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Republic of Madagascar: Ex Post Assessment of Longer-Term Program Engagement

This Ex Post Assessment of Longer-Term Program Engagement for the **Republic of Madagascar** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **May 12, 2005**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Republic of Madagascar or the Executive Board of the IMF.

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goals of poverty reduction. Even though the crisis only lasted a few months, it led to a significant increase in income poverty—thereby washing away many of the gains made in previous years—and in unemployment.

72. **Making the fiscal position sustainable in the medium term should rank high on the policy agenda.** Given the pitfalls of the past, tax policy reform should be a priority. The authorities need to establish a tax code that is simple, stable, transparent, and eliminates loopholes. An important first step would be to eliminate any remaining ad hoc exemptions. Work should be geared toward broadening the tax base. The tax base is relatively narrow, excluding or only lightly taxing some important sectors (such as the EPZs and the mining sector). This issue needs to be handled with care and changes should be implemented over time. A balance needs to be found between maintaining the country's competitive edge and increasing domestic tax revenue.

73. **Addressing the low level of domestic savings is a third challenge.** The authorities are to be commended for building a sound banking system. Further work is needed to enhance financial intermediation and access to credit, among other things through the development of other intermediation channels such as microfinance, to reach the rural population, and by removing other impediments to financial services.²⁵ Financial deepening will help boost domestic savings, could contribute to poverty reduction, and thus make the country less vulnerable to external shocks.

B. Structural Reforms

74. **Madagascar's recent track record in reform is promising and the current momentum should be maintained.** Moreover, there is good correspondence between the outstanding elements of the structural reform agenda and the priority areas identified in the PRSP.²⁶ Within this broad agenda, the Fund should focus on the areas discussed below, while working in close collaboration with the World Bank, who is actively engaged in several other structural reform areas.

- **Tax and customs administration.** An action plan to rehabilitate the tax and customs administration has been formulated recently with FAD's technical assistance, and its implementation began under the just-completed PRGF. Under a new program, the needs in the areas of management improvement, simplification of procedures, and improved IT should be a priority. Gains in efficiency and effectiveness of customs

²⁵ Structural impediments to lending include restrictions imposed by banks' headquarters on exposure to country risk and cumbersome procedures for the seizure of collateral in case of nonpayment.

²⁶ The agenda includes: reforms in the social sector, including education and health services; infrastructure; ensuring that growth becomes broad-based and diversified; enhancing productivity in the agricultural sector; civil service reform; tax policy; tax and customs administration reform; public expenditure management; strengthening the statistical base; finalization of the privatization agenda; legal reforms; and strengthening the judiciary system.

procedures should lead to better duty collection, which would to some extent offset the effects of tariff reductions. Finally, tax evasion and fraud should be tackled decisively.

- **Public expenditure management.** Strengthening the links between approved budgets and budget outturns, and between the PRSP and the annual budgets is needed to protect priority spending, safeguard spending discipline, prevent the accumulation of expenditure arrears, and ensure the efficient delivery of public services. In order to achieve this, it is necessary to (i) strengthen the budget preparation process; (ii) strengthen the link between the treasury and the budget; (iii) strengthen internal and external controls; and (iv) develop an expenditure tracking system.
- **Trade liberalization.** Notwithstanding the progress made, given Madagascar's dependency on external trade for economic growth, further liberalization would be welcome. The recommendation of the Diagnostic Trade Integration Study should be further implemented. A recent paper on regional trade initiatives in Africa argues that countries should engage more in nondiscriminatory liberalization (i.e., beyond the regional initiatives) and take additional measures to facilitate trade.^{27 28} As such, the focus should be on continuing to simplify the tariff structure; improving export services; strengthening the domestic supply response to export opportunities; developing a strategy to maximize the benefits from joining SADC; preparing measures to adjust to the new market conditions in the textile sector in the near term; and fostering cross-border sector cooperation.
- **Corruption and governance.** An anti-corruption strategy has been developed. An independent anti-corruption bureau was established at the end of 2004. In the coming years, the government is urged to implement anti-corruption reforms, focusing on government services. Corruption is perceived to be still pervasive in the police force, medical centers, land-titling agencies, and customs and lower courts (Country Report No. 04/403, 12/10/04). Progress in this area is essential to improve the business climate. In that regard, special attention should be given to making the judicial system more efficient and effective (the World Bank is providing technical assistance) and recent improvements in customs should be consolidated.

