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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED DEVELOPMENT POLICY CREDIT

IN THE AMOUNT OF SDR 30.5 MILLION (US$45.0 MILLION EQUIVALENT)

TO THE REPUBLIC OF MADAGASCAR

FOR A

REENGAGEMENT DEVELOPMENT POLICY OPERATION

November 18, 2014

Macroeconomics and Fiscal Management
Global Practice
Africa Region

THE REPUBLIC OF MADAGASCAR

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENT

(Exchange Rate Effective as of October 31, 2014)
Currency Unit = Ariary
US$1 = Ariary 2400
US$1 = SDR 0,67643895

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AGOA	African Growth and Opportunities Act
AVG	Alliance Voahary Gasy
BCM	Central Bank of Madagascar
BIANCO	Independent Anti-corruption Bureau
CITES	Convention on the International Trade of Endangered Species
CPF	Country Partnership Framework
DeMPA	Debt Management Performance Assessment
DPO	Development Policy Operation
ECF	Extended Credit Facility
EITI	Extractive Industries Transparency Initiative
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IMF	International Monetary Fund
INSTAT	National Institute of Statistics
ISN	Interim Strategy Note
JIRAMA	State-owned electricity and water company (Jiro sy Rano Malagasy)
LDP	Letter of Development Policy
MDG	Millennium Development Goal
MFB	Ministry of Finance and Budget
MICS	Multiple Indicator Cluster Survey
NGO	Non-Governmental Organization
NPL	Non Performing Loan
NPV	Net Present Value
PDOs	Program Development Objectives
PFM	Public Finance Management
PPP	Purchasing Power Parity
SADC	Southern African Development Community
SDR	Special Drawing Rights
UN	United Nations
UNDP	United Nations Development Program

US$	United States Dollar
VAT	Value Added Tax

Vice President :	Makhtar Diop
Country Director :	Mark Lundell
Senior Practice Director :	Marcelo Giugale
Practice Director :	John Panzer
Practice Manager :	Bernard Funck
Task Team Leader :	Keiko Kubota

THE REPUBLIC OF MADAGASCAR

REENGAGEMENT DEVELOPMENT POLICY OPERATION

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The proposed reengagement development policy operation was prepared by an IDA team consisting of: Keiko Kubota (Lead Economist, Task Team Leader, GMFDR), Faniry Razafimanantsoa (Economist, GMFDR), Catalina Quintero (ET consultant, GCFDR), Cecile Valadier (Economist, CROCR), Theresa Osborne and Victor Sulla (Senior Economists, GPVDR), Anne-Lucie Lefebvre and Hajarivony Andriamarofara (Senior Public Sector Specialists, GGODR), Giovanni Ruta (Senior Environmental Economist, GENDR), Nathalie Munzberg and Hélène Bertaud (Senior Counsel, LEGEN), Joseph Byamugisha (Financial Management Specialist, GGODR) and Rondro Rajaobelison (AFMMG). Finally, the team benefited of the guidance of John Panzer (Director, GMFDR), Mark Lundell (Country Director, AFCS2), Bernard Funck (Practice Manager, GMFDR), Julio Revilla (Program Leader, GMFDR), Coralie Gevers (Country Manager, AFMMG) and Alexander Marc (Chief Technical Specialist, GCFDR). Valuable peer reviewing comments and suggestions were provided by Alain D'Hoore and Khwima Nthara (both GMFDR).

SUMMARY OF PROPOSED CREDIT AND PROGRAM

THE REPUBLIC OF MADAGASCAR

REENGAGEMENT DEVELOPMENT POLICY OPERATION

Borrower	Republic of Madagascar
Implementation Agency	Ministry of Finance and Budget
Financing Data	Standard IDA credit: SDR 30.5 million (US$45.0 million equivalent). Maturity: 38 years; grace period: 6 years.
Operation Type	Stand alone, single tranche
Pillars of the Operation And Program Development Objective(s)	The proposed operation has a single pillar with the development objective of improving the efficiency and transparency of public service delivery.
Result Indicators	1) Share of cabinet ministers filing asset declaration with BIANCO. Baseline: 20.5% (2013). Target: 100%. 2) Transparency in the treatment of seized precious wood logs, measured by the periodic reports of the inter-ministerial committee to the Council of Ministers on the execution of approved use plan of the seized stock pile. Baseline: Use plan not yet submitted to CITES. Target: Seized precious wood handled under government use plan and international oversight. 3) (i) Number of infants (0-11 months) vaccinated during the year; (ii) number of pupils in public primary schools, disaggregated by boys and girls; (iii) amount of budget appropriations to social spending. Baseline: (i) 671,880 infants (2013); (ii) 3,741,700 pupils, of which 49.6% girls (2013-14 school year); (iii) Ariary 71.7 billion (2014, initial Budget). Target: 884,385 infants, (ii) 4,000,000 pupils, of which 49.8% girls, (iii) >Ariary 139.4 billion. 4) The ratio of "fees collected" to "estimated value of electricity generated" (based on the amount of fuel inputs used) by JIRAMA. Baseline: 68% (2014). Target: 75%. 5) Share of loan items starting without implication of MFB from the beginning. Baseline: >0%. Target 0%. 6) Restructured arrears outstanding to the 3 petroleum companies and Ambatovy. Baseline: Ariary 559 billion. Target: Ariary 259 billion.
Overall risk rating	Substantial
Operation ID	P150503

IDA PROGRAM DOCUMENT FOR A PROPOSED CREDIT TO THE REPUBLIC OF MADAGASCAR

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This program document proposes a reengagement development policy operation for the Republic of Madagascar** for the amount of SDR 30.5 million (US$ 45 million equivalent). It is a stand-alone, single tranche operation to accompany the government's efforts to solidify the country's return to constitutional order. It is the first operation for Madagascar presented to the Board of Executive Directors after O.P. 7.30 became inapplicable earlier this year.[1]

2. **Madagascar is emerging from a five-year political crisis that started in March 2009 with an unconstitutional regime change**. Following the Roadmap agreed by national parties under the international mediation led by Southern African Development Community (SADC) and the African Union, presidential and parliamentary elections took place in December 2013 and were deemed credible. President Hery Rajaonarimampianina took office on January 25, 2014 and after building an alliance of parliamentarians, appointed Dr. Roger Kolo as Prime Minister on April 11, 2014. A government of 31 ministers and State secretaries was named a week later.

3. **The crisis has had devastating effects on the economy, poverty and social outcomes**. Overall, economic growth between 2009 and 2012 averaged 0.6 percent per year, and with high population growth (2.9 percent), income per capita in 2012 fell to its 2003 level (around US$ 400). The economic and social effects of the crisis were intensified by the suspension of many donor activities which, in a country where international aid represented 40 percent of the government budget, led to significant cuts in investments and a sharp decline in the delivery of services.

4. **Poverty has risen and is now among the highest in the world**. Recent estimates[2] show that in 2010, about 82 percent of Madagascar's 22 million people was living on less than US$ 1.25 a day (PPP) and approximately 93 percent of the population was living on less than US$ 2.00 a day. When using the national poverty line, 75 percent of the Malagasies lived in absolute poverty and as many as 60 percent lived in extreme poverty. Extreme poverty incidence, though not absolute poverty, is higher among female-headed households. Labor market outcomes suggest that women's earnings are not as high as those of men when controlling for various other factors. The young tended to be poorer: 51 percent of the poor is less than 15 years of age, while population over the age of 65 represents only 2 percent of the poor. Preliminary estimates suggest that from 2008 to 2013, the proportion of the population living below the poverty line, already high before the crisis, may have increased by 10 percentage points, with the larger effects over 2011-13, as the crisis continued to deepen. When population growth is factored in, it is estimated that some 4 million more Malagasies live below the poverty line than in 2008.

[1] O.P. 7.30 is the operations policy of the World Bank on dealings with de facto governments. The de facto government of Madagascar made a conscious decision of remaining current on all obligations vis-à-vis the World Bank, and therefore, this reengagement operation does not entail arrears clearance to the Bank.
[2] These data are part of a Poverty, Gender and Inequality Assessment undertaken in FY13. A short update based on the 2012 poverty household surveys is under preparation.

About a third of the population in Madagascar is deprived along multiple dimensions. These are the so-called “have nothings,” disadvantaged in terms of consumption, literacy and education, basic household assets and electricity.

5. **The crisis also reversed the progress made in the 2000s on development goals**. Prior to the crisis, Madagascar had seemed likely to meet a few of the Millennium Development Goals (MDGs). For example, under-five mortality had declined from 94 per 1,000 in 2002 to 71 in 2008. School enrollment had increased rapidly also, especially in preschool (+21 percent between 2001 and 2012), college (+12 percent) and high school (+12 percent). The increase in primary school enrollment was slower, but still substantial with an annual growth rate of 6.4 percent. A rapid deterioration in health and education since 2009 has made Madagascar rank 151st in the world on the 2011 United Nation’s (UN) Human Development Index. Primary enrollment has been stagnating with an estimated 600,000 out-of-school children. Of every 100 pupils who access primary education, less than half of them reach grade 5 and learning outcomes are declining (e.g. a 19 percentage point drop in mathematics scores). Nearly two-thirds of teachers are currently “community teachers” with little or no training, and who are paid by parents. Maternal mortality has stagnated at 478 per 100,000 live births, far from the MDG target of 149 per 100,000. Children under five continue to face a high morbidity risk due to poor nutrition status: 50 percent of children under five are stunted, severely underweight, or anemic. Immunization coverage, a proxy indicator of the overall performance of the health system, decreased rapidly from an average of 80 percent in 2009 to 60 percent in 2013.

6. **Governance also deteriorated sharply during the crisis**. Even before the crisis, Madagascar did not rank high in various governance indicators, but there had been an upward trend. The two years leading up to the most recent crisis, 2007 and 2008, marked a turning point for this trend. For example, according to Worldwide Governance Indicators, between 2008 and 2013, Madagascar’s percentile rank for “government effectiveness” fell from 30.1 to 13.9, “rule of law” fell from 38.5 to 19.9, and “control of corruption” from 54.9 to 27.3. The absence of leadership and resistance to change during the crisis stalled the efforts that were underway to improve the rule of law and public sector efficiency. Bodies that should provide oversight to public finance, such as the Court of Auditors and the Parliament, only partially fulfil their roles. The civil service has difficulty in providing public services and enforcing laws and regulations.

7. **Ever since independence, the country’s development has been hindered by cycles of political and institutional instability**, in the form of recurrent political crises and revised constitutions at every presidential change. In the past 15 years, the country has experienced two political crises. Analyses point to a few structural and historical drivers of Madagascar’s fragility: i) elite capture of the state and a political system that serves the elites; ii) the increasing role of the army in political dynamics; iii) a fragmented society (geographically and socially); iv) an unrealized decentralization process; and, v) natural resources (land and extractives) that crystalize tensions and competitions between elites. The increased recurrence of crises is also fueled by a growing criminality and insecurity and the rapid growth of a trafficking economy (e.g., precious woods, gold), which take advantage of a weak justice system that is absent from large areas of the territory.

