15.0	0.0	15.0	15.0	15.0	30.0			
Total program grants and loans	61.3	56.9	1.4	5.9	43.0	30.3	69.9	82.1	74.4	118.4			
External debt service (budget, cash basis) ³	12.7	14.5	4.3	4.3	12.0	11.0	16.6	15.4	25.0	22.6			
Interest	6.8	6.3	2.3	2.4	5.5	4.8	8.1	7.2	11.6	9.7			
Amortization	5.9	8.2	2.0	2.0	6.5	6.3	8.5	8.2	13.3	13.0			
Net external budget support	48.6	42.4	-2.9	1.6	31.0	19.3	53.3	66.6	49.4	95.8			
<i>Memorandum item:</i>													
Program exchange rate (MGA/SDR) ⁴	2790	2834	2790	2844	2775	2575	2760	2575	2745	2575			

Source: Malagasy authorities and Fund staff estimates and projections.

¹ Cumulative since January 1, 2007.

² IMF Country Report No. 08/66, Republic of Madagascar-Staff Report for the Second and Third Reviews Under the PRGF.

³ Net of HIPC and MDRI debt relief.

⁴ Rate used only for accounting purposes to set and monitor indicative targets and performance criteria.