²⁷ See Y. Yang and S. Gupta, "Regional Trade Arrangements in Africa: Past Performance and the Way Forward," (IMF WP/05/36).

²⁸ These reforms would need to be phased in carefully and coordinated with the strengthening of domestic tax collection to minimize possible revenue losses.

VI. FUTURE FUND RELATIONS

A. Rationale for a Successor Program

75. **To assist in achieving Madagascar's poverty reduction goals, there is a strong case for continued Fund engagement, preferably through a successor-PRGF arrangement.** A PRGF would be justified on the grounds that Madagascar's economy remains vulnerable, domestically as well as externally. In addition, it is expected that the country will continue to have significant balance-of- payments needs in the medium term, given the very large investment needs and the low domestic saving rate. Continued Fund support would also facilitate the mobilization of donor support, in the form of grants and technical assistance. Donors themselves are keen on having further Fund involvement. Given the country's vulnerable position, external borrowing should be measured and remain at highly concessional rates. External assistance should preferably be in the form of grants. The structural reform agenda should build on the momentum achieved during the recently completed PRGF, and continue in the areas listed above. Fund involvement should assist in building up a diversified economy. Actions and benchmarks should be specific and selective.

76. **Risks associated with this strategy mainly stem from the political side.** There is nowadays a broad consensus in Madagascar about the need for, and direction of, reforms. However, this stronger ownership, experienced during the most recent years, needs to be consolidated. Democracy is maturing, although political upheaval remains a risk. In this context, broader-based growth will help distribute the benefits of the reforms and contribute to political and economic stability. To minimize the risks of political resistance to Fund program conditionality, careful coordination and prioritization, in consultation with the authorities, will be necessary. Finally, Madagascar is in very good standing with respect to repaying the Fund, so this is not considered among the high-risk factors.

B. Exit Strategy

77. **Fund involvement with Madagascar should be reevaluated after this successor program.** If the country continues on the current path of economic growth, stability, and structural reform, and lasting impact is made on poverty reduction, Madagascar could then perhaps move toward a low-access PRGF arrangement. If no progress is made, the Fund's position should be re-evaluated, in particular, with respect to the credibility of its involvement.

Madagascar: Millennium Development Goals

	1990	1995	2001	2002	2015
					Target
Goal 1. Eradicate extreme poverty and hunger					
Target 1: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day.					
1. Population below US\$ 1 a day (percent)	...	...	49.1	...	...
2. Poverty gap ratio at US\$ 1 a day (percent)	...	...	18.3	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	...	...	6.4	...	...
Target 2: Halve, between 1990 and 2015, the proportion of people suffering hunger					
4. Prevalence of child malnutrition (percent of children under 5)	40.9	34.1	...	33.1	20.5
5. Population below minimum level of dietary energy consumption (percent)	35.0	40.0	36.0	...	17.5
Goal 2. Achieve universal primary education					
Target 3: Ensure that, by 2015, children will be able to complete a full course of primary schooling					
6. Net primary enrollment ratio (percent of relevant age group)	...	60.6	68.7	...	...
7. Percentage of cohort reaching grade 5	21.5	39.7	33.6	...	...
8. Youth literacy rate (percent age 15-24)	72.2	76.3	80.8	81.5	...
Goal 3. Promote gender equality and empower women					
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education by 2015					
9. Ratio of girls to boys in primary and secondary education (percent)	98.9	99.2	...	...	100.0
10. Ratio of young literate females to males (percent ages 15-24)	85.6	88.8	92.1	92.5	...
11. Share of women employed in the nonagricultural sector (percent)	26.0	...	...	...	...
12. Proportion of seats held by women in the national parliament (percent)	7.0	4.0	8.0	8.0	...

Madagascar: Millennium Development Goals (continued)

	1990	1995	2001	2002	2015 Target
Goal 4. Reduce child mortality					
Target 5: reduce by two-thirds between 1990 and 2015, the under-five mortality rate					
13. Under-five mortality rate (per 1,000)	168.0	156.0	139.0	135.0	54.0
14. Infant mortality rate (per 1,000 live births)	103.0	95.0	86.0	84.0	
15. Immunization against measles (percent of children under 12-months)	47.0	55.0	55.0	61.0	
Goal 5. Improve maternal health					
Target 6: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	580.0	550.0	...	127.0
17. Proportion of births attended by skilled health personnel	57.0	47.3	46.2	...	...
Goal 6. Combat HIV/AIDS, malaria and other diseases					
Target 7: Halt by 2015, and begin to reverse, the spread of HIV/AIDS					
18. HIV prevalence among females (percent ages 15-24)	...	...	0.2	...	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	16.7	19.4	...	16.9	...
20. Number of children orphaned by HIV/AIDS	...	...	6,300	...	...
Target 8: Halt by 2015, and begin to reverse, the incidence of malaria and other major diseases					
21. Prevalence of death associated with malaria	...	...	...	...	...
22. Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...	...
23. Incidence of tuberculosis (per 100,000 people)	...	...	254.5	...	...
24. Tuberculosis cases detected under DOTS (percent)	...	65.0	60.0	61.6	...