8. **The end to the political stalemate opens the way for the country to put the country back on a positive development track by addressing some of the sources of fragility**. At the

political level, the President has initiated a process of "national reconciliation" which is facilitated by the Churches Council. He has consistently articulated the development priorities as: (i) improving governance and restoring the rule of law; (ii) addressing the high rate of poverty across the country and promoting social cohesion; and (iii) relying on the private sector and attracting investors as a way to generate growth and employment. These priorities are also reflected in the *Politique Générale de l'État* that was presented to Parliament in May 2014 and they are expected to form the core of the National Plan for Development, which is under preparation. This Plan is expected to be finalized and presented by the end of 2014 and will form the basis for several development partners' engagement in Madagascar, including the World Bank.

9. **In recent years, the World Bank's program in Madagascar has aimed at maintaining basic services (e.g., education, health, nutrition) to the poor, supporting livelihoods through agriculture and social protection, and rehabilitating essential infrastructure.** This program is performing satisfactorily and continues to deliver tangible results for the poor. It was complemented by a series of analytical work assessing the human and economic costs of the crisis and by 18 sectorial policy notes which will form the basis for the upcoming Systematic Country Diagnostic.

10. **In light of the potential turn-around, the World Bank is developing a set of activities to solidify the country's emergence from the crisis and to re-initiate structural reforms**. These are shaped by an active dialogue with the government and seek to address selected governance and institutional constraints to a more equitable, efficient, and accountable management of public resources. They build on previous work in the country and on experience in other fragile states. Initially, a follow-on Integrated Poles of Growth project will support local development and employment through regulatory improvements for the investment climate, better local governance and services to entrepreneurs. The ongoing Environmental Program 3 will be re-oriented towards enhancing its support for a transparent management of seized stocks of precious woods and for a more sustainable and effective system to curb illegal logging. A project is being developed to support the reform of the energy sector which is currently not performing (i.e., daily power outages) and is a large drain on the public budget while serving only 14 percent of the population.[3] This program will be formalized in a Country Partnership Framework.

11. **As part of this program, the proposed operation aims to help solidify the return to constitutionality by supporting improvements in public sector efficiency and transparency and encouraging an increase in fiscal space that would allow a reorientation of the State budget towards social spending.** The policy reforms supported by the proposed operation are first steps towards achieving the above aim, and the risk that they may not be followed through exists. On the other hand, the Bank can strengthen the momentum for the reforms and improve the chances of their success. Not accompanying the reformers at an early stage carries a risk of possibly depriving the new government to continue deepening the reforms upon which it has embarked.

[3] Figure for 2010. *Opportunities and challenges for inclusive and resilient growth* -- Madagascar reengagement policy notes, World Bank (2014).

2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

Real sector developments

12. **After a sharp contraction in 2009, growth has remained sluggish**. The economy showed signs of rebound in 2012 when real GDP grew by 3 percent, but the rate dropped back to 2.4 percent in 2013. The coming on stream of the nickel project in the east of the country increased mining exports by 3 percent of GDP between 2012 and 2013. Export from the export processing zones (EPZs) also showed notable pick up. Some companies from EPZs shifted their export destination from the United States to Europe to compensate for the drop in their activities when Madagascar's eligibility to the African Growth and Opportunities Act (AGOA) was suspended. On the other hand, the agricultural sector, which represents 16 percent of GDP and employs 75 percent of the population, contracted by 12.8 percent in 2013 because it suffered from natural disasters (locust and cyclones) which caused a large drop in paddy harvest. Tourism also underperformed partly due to continued sluggishness of the developed economies, and also due to perceived and actual deterioration in security conditions in the country. Overall, growth lagged behind the estimated population growth rate,[4] and remained below both sub-Saharan region's average GDP growth of 4.7 percent in 2013 and Madagascar's own pre-crisis average of 5.6 percent (2004-2008).

13. **Investment reached its lowest level of the decade in 2012-13** (total investment equaled 17.5 percent of GDP in 2013), down from an average of 25 percent of GDP in 2004-2007. Lower investments resulted from a combination of diminishing public sector financial capacity and reduction in appetite for new private investments. Public investment barely reached 3 percent of GDP in 2013 due to scarce internal resources and low external financing. Outside of mining enclaves, the private sector avoided making major investments due to general uncertainties over the political and economic stability and also due to deterioration in security and the respect for the rule of law. Major exceptions were the two large mining projects initiated before the crisis, but whose investment phase is coming to close: net FDI fell from US$ 1,270 million in 2009 to US$ 550 million in 2013.

14. **A major factor that discouraged private investors during the crisis was the breakdown of the rule of law**. An emblematic example is the uncontrolled poaching of natural assets. Logging of precious woods, which became illegal in the mid-2000s, worsened considerably during the last few years. A vast amount of stockpiles, ready to be smuggled through barges off the coast and then through larger ships, has been accumulated by logging operators. While a part of the stockpiles has been seized by the government, the majority is still in the hands of timber operators with an unclear legal status. Both unseized and seized stockpiles, the latter owing to their precarious protection, are subject to continued smuggling representing a sizeable squandering of public assets. In addition, the lack of a verifiable audit allows stockpiles to serve as buffers to hide newly cut logs temporarily, facilitating further dissipation of the State's wealth.

[4] The last national census was conducted in 1993, and therefore, the population growth estimation is a very rough approximation.

This situation is keeping under siege potentially valuable investments in a sustainable timber industry.

Table 1: Madagascar: Main Economic Indicators

	2011	2012	2013	2014	2015	2016
			Est.	Proj.	proj	proj
Real sector	(annual change, %, except noted otherwise)					
Real GDP growth	1.5	3.0	2.4	3.0	4.0	5.0
GDP per capita growth	-1.4	0.2	-0.4	0.1	1.0	1.9
Consumption (% GDP)	93.6	92.0	90.7	89.8	89.4	89.2
Investment (% GDP)	17.6	17.6	17.5	16.6	15.9	17.6
Net exports (% GDP)	-11.3	-9.5	-8.2	-6.5	-5.4	-7.0
Inflation, consumer prices (annual %, eop)	6.9	5.8	6.3	7.6	7.1	5.5
Public Finance	(in percent of GDP)					
Revenues, excluding Grants	11.3	10.5	9.6	10.2	11.4	12.1
of which: Tax Revenues	11.2	10.0	9.3	10.0	10.7	11.1
Grants	1.9	1.2	1.3	2.1	1.9	1.9
Total spending (commitment basis)	15.0	13.5	15.0	14.9	15.4	15.9
of which: Capital spending	4.2	2.7	3.1	4.3	4.5	4.5
Overall balance (cash basis)	-1.8	-1.6	-2.0	-2.5	-2.2	-1.9
Gross external financing	0.8	1.3	1.3	2.3	2.1	2.3
Total public debt	32.6	33.8	34.2	34.7	34.5	34.4
Monetary accounts	(annual change, %)					
Money Supply (M2)	18.1	6.1	9.0	13.3	..	..
Net Foreign Assets	6.1	-0.2	-12.7	13.0	..	..
Net Domestic Assets	8.0	18.5	8.0	12.0	..	..
of which: Credit to the Private Sector	3.3	8.7	16.7	13.0	..	..
External sector	(in millions of US$)					
Exports of goods	1472	1515	1914	2110	2280	2411
Imports of goods	2468	2629	2753	2827	2955	3262
Current account balance	-744	-709	-597	-409	-460	-510
Foreign Direct Investment	788	777	549	626	621	665
Foreign Reserves (months of imports)	3.7	3.3	2.2	2.3	2.3	2.9

Sources: Malagasy authorities and staff projections

Fiscal policies and developments

15. **Despite the challenging environment and dwindling foreign aid, the authorities maintained the fiscal deficit below 2 percent of GDP throughout the crisis period**. They focused on ensuring the functioning of the administration, and cut non-wage expenditure drastically. Current expenditures captured three quarters of total expenditures.

16. **Tax revenues, already secularly low, declined further from 13 percent of GDP in 2008 to 9.3 percent of GDP in 2013**, well below the low income countries average of 15.6 percent of GDP (2005-2012 average). Between 2005 and 2008, concerted efforts by the authorities to mobilize higher revenues through reforming tax policies and administration had resulted in an increase of almost 3 percentage points of GDP, but the interruption caused by the political crisis reversed the gains, leaving the tax to GDP ratio in 2013 approximately the same as it was in 2005. Feeble tax collection is attributable to a narrow tax base; tax revenues rely mainly on a single-rate VAT system,[5] from which small enterprises are exempt. The scope for raising tax rates is limited, as the VAT rate at 20 percent is one of the highest in Sub-Saharan Africa.

Box 1. Madagascar's ongoing efforts to increase revenues[6]

Raising tax revenues has been one of the priorities of successive governments in Madagascar, and has received extensive assistance and supports from development partners, including IDA and IMF. Tax revenues are collected by General Directorate of Taxes (*Direction Générale des Impôts*) and General Directorate of Customs (*Direction Générale de la Douane*). The share of taxes on international trade in total tax revenue has been falling as a result of trade liberalization. Madagascar has a great potential for tax and quasi-tax revenues from its sizeable natural resources (mining, precious stones, gold, petroleum, etc.), which is currently not exploited to the full.

Both Tax and Customs administrations implemented modernization reforms in the second half of 2000s, according to their respective strategies, supported by technical and financial assistance from IDA and France. Tax administration achieved progress in simplifying VAT regime and concentrating on larger tax payers, while reducing "nuisance taxes," which collected little revenues while being administratively burdensome. Customs modernized customs code and deployed state of the art software, Automated System for Customs Data (*ASYCUDA++)*, and moved to destination inspection program in partnership with *GasyNet*. These reforms resulted in an increase of the tax revenue ratio to GDP from 10.1 percent in 2005 to 13 percent in 2008. The progress was interrupted or reversed during the crisis, due to deceleration in economic activity, introduction of customs exemptions, adoption of distortionary measures and apparent increase in fraud.

With the return to the constitutional order, the reform process is now being re-launched. The two directorates have adopted action plans while they develop new strategies, and are collaborating closely with one another to streamline the activities. Technical assistance has resumed also. IMF has fielded technical assistance missions in both areas in 2014, which confirmed that the general direction of the pre-crisis reform strategies was still valid. More technical assistance missions are planned in the near future to continue to support implementation of the reforms. The Bank is preparing to provide technical assistance, especially in enlarging the tax base and enhancing efficiency of the revenue administrations through a new public sector project, under preparation. African Development Bank, European Union, France, Japan and others are also prepared to support the government's reform efforts to increase revenues once the new strategies are defined.

[5] The share of customs duties in tax revenues has been falling gradually from 15.4 percent in 2008 to 12.2 percent in 2013.
[6] See World Bank 2014: *Opportunities and challenges for inclusive and resilient growth -- Madagascar policy notes collection 2014*, Chapter 3: tax policy note for more details.

17. **To compensate for the revenue shortfall, social spending, transfers to lower levels of the government and capital expenditure were cut**. Capital expenditure was at its lowest level in 2012 and 2013 when it was only 2.7 percent and 3.1 percent of GDP, compared to the pre-crisis average of 8.8 percent (2004-2008), grossly inadequate for a country with large development needs.

Table 2: Madagascar: Central Government Operations

	2011	2012	2013	2014	2015	2016
			Est	Proj	Proj	Proj
		(in % of GDP)				
Total revenues and grants	13.3	11.7	10.9	12.3	13.3	14.0
Tax revenues	11.2	10.0	9.3	10.0	10.7	11.1
Non-tax revenues	0.2	0.5	0.3	0.2	0.7	1.0
Grants	1.9	1.2	1.3	2.1	1.9	1.9
Total expenditure	15.0	13.5	15.0	14.9	15.4	15.9
Current expenditure	10.8	10.7	11.9	10.6	10.9	11.4
Wages	5.3	5.4	5.7	6.4	6.2	6.2
Interest	0.7	0.7	0.7	1.0	1.2	1.2
Other 1/	4.8	4.7	5.5	3.1	3.5	4.0
Capital expenditures	4.2	2.7	3.1	4.3	4.5	4.5
Domesticaly financed	1.4	0.8	0.6	1.1	1.5	1.5
Externaly financed	2.8	2.0	2.5	3.2	3.0	3.0
Primary balance	-1.0	-1.0	-3.5	-1.5	-1.0	-0.7
Overall balance (commit. Basis)	-1.7	-1.7	-4.2	-2.5	-2.2	-1.9
Arrears variation (-=increase)	0.1	-0.1	-2.2	0.0	0.0	0.0
Overall balance (cash basis)	-1.8	-1.6	-2.0	-2.5	-2.2	-1.9
General government financing	1.8	1.6	2.0	2.5	2.2	1.9
External (net)	0.5	0.5	1.0	1.7	1.4	1.4
Domestic (net)	1.3	1.1	1.0	0.8	0.8	0.5

Source: Malagasy Authorities and staff projections

1/ includes goods and services, subsidies and transfers

18. **In this setting, the wage bill came to dominate spending**. There was, in fact, a significant increase in the wage bill over the 2008-12 period, in absolute terms and also as a share of the total expenditure: the budget allocated to wages rose from 25 percent of total expenditure in 2008 to 40 percent in the 2014 budget. The number of public servants in Madagascar, at 6 per 1,000 inhabitants, is well below the Sub-Saharan African average of 10 per 1,000 inhabitants. However, the civil service wielded enough power to secure the annual 10 percent statutory salary raise of public agents even during the crisis, and some groups were able to claim additional

special benefits. In addition, the aging civil service resulted in higher seniority. The number of civil servants also increased over the same period.

19. **In an effort to buy social peace, the government intervened to shield domestic fuel prices from price developments on global markets since 2013**, at a cost equivalent to a third of the non-salary current expenditure in 2013. The pump price of retail sales and the fuel purchased by JIRAMA, the State-owned electricity and water utility company, are subsidized. The stated objective of this policy is to help the poor, but it is estimated that the richest fifth of the population consumes 97 percent of the fuel, and 76 percent of transportation services. On the other side of the spectrum, it is estimated that 50 percent of the poorest to have captured only 1 percent and 7 percent, respectively, of the benefits accruing to the fuel and transportation subsidies. The government was unable to assume the cost of the subsidies fully, and started to accumulate arrears to the fuel distributing companies and to the Central Bank.

20. **In addition to subsidizing fuel, the government also had to cover the operational losses of JIRAMA**. The successive tariff hikes over the last few years, ostensibly to compensate for the higher fuel prices,[7] did not allow a significant improvement in the quality of service, access rates or its financial position. Instead, the company remained mired in rising technical and non-technical losses and low fee collection. Total subsidies granted were particularly high between 2011 and 2013, amounting to about Ariary 456 billion (roughly US$200 million) in total, representing approximately 6 percent of total government expenditure, annually. According to an estimate by Public Treasury, the fees collected from electricity sale represent only 68 percent of the potential electricity revenue that could have been generated based on the amount of imported fuel delivered to JIRAMA.[8] This 32 percent loss is divided into three categories, technical leakages, failure to collect fees from the electricity consumers and leakage of imported diesel before being used in electricity generating process.

21. **As external financing dwindled, the deficit was financed by domestic banks and an accumulation of arrears to domestic suppliers**. The crisis triggered suspension of most external financing and all of budget support. Prior to the crisis, external funds, roughly equal amounts in grants and credits, covered about a third of the government expenditure. Budget support reached US$197 million in 2008, financing about 11 percent of the government expenditure. Even with dwindling inflows of external aid, the government stayed current on external debt service obligations, and turned increasingly to domestic bank financing and to arrears. The latter are estimated at 3.7 percent of GDP in 2013, most of which was related to the fuel subsidies and to the delay in VAT refund to a mining company.

Monetary and financial sector policies and developments

22. **The Central Bank succeeded in keeping inflation at bay**. Inflation declined from 10.1 percent in 2008 to around 6 percent in the last two years, as the authorities refrained from excessive borrowing from the Central Bank and the banking sector, despite the tough environment. International price developments and domestic factors also contributed to lowering

[7] Electricity production in Madagascar is dominated by expensive thermal generation.
[8] Public Treasury Bulletin *Tahiry*, July 2014, No.45. Ariary 456 billion includes the subsidies for fuel purchase, discussed in the paragraph above.

inflation. The shortfall in rice production was compensated by massive imports, which helped maintain low prices of this staple even during the lean season. The stabilization of the retail price of petroleum products also helped contain inflation.

23. **Credit is scarce and expensive, standing only at 12 percent of GDP at end-2013**, well below the Sub-Saharan Africa average. The dynamics in monetary aggregate were driven mainly by net credit to the government and net foreign assets. Central Bank's base rate of 9.5 percent is more than three percentage points above inflation, and the 3-year average commercial lending rate (including banks, financial institutions and micro finance institutions) is 14.9 percent to compensate for risk profile of the business environment generally and the high proportion of funds held in government instruments, considered to bear lower risks in general,[9] and near cash form. Such high margins stifle borrowing, especially by riskier micro, small and medium enterprises.

24. **The banking sector, consisting of eleven commercial banks, is highly liquid and risk averse**. **Bank portfolios are concentrated on government and on a few large firms**. Long-term funding is largely unavailable and banks have a short term funding structure. Loan portfolios remain vulnerable due to a concentration in a few sectors, a decline in credit culture and a judiciary system lacking in credibility. Profitability indicators such as return on equity and return on assets are on a generally upward trend (source: FinStats). Non-performing loans (NPL) reached 15 percent in 2011, but are estimated to have declined to around 13.7 percent in 2013, according to the Central Bank of Madagascar. The NPL level would be higher if the loan portfolio classifications conforming to the International Financial Reporting Standards are used. Loan loss provisions have increased slightly, from 80 percent of total NPLs in 2012 to 82.4 percent in 2013. Although capital adequacy at 15-16 percent is solid, the system's capital base is composed of high levels of government instruments and near-cash assets.

External sector

25. **Externally, the economy had to adjust to the loss of market access for its textiles and sharply reduced foreign financing, though the coming on stream of nickel and cobalt exports in the last quarter of 2012 softened the blow**. The latter changed the volume as well as composition of exports: mining products, roughly 80 percent of which is nickel and cobalt, represented 27 percent of total goods exported in 2013 (36 percent during the first semester of 2014), compared to 10 percent in 2010. Consequently, nickel export outpaced the export of textiles, garments and agricultural products, which were the main export products of Madagascar in the last decade. Its dominance is expected to increase as the production increases from the current 60-70 percent of the capacity to 90 percent capacity by mid-2015. Even when textile and agriculture exports recover, the concentration of the country's export goods is expected to intensify.

26. **As the importance of the extractive industry sector increased, Madagascar has made efforts to adhere to the Extractive Industry Transparency Initiative (EITI)**; it should reach full compliance with the standard by 2016. The country originally applied to the EITI in 2008

[9] At the auction on November 5, 2014, the yields on T-bills ranged from 4.5 percent for those maturing in 4 weeks to over 12.5 percent for those with a one year maturity.

and obtained support from the World Bank earlier on, but the 2009 political crisis slowed implementation. The international EITI Board formally suspended Madagascar from the initiative in October 2011 for lack of an internationally recognized government. The suspension was lifted in June 2014 following the elections, and Madagascar was granted a new period of 18 months before being subject to a validation test. The EITI has provided a unique platform for sector dialogue and promotion of transparency even during challenging times. The initiative is viewed as an opportunity to continue to push for transparency in the sector, and the determination of all parties involved in the EITI in Madagascar during the transition has been widely acknowledged. Good governance needs to go beyond transparency over fiscal payments, however, and renewed efforts are critical in both mining and emerging petroleum sectors.

Table 3: Madagascar: External Financing Requirements and Sources

(in US$ million)	2012	2013 Est.	2014 Proj	2015 Proj.	2016 Proj.	2017 Proj
Financing requirements						
Current account deficit (excluding official transfers)	-777	-664	-559	-559	-672	-678
Long term debt amortization (excl. IMF) 1/	-80	-33	-115	-115	-131	-123
Financing sources						
FDI and portfolio investment (net)	777	549	626	621	665	655
Capital grants	85	135	158	187	200	197
Official transfers	68	67	178	91	162	160
Long term debt disbursments (excl. IMF) 2/	-122	-315	-315	-187	-127	-104
Change in reserves	91	272	3	-1	-149	-121
IMF credit (net)	-7	-9	28	-19	-2	-12
Errors and omissions	-36	-3	-5	-	-	-
Financing gap	-	-	-	-	-53	-27

Source: Malagasy Authorities and IMF projections

1/ Government only

2/ Net financing for private sector, gross borrowing for government

27. **With weak domestic demand, imports remained subdued**. Imports of petroleum products increased in the last couple of years, representing over a fifth of the total imports, in large part because of the government's policy introduced in 2013 to stabilize the domestic retail price of petroleum products below market costs. The petroleum importers received a preferential exchange rate for the part of imports directed to retail market, as well as subsidies to compensate for the remaining gap between the official and market cost-based price. Imports of food also

increased in 2013 and are expected to stay elevated in 2014, due to rice imports replacing the domestic production shortfall.

28. **The subsequent reduction in the current account deficit (to 5.6 percent of GDP in 2013) was not sufficient to improve the overall balance of payment position** as it was accompanied by a reduction in FDI inflows and non-repatriation of export proceeds. The flexible exchange rate regime facilitated the adjustment, and the local currency, Ariary, has been depreciating gradually. Still, international reserves declined from 3.3 months of import cover in 2012 to 2.2 months of import cover in 2013, but seem to have bottomed out with the discontinuation of the preferential exchange rate arrangements for the petroleum companies and resumption of external finance inflow.

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

29. **The return to constitutionality with the election of the President and the subsequent normalization of relations with international partners have opened an opportunity** to turn the economy around and put it back on a path of inclusive sustainable growth.