Madagascar: Millennium Development Goals

	1990	1995	2001	2002	2015
	Target				
Goal 7. Ensure environmental sustainability					
Target 9: Integrate the principles of sustainable development into policies and programs. Reverse the loss of environmental resources					
25. Forest area (percent of total land area)	22.2	...	20.2	...	...
26. Nationally protected areas (percent of total land area)	...	1.9	1.9	2.1	...
27. GDP per unit of energy use (PPP \$ per kg oil equivalent)	...	...	...	...	...
28. CO2 emissions (metric tons per capita)	0.1	0.1	0.1	...	...
29. Proportion of population using solid fuels					
Target 10: Halve by 2015 proportion of people without access to safe drinking water					
30. Access to improved water source (percent of population)	44.0	...	47.0	...	72.0
Target 11: Achieve by 2020 significant improvement for at least 100 million slum dwellers					
31. Access to improved sanitation (percent of population)	36.0	...	42.0	...	...
32. Access to secure tenure (percent of population)	...	...	...	...	...

Madagascar: Millennium Development Goals (concluded)

	1990	1995	2001	2002	2015 Target
Goal 8. Develop a Global Partnership for Development 1/					
Target 16: Develop and implement strategies for productive work for youth.					
45. Unemployment rate of population ages 15-24 (total)	...	...	...	...	...
Female	...	...	...	...	...
Male	...	...	...	...	...
Target 17: Provide access to affordable essential drugs					
46. Proportion of population access with access to affordable essential drugs	...	...	...	...	...
Target 18: Make available new technologies, especially information and communications					
47. Fixed line and mobile telephones (per 1,000 people)	2.8	3.0	13.3	14.0	...
48. Personal computers (per 1,000 people)		1.5	2.6	4.4	...

Sources: World Bank; and Fund staff estimates.

1/ Targets 12-15 and indicators 33-44 are excluded because they can not be measured on a country specific basis. These are related to official development assistance, market access, and the HIPC initiative.

Madagascar, Ethiopia, and Tanzania—A Comparison

	Madagascar	Ethiopia	Tanzania
1995 Real GDP per capita (in 1990 U.S. dollars)	228	164	177
Banking sector reform	As early as 1994, emphasis was on restoring a sound banking system. New banking legislation had been enacted in early 1996. Independent managers had been appointed for the two remaining state-owned banks in 1995, which were privatized in 1998. The legal framework for the divestiture program was approved in 1996.	Financial restructuring of the largest commercial bank (CBE) started in November 2003. The second largest commercial bank (CBB) to be privatized soon.	In November 2003, Parliament approved privatization plan for the rural development bank.
Privatization	Excluding commercial banks, only three strategic companies were privatized (e.g., the telecommunications company, cotton company, railway company).	Half of all SOEs were privatized. Many strategic corporations remain in state hands (including the largest commercial bank, the telecommunications corporation, Ethiopian Airlines, and a large number of industrial enterprises).	Two-thirds of all state-owned enterprises (SOEs) privatized, including some strategic corporations (e.g., The National Bank of Commerce, Port Container Terminal, Telecommunications, and Air Tanzania).
Land reform	Land Act revised to allow foreigners to own land under certain conditions (e.g. requirement of US\$ 500,000 investment).	Some reforms have been implemented to improve security of tenure. Land, however, cannot be offered as collateral.	Land Act revised to allow land to be used as collateral, including the preparation of a land registry.