30. **Among its first initiatives, the new government prepared a supplementary budget reflecting its priorities, which was adopted in August 2014**. In the supplementary budget, government spending increases by 2.9 percentage points of GDP. An emphasis is on investments which include road rehabilitation, new classrooms and agricultural infrastructure. Consequently, the share of current expenditure is reduced, though not substantially. The government also increased allocation to social spending, including regularization of the employment status of a part of the "community teachers" for public schools. The number of such teachers had increased rapidly during the transition period, hired as replacements of retiring teachers or to staff new schools constructed to meet the needs of Madagascar's growing and young population. Around 40 percent of the increased spending is also allocated to transfers and subsidies, including the fuel subsidies and for partial clearance of the existing arrears and prevention of future accumulation.

31. Indeed, **the government intends to phase out fuel subsidies**, with technical assistance from the IMF. After the first small price increase[10] in July 2014, the retail price of diesel was roughly 20 percent below the market-based price. A second round of price increases is expected later this year. The government plans to introduce temporary measures to mitigate the impact of fuel price increase on urban transport. The government has also confirmed its intention of taking measures to begin reducing the operational losses of JIRAMA.

32. **The supplementary budget provides that the additional spending would be matched in equal measures by additional tax revenues and renewed budget support, for a total amount of 2.2 percentage points of GDP**. At this stage, these ambitious spending and revenue targets appear unlikely to be met, partly because the supplementary budget law was adopted relatively late, and also because the current Malagasy public financial management system requires reappointment of all budget execution officers (*ordonnateurs*), which typically takes about a

[10] The retail price of diesel was increased by 50 Ariary to 2940 Ariary/liter.

month and most budget execution comes to a virtual standstill while this procedure is done. Revenue increases have also proven challenging; as of September 2014, the revenue collection has barely outperformed the results corresponding to the same period in 2013 in nominal terms.[11] The authorities have started to curb expenditure to avoid increasing the fiscal deficit.

33. **The 2015 budget is under preparation, with the vote by the parliament expected in December. The macroeconomic policy framework is being firmed up as a result of the recent Article IV mission of the IMF**. The staff projects that the fiscal deficit will stay around 2 percent of GDP in the near future, as gradual improvement in tax collection, receipt of mining royalties and foreign aid offset a modest increase in spending. The bulk of social spending and rehabilitation of infrastructure is expected to be financed through increased support from development partners through grants and loans. Tax and customs revenues are expected to recover gradually from 9.3 percent of GDP in 2013 towards the pre-crisis average of 11.8 percent in the medium term as a result of rehabilitation of the tax and customs administration and a modest progress in expanding the tax base. Ambatovy, a major mining investor, is expected to start paying royalties on its exports early next year.[12] In addition, the public sale of a part of precious woods stockpiles could bring one-off but substantial proceeds, estimated in the order of several tens of millions of dollars, if the trade embargo supported by the Convention on the International Trade of Endangered Species (CITES) is lifted following a campaign to clarify the legal status and to seize those stockpiles in the hands of private operators.[13]

34. **While the decline in international reserves appears to have stabilized, markets are still waiting for the clarity of policy directions and reduction in political uncertainty**. As a result, the pace of depreciation accelerated since the beginning of 2014, apparently due to hoarding of hard currencies by commercial banks and large exporters. The paucity of hard currency is expected to ease in the coming months, as the exporters start to repatriate more of their earnings, as the repatriation requirement clause under the Large Mining Investment Law is triggered as the operation approaches full capacity, and the newly-introduced regulation on repatriation requirements on other exporters take effect. The authorities expect that such administrative measures will become less constraining over time, as confidence takes hold. The Central Bank indicated that it plans to maintain its policy of intervening in the exchange rate markets only to smooth out excessive fluctuations.

35. **With the private sector still undecided, growth is projected to remain modest this year** at 3 percent,[14] while the positive trends in the mining and export-oriented sector are likely to continue and the agriculture sector revives. The formulation of a medium-term strategy under the National Development Plan under preparation and of a robust budget for 2015, built on credible revenue efforts, paving the way for the finalization of an Extended Credit Facility (ECF) arrangement with the IMF, are key to cementing confidence**.**

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[11] The tables present staff projections rather than the Supplementary Budget Law 2014.

[12] Under the Law on Large Mining Investments, royalties are shared between the central and local governments, 30 and 70 percent, respectively. Royalties from the exports are forecast to be approximately US$ 10 million per year when the production reaches full capacity (subject to change with the metal prices).

[13] Potential sale of the seized stocks of the precious woods are <u>not</u> incorporated in the budget at this time.

[14] The projection by the authorities to which the Bank staff concurs.

36. **The Central Bank is expected to maintain prudent monetary policy**. Net credit to the government should decline as tax collection improves progressively. Inflation is expected to rise temporally as the fuel subsidies are phased out, but stabilize around the level similar to 2013-2014 in the medium term.

37. **On this basis, growth could recover to around 5 percent over the medium term**, close to the pre-crisis average rate. Increased mining exports, recovery of leading export industries such as textile, garment and tourism, and resumption of externally financed capital investments are the main drivers of growth in the near future. Improved political stability and the government's efforts to improve business environment are expected to restore investor confidence in the medium term. Growth in agriculture is expected to return to positive in 2014 onwards, as the sector recovers from the natural disasters, and the rehabilitation efforts bear fruit.

38. **With the recovery, the current account deficit would be expected to climb back to above 4 percent of GDP in 2015-16**, as export growth slows and import growth accelerates. Mining exports are expected to decelerate after the two major projects reach full production capacity by mid-2015, up from around 60 percent as of May 2014. Decline in commodity prices as a result of slowing global demand may reduce the mining export value further.[15] The resumption of the AGOA privileges is also expected to lead to a recovery of the textile and garment exports. Increase in exports will be accompanied by a bounce back in imports, as domestic consumption and investment recover.

39. **Foreign aid is expected to resume meeting about a half of Madagascar's external financing requirements**. With the normalization of donor relations and the implementation of the macroeconomic policies outlined above, official transfers would increase by over US$100 million in 2014 already. A mutual understanding on the direction of future development and financial policies over the medium-term would need to be reached to secure the international policy-based support needed to prevent financing gaps from reemerging from 2015 onwards.

40. **The latest debt sustainability analysis[16] assesses the risk of debt distress to be low and the level of debt would remain stable in the medium term under such a policy framework**. Madagascar is among the countries with the lowest public debt to GDP ratio (34.2 percent in 2013), with external debt representing two thirds of the total. Domestic arrears are expected to be cleared over the next few years.

41. **In sum, Madagascar's macroeconomic policy framework is adequate for the proposed operation**. This is predicated on the government's ability to define a credible set of development and fiscal policies to serve as a basis for (i) agreeing on an ECF program with the IMF, and (ii) the continued policy-based support needed to close the financing gap. Remaining risks include delays in economic recovery if the government fails to restore political stability convincingly. An inflation hike is possible if the phasing out of the fuel subsidies is not managed well. Low

[15] A reduction in the value of mining exports will tend to increase the trade deficit, but will have limited impact on the overall balance of payments, as much of the mining export earnings are not repatriated.
[16] Prepared jointly by the staffs of the IMF and the World Bank in June 2014.

international reserves are also of concern, although it is allayed by the expected recovery in exports and increased repatriation of export proceeds as well as resumption of external aid flows.

2.3 IMF RELATIONS

42. **On June 18, 2014, the Executive Board of the IMF approved the disbursement of a financial assistance to the government of Madagascar under the Rapid Credit Facility** in the amount equivalent to SDR 30.55 million (about US$ 47.1 million). This is the first operation with the IMF since the suspension of its relationship with the country five years ago. The financing supports the implementation of key economic and structural policies including: (i) improvement of tax and customs revenue collections, (ii) increase in funding of priority public investment programs and social spending, (iii) cessation of the accumulation of new domestic arrears and clearance of existing arrears, and (iv) addressing the issue of fuel price subsidies and identifying mechanisms for supporting vulnerable groups. The IMF has recently completed its first Article IV consultations since reengagement in October-November 2014. It is expected to pave the way for a possible agreement under the Extended Credit Facility, currently under preparation.

43. The Bank maintains a close working relationship with the IMF, with regular collaboration across policy issues between the two institutions.

3. THE GOVERNMENT'S PROGRAM

44. **A government vision for the medium-term is beginning to emerge. The General Policy of the State ("*Politique Générale de l'Etat*") was presented to the Parliament[17] on May 9, 2014**. The General Policy identifies the "fight against poverty through inclusive growth" as its main target, and rests on three main priority pillars: improved governance, economic recovery, and expansion of access to basic social services. Main challenges within each pillar include:

- Pillar 1: national reconciliation, rule of law and democracy, fight against corruption, equity in justice.
- Pillar 2: job creation, infrastructures and public works, energy efficiency, rural development, development of tourism, management of strategic resources.
- Pillar 3: social protection, water and sanitation, health, improvement of education system and vocational training.

45. **These general directions should be fleshed out in a new National Development Plan, which is being drafted with an ambitious completion deadline of December 2014**. Its formulation is led by the Ministry of Economy and Strategic Planning. The Council of Ministers has approved the concept note, which lays out the context, principles, processes, methodology, approach for consulting the public and timeline. The kick-off meeting has been held inviting sectoral ministries, private sector representatives and other stakeholders. Upstream public consultations in four regions have already been held. The national development plan is expected to take sectoral strategies into consideration.

[17] According to the Constitution, a Government has to present its '*Politique Générale*' within 30 days of its appointment.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

46. **The development objective of the program is to improve the efficiency and transparency of public service delivery**. By supporting an increase in social service expenditures, the program is expected to contribute to reducing the incidence of extreme poverty in Madagascar, estimated to be over four fifths of the population. The proposed operation is stand-alone, single tranche to accompany the government's efforts to consolidate the return to constitutional order. IDA intends to support implementation of the country's new national development strategy, currently under preparation, with programmatic DPOs in the future. This operation will support two of the three pillars identified in the government's "general policy," strengthening governance and increasing social service delivery. The third pillar, economic recovery, is supported by complementary investment and technical assistance operations and future DPOs. The two pillars were selected as the natural foundations for overcoming the country's main challenges to reducing poverty. To conduct appropriate pro-poor policies, economic growth and fiscal space for the government are necessary.

47. **This operation builds on lessons emerging from the past DPOs prepared for the country as well as those prepared for fragile environments, especially as part of a reengagement process**. An Independent Evaluation Group (IEG) report on engaging with fragile states[18] highlights the need to focus on politically feasible reforms that can build momentum for future changes, with a particular emphasis on restoring and strengthening basic state functions. Such operations should strike an appropriate balance between policy changes and institutional reforms. According to the evaluations of previous DPOs in Madagascar, the objectives were overly ambitious in scope and complexity, despite the country's limitations. While the reforms were grounded in analytical work, the design of these reforms would have benefitted from a more realistic assessment of political economy constraints. Flexibility is needed in supporting governance reforms through DPOs, to act as a catalyst when there is a drive from within, but not to threaten the fragile political balance when the timing is not ripe. It is also important to complement DPOs with an extensive capacity strengthening and technical assistance program.

48. **The proposed prior action regarding the precious woods builds on lessons learned from the implementation of the Environment Program activities on precious woods during the transition period**. In 2012, the Prime Minister established a consultative steering committee tasked with identifying actions which were in turn implemented by the government. The advisory role assigned to the committee proved inadequate in obtaining the expected results due to the political divisions in the government. This operation therefore supports a committee with an executive role, which provides a tool for mutual accountability of the relevant ministers who are involved in controlling trafficking. The accountability is strengthened further by the creation of a post for a fulltime Executive Secretary, who will chair the Secretariat, composed of director-level staff from the relevant ministries, and who will follow the implementation of actions on a

[18] *World Bank Group Assistance to Low-Income Fragile and Conflict-Affected States: An IEG Evaluation* (2013).

daily basis. S/he will also have the obligation to report back periodically to the Council of Ministers and to the public.

49. **There is also a need for much greater clarity on what constitutes monitorable indicators of progress**. For instance, measurement of actual levels of corruption is nearly impossible to determine with accuracy and precision, whereas assessments of opportunities to exercise discretion are doable. Poverty reduction in a fragile setting is a complex process, and the relationship between policy reforms and development outcomes is often difficult to attribute. Overly ambitious indicators should be avoided, especially for stand-alone operations where the lapse of time between the policy actions and post-operation evaluation is often too short for full effects of the reforms to become apparent.

4.2 PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

50. The proposed operation supports six prior actions that signal the State's intention to restore the rule of law, contribute to expanding inclusive service delivery or both.

Prior Action 1: All ministers of the Recipient's Cabinet have filed an asset declaration with the Independent Anti-corruption Bureau

51. **Rationale**. Restoring the credibility of the State is an important contributing factor in breaking the cycle of political instability, as the perception by the general public of impunity and lack accountability of high public office holders deteriorated markedly over the last few years. One of the manifestations of the rule of law not being respected by those in power is non-compliance with the requirement stipulated in the constitution that filing an asset declaration annually is mandatory for all high office holders in the executive branch as well as for the National Assembly. For example, in 2013, when the country was still under an unconstitutional regime, only 7 out of 35 cabinet ministers filed asset declaration. This year, by urging of the newly appointed Prime Minister, all cabinet ministers have filed. Continued enforcement of compliance by the cabinet ministers would constitute a high profile example of starting to reverse the perception of impunity. The independent anti-corruption bureau (BIANCO) is developing a strategy, which is likely to include expansion of compliance to other branches of the government, and possible enhancement of transparency.

52. **Policy**. All cabinet ministers filed their asset declaration by the deadline stipulated in the constitution. BIANCO, the recipient of the declaration, published on its website the ministers who are in compliance as the declarations were filed.

53. **Results**. The ultimate result is to improve the rule of law. The result expected in the short run is to ensure that all cabinet ministers are in compliance with this requirement stipulated in the constitution, to signal the government's intention to improve governance. Filing results are monitored and published by BIANCO.

Prior Action 2: An interministerial committee is established to improve governance and transparency in the securing and disposing of the seized stockpile of precious woods

54. **Rationale**. The seized stockpile of precious woods is a valuable public asset, and its securing and transparent disposal is an important step towards ending elite capture of the financial flows, which have contributed to instability. Sending a clear message that the State intends to stop the pillage and make transparent use of the valuable State asset to benefit the population, especially the poor, is important in reducing the sense of lawlessness. Reducing opportunities for a corrupt few to profit from the lucrative illegal activities of trading the precious woods stockpile would contribute to diminishing fragility. The establishment of an interministerial committee chaired by the Prime Minister, with an executive role and clear accountability is a concrete step towards rigorous management of the seized stockpile, with national and international oversight. The support from the international community, including CITES and Interpol, is deemed critical in introducing this governance reform as the new government seeks to assert its authority over those benefiting from illegal disposal of precious woods.

55. **Policy**. A decree was issued to establish an interministerial committee for securing and disposing seized stockpile of precious woods. The committee has an executive role, follows the implementation of actions on a daily basis, and has the obligation to report back periodically to the Council of Ministers and to the public. A permanent executive secretary has been nominated and confirmed officially. The government has indicated in the Letter of Development Policy, its commitment to allocate an adequate operational budget to the committee in the 2015 Budget when the detailed appropriations are established in the coming weeks.

56. **Results**. The ultimate result of the operation is for the Government to demonstrate transparent management of seized illegal precious woods. Under international oversight of the Conference of the Parties of the CITES, it is possible for the government to dispose of stockpiles through a transparent process, in turn ensuring that any resources obtained support poverty reduction efforts. In the short run, the interministerial committee will formulate a “stockpile use plan” and submit it to the CITES Standing Committee[19] in December 2014.

Prior Action 3: The Recipient’s National Assembly has adopted a Supplemental Budget Law for 2014, approximately doubling the amount of public expenditures aiming at fighting poverty compared to the original Budget Law for 2014

57. **Rationale**. During the transition period, social spending dwindled dramatically as the government had resorted to “survival public expenditure.” As a result, human development indicators deteriorated markedly. It is therefore important that the appropriations for social spending be increased in this and the future State budgets to reverse this trend.

[19] The CITES Standing Committee meetings are held annually around June-August.

58. **Policy**. The budget appropriations in the supplemental budget law 2014 to programs supporting improved service delivery in education and health were doubled. The increase in education sector covers rehabilitation of classrooms, distribution of school kits, and reduction in the parents' burden to pay for "community teachers" through regularizing the employment status of qualified teachers. The health sector supports reopening of 30 basic health centers through light rehabilitation of sites, recruitment of health care staff, increased provisioning of medicines and vaccines, as well as gender specific actions such as activities to lower maternity risks.

59. In an effort to have the earliest possible impact, the focus has been put on scaling up existing programs, rather than launching new ones. As a result of the delay in adopting the supplementary budget, it is possible that these program initiatives will not reach the full expected scale during fiscal year 2014. The authorities are committed to keeping the budget appropriations to programs supporting inclusive social service delivery in the future State budgets, starting with the 2015 Budget currently under preparation.

60. **Results**. The ultimate result is improvements in human development indicators facilitated by the government's policies. The immediate result is improved public service delivery in selected areas, such as basic vaccinations of infants, and the number of children in public primary schools. Monitorable result indicators are the number of pupils in public school, number of infants vaccinated and the amount of budget appropriations to social spending remaining no lower than in 2014 Supplementary budget.

Prior Action 4: The Recipient has instituted a system of coloring diesel delivered to JIRAMA with the aim of reducing leakages as a first step towards reducing operating losses of the company

61. **Rationale**. The deteriorating performance of JIRAMA has led to poor operational and financial results. While overhauling the underperforming utility company is a major undertaking necessitating significant technical and financial assistance, there are a number of immediate measures that could be taken to decrease the operational losses of the company. Decreasing the estimated 32 percent non-fee recovery (see paragraph 20) would represent a step towards holding the JIRAMA management accountable, and will also free fiscal space, allowing the government to reallocate funds for social spending, especially when electricity remains a luxury enjoyed by only 14 percent of the population.

62. **Policy**. Pending the development of a full-fledged strategy to rehabilitate the company, the Council of Ministers adopted on August 19, 2014, an action plan to stabilize the finances of JIRAMA in the short term. The government has taken the first action in the plan, to dye the diesel delivered to JIRAMA at a subsidized price to prevent leakage of imported diesel before being used in the electricity generating process. Other actions, such as bringing JIRAMA's statute to be in conformity with the law governing commercial companies (Law No. 2003-036), and switching to less expensive electricity generation using fuel oil from diesel are under preparation.

63. **Results**. The ultimate result is to transform JIRAMA into a well-managed company that provides quality service to a larger share of the population. The immediate result expected is a reduction in JIRAMA's operational losses.

Prior Action 5: The Recipient's National Assembly has adopted a law on public debt which provides a legal framework to ensure public borrowing is conducted strategically and prudently and stipulates for the preparation of a medium term debt strategy

64. **Rationale**. Madagascar has never had a unified law on public debt since independence. The legal framework gave a limited mandate "for the implementation of various development projects" to the Ministry of Finance to borrow on behalf of the State through the annual budget laws. With this formulation, it was unclear whether the State can borrow to cover operational expenditures, which is the main function of the T-bill issues. In addition, the rules for involving the Ministry of Finance from the beginning of loan discussions were not clearly defined, leading to line ministries and agencies pursuing loan discussions without the knowledge of the Ministry of Finance and Budget until the last moment for signing conventions. As the country establishes a medium term development plan, it is desirable to have an accompanying debt strategy to optimize the tradeoff between available instruments in a holistic manner, rather than making decisions on a loan-by-loan basis based on the cost-benefit analysis of individual loans as they come up. It is also important to develop in-house capacity to analyze sustainability of debt, even if the probability of debt dress for Madagascar is currently low. The law provides a clear legal framework for these eventualities, and endows the government with the tools to make sound decisions in the future.

65. **Policy**. The National Assembly adopted a law on public debt to provide a legal framework to ensure public borrowing is conducted strategically and prudently. The law also stipulates preparation of a medium term debt strategy and periodic assessment of debt sustainability.

66. **Results**. The expected results are continued prudent management of public debt, and strategic borrowing with appropriate assessment of trade-offs and under a medium term framework. The immediate result expected is a reduction of the share of loan negotiations that start without involving the Ministry of Finance to ensure a holistic view of the loan portfolio.

Prior Action 6: The Recipient has entered, with its major creditors, into legal agreements for the clearance of its arrears to said creditors under terms and conditions compatible with the Recipient's weak revenue environment to avoid future accumulations

67. **Rationale**. The arrears the government accumulated against the private sector during the crisis are undermining the credibility of the State and investor confidence. Regularizing them is an important signal that the government respects legal agreements. The arrears, estimated to be around 1 trillion Ariary (roughly equivalent to US$ 450 million and equivalent of about a third of government's total revenues and grants in 2013) in total, are however too large to be cleared in one year, given the paucity of public revenues. It is therefore desirable to confirm the government's intention to regularize the payment arrears, but to spread the repayment in an orderly way that does not overwhelm the government's ability to pay.

68. **Policy**. The government has entered into legal agreements with major creditors, Ambatovy, Galana, Total and Vivo, to regularize the existing arrears. The repayment periods are spread out over a number of years, commensurate with the government's ability to pay. Budgetary resources will be used to pay the regularized arrears. To prevent future accumulation of arrears, gradual removal of the fuel subsidies, its main cause, is pursued. The ongoing efforts to increase tax revenues and reduction in subsidies to JIRAMA will contribute to ensuring budgetary resources are available.

69. **Results**. The ultimate results are improved confidence in the State by the private sector, leading to new investments and economic recovery. The immediate result expected is elimination of arrears as they are converted to new agreements, and a gradual reduction in the amount outstanding of these new agreements.