Madagascar, Ethiopia, and Tanzania—A Comparison (concluded)

	Madagascar	Ethiopia	Tanzania
Private sector credit growth (average 2001-03)	9.4 percent.	-2 percent.	35 percent
Credit to private sector in percent of GDP (average 2000-03)	9.2	22.9	5.8
Broad money in percent of GDP (average 2000-03)	22.8	46.3	20.8
Foreign direct investment (average 2001-03)	0.8 percent of GDP.	0.3 percent of GDP.	3.3 percent of GDP
Current account deficit excluding grants (average 2001-03)	5.6 percent of GDP (4.4 percent, including grants)	11.8 percent of GDP (4.7 percent, including grants).	8.5 percent of GDP (3.9 percent, including grants)
Fiscal deficit (average 2001-03)	8.9 percent of GDP (5.1 percent, including grants).	13.6 percent of GDP (7.7 percent, including grants)	6.4 percent of GDP (1.5 percent, including grants)
Domestic savings (average 2001-03)	11.1 percent of GDP	2.5 percent of GDP	9.6 percent of GDP
Private investment (average 2001-03)	10.2 percent of GDP	9.7 percent of GDP	13.5 percent of GDP
HIPC Completion point	October, 2004	April, 2004	November, 2001
2003 Real GDP per capita (in 1990 U.S. dollars)	220	202	217

1/ Madagascar, Ethiopia, and Tanzania emerged from decades of economic stagnation under a policy of state controls and planning in 1995. Since then, Tanzania has made greater progress in a number of areas than Ethiopia and Madagascar.

	ESAF (1988-91)		ESAF (1996-2000)		PRGF (2001-04)	
	target date	Met	Not met	Met	Not met	Met
I. Tax policy and administration						
Prior Actions						
Fully implement the new value-added tax (VAT) reimbursement system for free export zone producers.	June 1, 1999		Not met		Not met	
Modify and implement the new contract with the preshipment inspection company, BIVAC, in line with Fund staff recommendations, and instruct the customs administration to collect customs taxes in an amount that equals, as a minimum, the level assessed by BIVAC.	Mid-June 1999		Not met		Not met	
Adjust the prices for petroleum products, that is, increase super gasoline price by 10 percent and regular gasoline by 5 percent.	Mid-June 1999		Not met		Not met	
Implement an effective tax audit program within the large-taxpayer unit (SGE) that will be the basis of a program to combat tax evasion.	July 1, 1999		Not met		Not met	
Establish a bipartite committee (private-public) to monitor implementation of tax and customs administration reform.	End-May 2003			Met		
Performance Criteria						
Start operations of the Tax Bureau for Large Taxpayers	End-March 1997		Not met		Met	
ASYCUDA 2.7 customs system to become operational at the 3 main customs offices.	June 30, 2001				Met	
Bill to revise upward the mining royalty and lower the excise tax.	End-2001				Met	Not met
Adopt new regulations, in consultation with the Fiscal Affairs Department of the Fund, introducing a system authorizing the deferral of the VAT payment obligations on capital goods imports until the monthly declaration following the import.	End-June 2003					
Issue a resolution approving the newly installed ASYCUDA ++ software and setting a date for the use of the software by customs.	End-December 2004				Met	
No tax or tariff exemptions will be granted beyond those specified in the 2004 budget law.	End-December 2004				Met	
Structural benchmarks						
Reduction of the number of prohibited customs nomenclatures.	End-June 1989	Met				
Install new version of SYDONIA software in the customs administration.	End-1999		Not met			Not met
ASYCUDA 3 ++ installed in three most important offices.	End-September 2001					Not met
ASYCUDA 3 ++ installed in four more offices.	End-December 2001					Not met
II. Fiscal policy management (including expenditure policy)						
Prior actions						
Complete the harmonization of the budget and the public accounting nomenclature (in accordance with Fund technical assistance recommendations).	End-June 1999		Not met			
VAT reimbursement arrears will be settled.	End-May 2003				Met	
Performance criteria						
Treasury computer system, designed to centralize each month the accounts of the 22 main treasury offices, will be operational.	End-November 2001				Met	
Submission of draft budget execution laws for 2000 and 2001 to the Audit Court.	End-December 2003				Met	
Structural benchmarks						
Presentation of budget on three agreed bases.	End-June 1990			Met		
Apply the new nomenclature in the preparation of the budget law for 2000.	August 1, 1999					
Integrate the administrative personnel database and pay systems.	End-June 2001				Met	
Separation of the functions of the Chairman of the Central Procurement Committee and the Director General of Expenditure Commitment Control.	End-June 2001				Met	
Study on the improvement in the operation of the State Inspector General.	End-June 2001				Met	
Treasury's monthly balance sheets up to end 2001 will be prepared.	End-June 2003					Not met

Madagascar: Structural Conditionality Under Fund Program 1988-2004 (continued)