Table 4: DPO Prior Actions and Analytical Underpinnings

Prior Action	Analytical Underpinnings
All ministers of the Recipient's Cabinet have filed an asset declaration with the Independent Anti-corruption Bureau	Madagascar reengagement policy notes (2014)
An interministerial committee is established to improve governance and transparency in the securing and disposing of the seized stockpile of precious woods	a) Rosewood stock disposal technical assistance (comprising three studies: legal analysis, inventory feasibility, and disposal options); b) Securing seized stockpiles action plan prepared under EP3 AF; c) Final report on the technical assistance for satellite monitoring of vessel movement in trafficking areas; Stockpile use plan to analyze how liquidation of seized stock can be undertaken in conformity with Madagascar's international obligations as a signatory to the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).
The Recipient's National Assembly has adopted a Supplemental Budget Law for 2014, approximately doubling the amount of public expenditures aiming at fighting poverty compared to the original Budget Law for 2014	Madagascar reengagement policy notes (2014)
The Recipient has instituted a system of coloring diesel delivered to JIRAMA with the aim of reducing leakages as a first step towards reducing operating losses of the company	Madagascar reengagement policy notes (2014)
The Recipient's National Assembly has adopted a law on public debt which provides a legal framework to ensure public borrowing is conducted strategically and prudently and stipulates for the preparation of a medium term debt strategy	Debt Management Performance Assessment report (2014)
The Recipient has entered, with its major creditors, into legal agreements for the clearance of its arrears to said creditors under terms and conditions compatible with the Recipient's weak revenue environment to avoid future accumulations	Madagascar reengagement policy notes (2014)

4.3 LINK TO CPF AND OTHER BANK OPERATIONS

70. **The proposed DPO is grounded in the Bank's interim strategy for Madagascar and will form an integral part of the post-crisis reengagement process**. The program supported by the DPO, including rehabilitation of the rule of law and increasing social sector spending to benefit the poorest, is fully aligned with the FY12-13 Interim Strategy. In particular, the DPO builds on the work carried out during the ISN period to improve efficiency and accountability in public expenditure management and to strengthen the delivery of basic public services, especially health, education and nutrition. In parallel, the reengagement with the duly-elected government presents an ideal timing for the Bank to prepare a country partnership framework to accompany the country's development plan, also under preparation. A systematic country diagnostic is being conducted in parallel to the proposed operation, based on the analytical work undertaken in the past five years, including a Poverty, Gender and Inequality Analysis (2014), two sets of Policy Notes collections (2010 and 2014), Public Expenditure and Financial Accountability reports (multiple years, and mostly recently a self-assessment in 2014), Public Expenditure Review (2011) and analysis on political fragility. Improving inclusive service delivery through enhanced fiscal space and better governance is expected to be among the fundamental themes of the framework.

71. **The proposed operation complements the investment and technical assistance projects that are ongoing or under preparation**. Its principal goal of increasing inclusive service delivery complements two ongoing projects, Emergency Support to Critical Education, Health and Nutrition Services Project (P131945) and Emergency Support to Education for All Project (P132616), as well as the Social Protection Investment project (P146919) under preparation. The policy actions to improve governance contribute to the objectives pursued in the recently completed governance and institutional development project (P103950), as well as its successor operation under preparation. The policy measure on precious woods governance is supported by the Additional Financing to the Third Environment Program (P074235). The energy project (P151785) under preparation will help carry out the action plan to improve the management of JIRAMA. The energy project and the second Integrated Growth Pole project (P113971) complement this operation by contributing to economic recovery, the third pillar of the General Policy of the State, which is not supported explicitly by the proposed operation.

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

72. **The *Cadre de Partenariat* provides a forum for collaboration among potential providers of budget support**. The members are the African Development Bank, European Union, France, and the World Bank. Collaboration among the members continued during the political crisis, even as other development partners curtailed aid, many closed local offices and all budget support operations were suspended. Since the duly-elected government took office, all members of the *Cadre de Partenariat* started to prepare budget support operations. Due to the different procedures and timing that the development partners followed in resuming budget support operations, the members have opted not to develop a unified policy action matrix common to all partners for the first operation. However, the reforms supported by the budget support operations and by the IMF overlap to a large extent, reflecting the convergence of views on what are the priorities and feasible reforms for the country at this juncture. The members

intend to restore government participation in the *Cadre*, which had been suspended during the crisis, and move towards a more harmonized approach to policy dialogue to improve alignment with the government's budget cycle, deepen impact and reduce transaction costs for the government. The Bank will assume the rotating chairmanship of the *Cadre* this year.

73. Other development partners who had closed the local office or curtailed operation are returning to Madagascar. The resumption of donor activities, however, has been tentative, as political uncertainties linger while the coalition government seeks to consolidate the return to constitutionality. International partners have collectively disbursed an estimated amount of US$250 million so far in 2014, compared to approximately US$650 million in 2008.

74. **On precious woods, the Bank has engaged in extensive consultation and collaboration with both the civil society and the international community**. Since the political transition period, when the precious wood crisis became more acute, the Bank coordinated closely with a number of international Non-Governmental Organizations (NGOs) very active in the sector including Conservation International, Wildlife Conservation Society and the World Wildlife Fund. The Bank has also partnered with Alliance Voahary Gasy (AVG), a network of national civil society organizations operating in the environment sector. Both the Bank and AVG were members of the advisory committee on precious woods, chaired by the Minister of Environment. Throughout the political transition period and since the return to constitutional order, the Bank has consulted extensively with the donor community in Madagascar. By its partners the Bank is perceived as a key presence in the sector and as being in a unique position, technically, to pursue policy dialogue. Other donors are looking with increasing attention at the sector and it is expected that the return to constitutional order and donor financing will increase opportunities for collaboration on forestry issues.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

75. **The policies supported by this DPO are likely to contribute to poverty reduction and a positive social impact**. Increasing the budgetary allocation to social spending is expected to have a direct positive impact on poverty, and especially on female-headed households, as the incidence of extreme poverty is higher among this group. The measures supporting rehabilitation of the rule of law are expected to contribute to restoring State credibility, which should lead to higher investments from the private sector and external aid inflows, resulting in higher growth and poverty reduction. The actions designed to increase fiscal space are expected to contribute indirectly to poverty reduction in the future, as the available resources are increasingly directed towards measures to alleviate poverty.

76. The transparent disposal of precious woods stockpiles in itself is not expected to have any poverty and social impact. The distributional consequences of any resulting additional public revenues are positive if the additional resources are deployed for social expenditure. If transparent disposal of seized stocks leads to reduced illegal activities, the action could have short term negative impacts on livelihoods of the poor (discussed further in the risk section below).

77. Improving financial management of JIRAMA will likely have two broadly progressive distributional impacts. First, households using electricity provided by JIRAMA will pay a higher portion of the financial cost of electricity provision: billing accuracy, receivables turnover/management, and non-technical losses generally should be reduced, even if electricity tariffs are not explicitly raised. Since electricity usage, and therefore explicit and implicit subsidies, is highly regressive, improvements to JIRAMA's cost recovery would be progressive. Second, based on international evidence, improved financial soundness of the electricity provider would in the long run result in expansion of service and more reliability of existing service. Expanded availability of more reliable power would, if achieved, primarily benefit currently un-served populations which tend to be below the top 40 percent of the consumption distribution.[20]

78. A more detailed analysis of poverty and social impact is included in Annex 4 of this document.

5.2 ENVIRONMENTAL ASPECTS

79. **The policy actions supported by this operation are not expected to have any direct impact on environment**. There is, however, a possibility that the establishment of an interministerial committee to manage the seized precious wood stockpile more transparently may have indirect spillover effects on the environment. If the committee is successful in carrying out its tasks, it would become more difficult to use the existing stockpile as a buffer to hide new logs. Success in tackling elite capture of the financial flows associated with this valuable State asset would make it more difficult to execute illicit activities with impunity, hence may lead to less illegal logging in the medium term.

80. **A possible though unlikely indirect spillover impact on environment of this governance reform is the potential perverse acceleration of trafficking linked to expectations of improved transparency in managing State assets**. This is analyzed in the 'risks' section below. This governance action is a companion measure to a set of technical and investment activities funded by the Environment Program 3 Additional Financing (see box 2).

Box 2. The Environment Program 3 Additional Financing (P074235)

The Bank has been supporting the protection of 2.7 million hectares of Madagascar's protected area network. The project has a focus on park surveillance and social safeguards activities, through the provision of bridge financing to 30 protected areas and three forest corridors. With respect to the precious woods sector, the EP3 AF has financed several activities:

a. *A series of studies on the legal and logistical aspects of labeling and disposal*, which were completed in August 2014. The Government is currently deciding whether these studies will be made public. These studies have helped to fill the information gap on the costs and methodological best practices for various possible courses of action in terms of stock disposal, taking into account the current political context.
b. *An action plan for the marking, relocation, inventory and securing of precious woods stockpiles* that have already been seized by the Government. This action plan has

[20] If eventual improvements to the governance of the electricity sector are sufficient, this could result in greater productive employment opportunities, which would benefit the general population, including the poor.

provided the detailed logistical recommendations required to collect stocks, which have already been seized but not necessarily secured by Government, throughout the country and transport them to secure locations where they will be inventoried. The action plan can be readily extended to collect declared and yet unseized stocks. This will put an end to exports and prevent further stock laundering, until the sale takes place.

c. *The implementation of pilot coastline surveillance activities*, which took place in March-April 2014, and included coastline patrolling as well as the provision of specialized satellite surveillance. This initiative has provided important insights into traffic patterns and allowed the seizure of illegal shipments in the ports of Singapore in March 2014.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

81. **Addressing fiduciary concerns and strengthening the government's public financial management has been a subject of an ongoing dialogue and technical assistance** over the last decades. A series of reforms are been implemented in the areas of taxation, budgeting, treasury and cash management. Progress has been made in the area of budget management. The 2014 PEFA self-assessment (see Annex 5 for a summary of results) showed the country has improved budget credibility regarding revenue forecasting. Annual Budget Laws are published on the MFB website in a timely manner. In addition, efforts have also been made to improve budget transparency with the regular publication Quarterly Budget Execution Reports on the MFB website within a month of the end of the period. This is an improvement compared to 2008. Annual execution reports are produced, but not made available to the public. The completion of the first Open Budget self-assessment in July 2014 is an additional step in the right direction. Government has also recently announced its intention to officially join the Open Budget Initiative.

82. **Challenges remain, however, in several areas**. The evaluation of expenditures is showing mismatches between budget previsions and execution, both on the amounts and the composition. Budget information is not exhaustive. Budget preparation has been undermined by a lack of adequate inclusion of sectoral ministries. On the expenditure side, extra-budgetary expenditures are common practice, creating opportunities for abuse. Major shortcomings also exist in the production of annual consolidated accounts as well as in significant delays in external audits by the Accounting Agency. The Accounting Agency is now completing the audit of public accounts dating back to 2007 and 2008, which are also the latest produced consolidated accounts. The latest financial statements (*Loi de Règlement*) approved by Parliament (in early 2014) was those of 2007. Furthermore, the audit reports are not disclosed to the public.

83. **Currently, there is no Public Financial Management (PFM) reform strategy in place, but the government is taking steps to prepare one**. In the interim, government prepared an interim PFM Action Plan with the support of the IMF. The interim 12 months PFM Action Plan is informed by the 2014 PEFA self-assessment and an extensive PFM diagnosis financed by a World Bank project.[21] The Plan focuses on the following areas: (i) change management; (ii) enhanced transparency of public finances; (ii) improved budget credibility and financial

[21] The PFM diagnosis was conducted under the Madagascar Second Governance and Institutional Development Project (P103950), which closed on August 31st, 2014.

sustainability of public policies; (iv) sound public debt management; and (v) enhanced accountability of accounting officers. The interim PFM Action Plan was approved by the Council of Ministers on October 28, 2014. The future PFM Vision and 5 years Action Plan under preparation will aim at further improving budget transparency and comprehensiveness, accounting, financial reporting, internal controls, external audit and external scrutiny. Although weaknesses remain in many areas, the country PFM system is deemed adequate to manage the proceeds of the proposed operation.

84. **The IMF has conducted a safeguards assessment of the Central Bank in October 2014** to confirm that the Central Bank of Madagascar's control, accounting, reporting, and auditing systems are adequate and aligned with international standards. The results are expected to be made available in due course. Publication of the annual reports of the Central Bank, suspended during the crisis, is expected to resume soon, the Council of Ministers having approved on November 13, 2014 the Central Bank's accounts for 2010 through 2013. As the IMF assessment is unlikely to become available in time for this operation, IDA will require an audit of the dedicated account of the Treasury at the Central Bank of Madagascar.

85. **The proposed credit will be disbursed following the standard IDA procedures for development policy operation**. A credit in the amount of SDR 30.5 million (US$ 45.0 million equivalent) will be made available upon effectiveness and, provided IDA is satisfied with the implementation of the development policy program and the appropriateness of the Recipient's macroeconomic policy framework, disbursed as a single tranche following the submission of an acceptable withdrawal application by the government. IDA will deposit the proceeds into a dedicated US dollar-denominated account designated by the Borrower that is part of the country's foreign exchange reserves accounts at the Central Bank of Madagascar. The dedicated account will be used exclusively for the DPO credit proceeds. The Recipient shall ensure that upon the deposit of the credit proceeds into said account, an equivalent amount is credited in the Borrower's budget management system, in a manner acceptable to IDA. The Recipient will report to IDA on the amounts deposited in the foreign-currency account and credited to the budget-management system within 30 days of deposit.

86. **The financial support provided under this operation is not intended to finance goods or services in the standard negative list**. If the proceeds of the credit are used for ineligible purposes as defined in the Financing Agreement, IDA will require the Borrower, promptly upon notice from IDA, to refund an amount equal to the amount of said payment to IDA. Amounts refunded to IDA upon such request shall be cancelled. An audit of the deposit will be carried out within four months of the deposit. A legally registered, private and independent audit company meeting appropriate international standards will be contracted to perform the audit, and in accordance with the Terms of Reference agreed upon with the government of Madagascar. All audit costs will be borne by the government of Madagascar.

5.4 MONITORING AND EVALUATION

87. **Progress on the results indicators will be monitored and evaluated jointly by the Borrower and the Bank**. The monthly budget execution reports, prepared by the MFB, will serve to monitor progress on increased social spending, decrease in subsidies granted to

JIRAMA and outstanding amount of the restructured arrears. The share of asset declaration filed will be reported by BIANCO. The improvement in governance and transparency in handling the seized stockpiles of precious woods will be monitored by periodic reports by the interministerial steering committee for securing and disposing seized stock of precious woods to the Council of Ministers and to the public. The share of loan items starting without involving MFB will be reported by the MFB at the time of evaluation.

88. Relevant units of the MFB and BIANCO have the necessary technical capacity to carry out monitoring and evaluation. The technical capacity of the interministerial steering committee, which is being established, is unknown, but an independent verification of progress is possible through CITES.

6. SUMMARY OF RISKS AND MITIGATION

89. **The overall risk rating for the operation is 'substantial,' with four main sources of risk that are inter-connected and that could potentially jeopardize the expected outcomes and benefits of this operation**. The risks are (i) political and governance; (ii) indirect spillover on environment; (iii) related to stakeholders and reputational, specifically as they affect sector policies and broader turn around; and (iv) macroeconomic. Measures to mitigate these risks are outlined below. The potential benefits of the proposed operation outweigh the residual risks and warrant IDA's assistance.

Risk categories	
1. Political and governance	High
2. Macroeconomic	Moderate
3. Sector strategies and policies	Substantial
4. Technical design of program	Moderate
5. Institutional capacity for implementation and sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and social	Moderate
8. Stakeholders	Substantial
9. Others (i.e. vulnerability to weather-related shocks and natural disasters)	Moderate
Overall	Substantial

90. **The principal risk to the objectives of this operation is that the supported actions are not enough to build the reform momentum**. Because the proposed operation is a single-tranche, stand-alone, reengagement operation, the actions supported are necessarily first steps towards larger reform agenda. If the reform efforts stall, unable to overcome resistance from stakeholders with vested interests or overwhelmed by political events, the development objectives would not be achieved. This risk is substantial and cannot be controlled completely, but this operation mitigates it in three ways. First, it seeks to attain strongest possible actions needed to build the reform momentum without overwhelming the capacity of the post-crisis government. Second, the policy action supporting the governance reform of seized precious wood stockpiles mitigates the lack of coordination among government agencies, making it more likely that the intended results of the reforms are achieved. Third, it is complementary to other

projects and technical assistance provided by IDA and development partners, which together constitute a more holistic support environment than one operation can offer.

91. In particular, there is a risk that the interministerial committee proves ineffective in achieving the governance reforms and transparency that the policy action supported by this operation is designed to achieve. Although IDA will not have any recourse in this event, this risk is mitigated by the obligations of the committee to report periodically to the Council of Ministers as well as to the public at large, which together are expected to hold the committee accountable.

92. **Perverse acceleration of timber smuggling and possible loss of income-generating activities due to reduced illegal activities are environmental and social risks, indirectly associated with the proposed operation**. By signaling the intention to improve transparency in disposing seized stockpiles, the government could drive operators to embark on "last-chance" logging and exports of precious woods. To mitigate this risk, the preparation of sales operations is being handled confidentially. Once the conditions are in place, the logs will be collected and transported in one operation throughout the 11 affected regions of Madagascar. The studies mentioned in box 2 have been carried out to assess the best methodology to implement this action. On the other hand, improved governance in disposing the seized stockpile could lead to reduced illegal logging, which is a source of income for poor local farmers and cattle herders who live around the forests. According to newspaper articles, the illicit traffic has improved the purchasing power of these poor people. To mitigate this risk, civil society and local media will be involved to ensure the operation's objectives are clearly communicated. In addition, the President of Madagascar has flagged the importance of supporting local communities through alternative revenue-generating activities, and of using the improved State finances for social service delivery. The Bank already supports communities throughout Madagascar through its social protection programs and Madagascar National Parks has a policy on community engagement.

93. **The Bank faces a reputational risk in case the policy actions supported by this operation do not succeed in achieving the intended results.** The post-crisis situation of the country is complex and the governance problem deep. Tackling the root problems will take time, much beyond the scope of this operation. There is a risk that the Bank's reputation will suffer if the results are imperfectly achieved, especially with respect to the governance reform of the seized precious wood stockpiles. On the other hand, the Bank's reputation stands also to suffer from withdrawing from the policy dialogue and technical work, as it would be criticized for abdicating a role in mitigating a complex problem and leaving a free hand to vested interest groups.

94. **Low tax revenues and international reserves constitute a macroeconomic risk, while a delay in economic recovery and resumption of aid inflows will compound it**. Increasing tax revenues is one of the main goals of IDA's new public sector project under preparation, and is also subject to technical assistance from the IMF. Reducing inefficient use of imported fuel by JIRAMA, supported by this operation, would mitigate this risk. The financial contribution provided by this operation will also reduce this risk directly.

95. **In addition, Madagascar's vulnerability to natural disasters and weather-related shocks represents a moderate and indirect risk to this operation.** Madagascar ranks among

the countries most exposed to droughts, floods and cyclones. Severe natural hazards present threats to public health, food security, and the government's poverty reduction goals. The immediate necessity of responding to environmental shocks could draw scarce administrative resources away from the reform program and threaten its long-term continuity. This risk is mitigated by the ongoing dialogue on enhancing resilience to natural disasters, and support provided by the Bank and other development partners to the government. For example, the Bank is currently supporting the rehabilitation of cyclone and flood early warning systems and hydro meteorological station nationwide. Even though active support from development partners had declined during the transition period, it is expected to revive and contribute to mitigating this risk.

Annex 1: Policy and Results Matrix
Republic of Madagascar – Reengagement development policy operation – Result Framework

Prior Actions	Indicator	Baseline (year)	End program Target (2016)
All ministers of the Recipient's Cabinet have filed an asset declaration with the Independent Anti-corruption Bureau	Share of cabinet ministers filing asset declaration with BIANCO	20.5% (2013)	100%
An interministerial committee is established to improve governance and transparency in the securing and disposing of the seized stockpile of precious woods	Transparency in the treatment of seized precious wood logs, measured by the periodical reports of the interministerial committee to the Council of Ministers on the execution of approved use plan of the seized stock pile.	Use plan not yet submitted to CITES	Seized precious wood handled under government use plan and international oversight
The Recipient's National Assembly has adopted a Supplemental Budget Law for 2014, approximately doubling the amount of public expenditures aiming at fighting poverty compared to the original Budget Law for 2014	(i) Number of infants (0-11 months) vaccinated during the year; (ii) number of pupils in public primary schools, disaggregated by boys and girls; (iii) amount of budget appropriations to social spending	(i) 671,880 infants (2013) (ii) 3,741,700 pupils, of which 49.6% girls (2013-14 school year) (iii) Ariary 71.7 billion (2014, initial Budget)	(i) 884,385 infants (ii) 4,000,000 pupils, of which 49.8% girls (iii) > Ariary 139.4 billion
The Recipient has instituted a system of coloring diesel delivered to JIRAMA with the aim of reducing leakages as a first step towards reducing operating losses of the company	The ratio of "fees collected" to "estimated value of electricity generated" (based on the amount of fuel inputs used) by JIRAMA	68 % (2014)	75%
The Recipient's National Assembly has adopted a law on public debt which provides a legal framework to ensure public borrowing is conducted strategically and prudently and stipulates for the preparation of a medium term debt strategy	Share of loan items starting without implication of MFB from the beginning	> 0 %	0%
The Recipient has entered, with its major creditors, into legal agreements for the clearance of its arrears to said creditors under terms and conditions compatible with the Recipient's weak revenue environment to avoid future accumulations	Restructured arrears outstanding to the 3 petroleum companies and Ambatovy.	Ariary 559 billion	Ariary 259 billion

Annex 2: Letter of Development Policy
Translated from original French

MINISTRY OF FINANCE AND BUDGET

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Minister

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Antananarivo, November 6, 2014

The Minister of Finance and Budget

Dr Jim Yong Kim

The World Bank

1818 H Street NW, Washington DC

Development Policy Letter For 2014-2015

Mr. President,

Madagascar is currently opening a new page of its history following the presidential and legislative elections, as well as the establishment of the institutions of the Fourth Republic. Return to constitutional order after five years of transition thus allows developing a better visibility on policies and strategies for the country to recover in all affected areas.