	Target date	ESAF (1988-91)	ESAF (1996-2000)	PRGF (2001-04)	
		Met	Met	Met	Not met
III. Monetary and exchange rate policies					
Performance criteria					
Introduction of new money market	End-October 1990	Met			
Structural benchmarks					
Replacement of the existing system of exchange rate determination by a continuous interbank system.	End-March 2004				
Issue a resolution by the Board of Executive Directors of the Central Bank (BCM) establishing the operational guidelines for BCM intervention in the interbank foreign exchange market.	End-December 2004			Met	Delayed (Jan. 2004)
IV. Financial sector reform					
Performance criteria					
Complete cleaning of the BTM and BEV portfolios with private sector agreement to 25 percent participation in the equity capital of at least one of the two banks.	End-June 1989		Not met		
Complete the organizational, financial and actuarial audits of the pension systems for government workers.	End-May 2000		Met		
Structural benchmarks					
Finalize a scheme for the restructuring of the nonperforming assets of the two public banks (BTM and BEV).	End-December 1989				
Authorize legislation that orders debtors in default to one of the two banks being privatized to pay their debts.	End-September 1997		Not met		Not met
Draw up activity plan for the central bank's internal audit department, together with an organizational chart defining how the internal audit department will report to the various organs of the bank.	End-September 1999		Met		
Conduct an internal audit of the management of the central bank reserves.	End-March 2003			Met	
Publication of the BCM's 2001, 2002, and sub-present financial statements and attendant audit opinions in the <i>Journal Officiel</i> .	End-March 2004			Met	
Publish the BCM's complete audited financial statements for 2003.	End-December 2004			Met	
V. Civil service reform					
Performance Criteria					
Correct the budgetary wage bill for "ghost" workers identified in the civil service census of April 1999.	End-August 1999				Delayed (end-March 2000)
Structural benchmarks					
Completion of census of central government personnel.	End-October 1989				
Finalization of strategy for civil service reform.	End-June 1997				Not met
Implement a new code of conduct for the civil service.	End-February 2000		Delayed (Jun-90)		Not met

Madagascar: Structural Conditionality Under Fund Program 1988-2004 (concluded)

	Target date	ESAF (1988-91)		ESAF (1996-2000)		PRGF (2001-04)	
		Met	Not met	Met	Not met	Met	Not met
VI. Public enterprise reform (including privatization)							
Prior actions							
Obtain the approval of the AFH group shareholders for the memorandum of agreement on the purchase of the state-owned bank BTM.	End-May 1999						Not met
Obtain a sales contract for the oil company (SOLIMA).	End-June 1999						Not met
Offset JIRAMA's debts to private sector petroleum suppliers with these suppliers tax obligations.	Mid-December 2002						Met
Repayment agreement to be signed between the government and the BCM regarding SOLIMA's debt vis-à-vis the BCM assumed by the government.	End-May 2003						Met
Begin audit of JIRAMA's operations and financial condition.	June 15, 2003						Met
Complete the bidding process for the privatization of HASYMA.	October 1, 2004						Met
Performance criteria							
Transformation of IVAMA into a trade association without government participation	End-December 1996						Del. (end-Sept. 04)
Completion of the bidding process for the purchase of HASYMA.	End-March 2004						Met
Completion of the bidding process for the selection of the company that will manage SIRAMA.	End-June 2004						Met
Structural benchmarks							
Privatization of 20 public enterprises.	End-October 1989		Not met				
Obtain a sales contract for the national airline (initial timing end-September 1999).	End-September 1999						Not met
Obtain a sales contract for the telecommunications company (ini. timing end-Sept. 1999).	End-September 2000						Del. (end-Sept. 04)
General shareholders meeting of SOLIMA will examine accounts for fiscal 2000.	End-February 2003			Met			Met
General shareholders meeting of SOLIMA will examine accounts for fiscal 2001.	End-July 2003						Met
VII. Sectoral policies/Other							
Prior action							
External commercial arrears to a preshipment inspection company will be settled.	May 1, 2003						Met
Hire staff and begin operation of the Independent Anti-corruption Bureau	October 1, 2004						Met
Structural benchmarks							
Elimination of all controls on profit margins.	End-March 1989			Met			
Abolition of Stabilization Funds for coffee and cloves.	End-December 1989						Del. (Jun-90)
Abolition of restrictions on transfers of dividends and private debt services payments.	End-November 1990			Met			Not met
Liberalization of air transport on domestic routes.	End-November 1990						Not met
Publish in the official gazette the new formula for pump prices for gasoline.	End-July 1999						Met