The General Policy of the State (PGE), which is based on the vision of "Madagascar: a modern and prosperous nation," was defined and presented to the National Assembly in May 2014. It focuses on three priority areas: (i) reinforcement of governance, the rule of law and establishment of a fair justice, (ii) economic recovery, maintaining macroeconomic stability and restoring an attractive business climate, as well as (iii) broadening access to quality basic social services. The new Government through such PGE commits to build the pillars of a modern and prosperous nation in order to fight against poverty and achieve inclusive and sustainable development. Such long-term vision will be supported by the National Development Plan, which is being finalized, and which provides a medium term challenges and strategic orientations of the PGE.

This letter testifies to the will to meet the challenges to strengthen the performance of the tax and customs administrations for effective recovery of economic growth and to optimize the allocation of resources in favor of sectors that have tangible impact on the population (education, health, and infrastructure).

From 2009 to 2013, Madagascar experienced a period of social and political crisis, leading the country into a difficult socio-economic context. Economic activity slowed down, poverty increased, and the achievement of Millennium Development Goals is undermined. Per capita income has dropped and economic growth has been largely below the rate of population growth. Such poor performance has resulted in a 0.6% estimated growth rate over the period.

Poverty rate increased from 69% in 2005 to 71% in 2013. The political crisis has caused decline in the social indicators of Madagascar, 90% of the population lived below $2 a day in 2012. Limited access to quality health services increased maternal mortality. In parallel with the chronic under-nutrition problem, the impact of the crisis also appeared in increasing acute malnutrition. Similarly, in the area of education, primary school enrollment has stagnated at 4.3 million students since 2009, despite a sustained estimated population growth. Indeed, an increase in the number of out-of-school children on account of the crisis is estimated between 400,000 and 600,000.

Weakening rule of law, increasing insecurity, poor governance in the natural resources sector (rosewood, gold, and precious stones), limited progress on the anti-corruption front, and low transparency in public resource management are issues that the crisis has only worsened. The long-term governance problems in Madagascar have been exacerbated.

During this period, public and private investments fell significantly to around 16% of GDP, versus 35% of GDP in 2009. Suspensions in external funding, as well as low Foreign Direct Investment (FDI) flows, partly explain such deterioration. Indeed, FDI significantly declined following the completion of major mining sector investment.

With regard to public finance, suspension of budget support forced the authorities to implement an austerity policy. Moreover, the performance in tax revenues, which is structurally weak, was aggravated by the slowdown in economic activities. The tax collection decreased from 13% of GDP in 2008 to 10.5% of GDP in 2013. Thus, public expenditure relating to infrastructure and social spending has been reduced considerably and budgetary arrears have accumulated. In addition, faced with international oil price volatility, the Government implemented a policy to subsidize prices at the pump in order to control an underlying inflation pressure. However, thanks to the implementation of prudent fiscal and monetary policies, macroeconomic stability has been maintained: inflation has been curbed and the fiscal deficit contained at a level below 3% of GDP over the 2009-2013 period.

Following the presidential and legislative elections, as well as the formation of the new government, the return to constitutional order was acquired. Dialogue with technical and financial partners resumed and the Government is determined to tackle the pressing economic and social challenges in the country. The actions primarily aim to lay the foundations for inclusive and sustainable development. The Government is convinced that the economic recovery is possible by the implementation of the PGE. Such commitment by the Government is supported by the technical and financial partners through a gradual return of external financing.

In 2014, the recovery of economic activities still remains fragile and performance of economic activities remains mixed. They are a reflection of the investors' prudence, as well as weak supply response. Nevertheless, the national economy is estimated to maintain a 3.0% growth rate. Despite locust invasion, insufficient rainfall and silting of rice fields, the primary sector returned to a 1.5% growth rate. The secondary sector continues to propel the national economy with a 8.6% growth rate thanks to extractive industries, energy, and drinks. The tertiary sector is expected to achieve 2.5% growth, with construction of buildings and public works (BTP), and dynamism in tourism despite the difficulties encountered in air transport.

Inflation is estimated at 6.9%. It results from the gradual return to market prices of petroleum products which will impact consumer prices. The continued depreciation of the national currency also plays a determining role in the evolution of imported products prices.

An 11.6% tax collection rate is expected for 2014, of which 54.2% from domestic tax revenues and 42.8% from customs revenues. In order to optimize the quality of public expenditure allocation, the fiscal policy reflects the will of the government to meet the new challenges and priorities that are defined in the PGE. Expenditures are geared towards social sectors (health, education and social protection), as well as to rehabilitation and reconstruction of basic infrastructure. The 2014 Supplementary Budget Law has increased expenditures in infrastructure and essential services while prioritizing expenditures in education, health and nutrition compared to the initial 2014 Budget Law.

Growth forecast for 2015 is 5.0%. Investment and exports are expected to sustain such growth to initiate economic recovery. The secondary sector remains the engine of economic growth with an 11.4% rate, driven primarily by the dynamism of the extractive industries (28.1 %). Regarding the primary sector, growth is projected to be 2.0%, resulting from the actions undertaken by the Government in favor of developing the agriculture sector. For the tertiary sector, 4.7% growth is expected, driven by increased activities in “'BTP" (13.1%), "auxiliary transport" (17.4%), and "services to companies and households" (3.3%).

By further intensifying domestic resource mobilization, the tax collection in 2015 is expected to achieve 12.3% of GDP. Activities will focus on broadening the tax base via taxation of the informal sector, increased control and audit system, and limitation of tax exemptions. A priority action plan to increase domestic revenues has been developed and implemented for this purpose. With regard to customs revenues, national border controls and fight against fraudulent imports will be strengthened. A center for monitoring and coordinating business operations will be created.

Recovery in total investment is expected. Investment is projected to achieve 19.1% of GDP, of which 14.6 percentage points by the private sector and 4.5 percentage points by the public sector. Compared to the 2014 Supplementary Budget Law, public investment expenditures will increase by 7.1% in 2015.

Public spending will focus not only on activities contributing to economic growth, but also on those that will have tangible impact on the life of the population. Thus, the government priorities include: (i) Strengthening governance, the rule of law and establishing a fair justice (ii) Improving the security of people and properties, (iii) Support to rural development (iv) Infrastructure development, (v) Strengthening food security, (vi) Facilitating access to basic social services (health, education); (vii) Revitalizing the energy sector and promoting renewable energies; (viii) Reestablishing an attractive business climate; and (ix) Developing employment generating activities.

The Government is also committed to avoiding accumulating new domestic arrears and to clearing the existing stock within a period commensurate with its capacity. An action plan with a repayment schedule of the existing arrears (VAT, trade payables) has already been established. Repayment has started already in 2014. Meanwhile, an audit of arrears relating to extra budgetary expenditures for previous years will be made.

As part of the long-term objective of public finance management (PFM) recovery and reform, the Government will strengthen its efforts to increase efficiency and transparency in public finance. To meet the identified priorities, the reform action plan will take into account the results of the PEFA self-assessment developed in 2013 and recommendations by technical and financial partners.

With regard to foreign trade, trade deficit is expected to grow by 12.2% compared to 2014 because of increase in exports (4.5%) is expected to be lower than that in imports (6.5 %). The exports to imports ratio will thus decline to 73.3% in 2015 from 74.6% in 2014.

In the medium term, the macroeconomic policy should support efficiency in sectoral measures and actions. It will strive to improve predictability and provide economic actors with stable environment for their activities. In addition, the National Development Plan, which is currently being finalized, will reflect the "Madagascar: A modern and prosperous Nation" vision, and the basic directions of the PGE. The plan will define the main axes of the strategy to be followed, as well as the implementation ways and means required for materializing it.

A medium-term strategy relating to investment and debt management will be developed to ensure that public debt and external debt remain within debt sustainability limits. To this end, external financing on concessional terms will be favored. Recourse to non-concessional external loans would be justified by the significant social and economic benefits of the project and by its importance. For the case of domestic loans, a new security will be established on the domestic market in 2014, and efforts will be concentrated on developing the domestic market for the coming years.

The Government will continue reforms to strengthen the performance of the tax and customs administrations to establish an efficient and fair tax system. Fiscal policy will focus on increasing revenues, optimal allocation of resources depending on priorities established in advance, as well as on controlling the deficit. In the short term, the focus will be on increasing tax collection and correcting dysfunctions that are sources of distortion and imbalance.

In order to optimize the quality of public expenditure allocation, the 2014 Supplementary Budget Law increased spending on infrastructure and essential services while prioritizing expenditures related to education (+ 5.5%) , health (+ 22%) and nutrition compared to the 2014 Initial Budget Act. The level of budget appropriations to social spending will continue in the future starting with the 2015 Budget Law.

Indeed, the social sector will have a budget of 32.6% of the Public Investment Program in the 2015 Budget Law. This sector will primarily support activities in providing school kits, further integrating and reintegrating school-age children, supplying desks and benches, building new classrooms, creating new schools and supplying them with new equipment and tools (high schools and Vocational training centers). In addition, a funding strategy appropriate to the health sector will be developed to improve access to health services.

In terms of governance, the efforts undertaken to strengthen the fight against corruption and illicit precious woods trafficking will continue. The government established an inter-ministerial committee chaired by the Prime Minister, which will outline an action plan for improving the governance and transparency of the precious wood industry. The action plan will include enforcement of the law in and around potential logging areas, as well as marking, transportation, securing and liquidating stocks of precious wood in accordance with international obligations. A use plan for the stocks will be submitted for approval by CITES in December 2014. In addition, a "0" export quota will be scheduled through August 2015. The action plan for rehabilitating the industry will be implemented under the auspices of an Executive Secretariat housed in the Prime Minister Office. A budget line will be provided for the operating expenditure of the Executive Secretariat.

Regarding corruption prevention, the members of the government, under the leadership of the Prime Minister, have all filed the declaration of assets. BIANCO has published on its website the list of names of complying ministers. Declaration by officials holding high positions and magistrates will also be expected to file declarations in the future.

As part of the rehabilitation of JIRAMA, the Government has put in place a system of dyeing the fuel delivered to JIRAMA with the aim of reducing fuel leakages, as a first step towards improving its cash flow. A plan to revitalize the national water and electricity utility company has also been developed, as confirmed by an official communication adopted by the Council of Ministers. The short term measures include reform in management and operations, in order eradicate power cuts. In the medium term, the Government plans to take measures to reduce fuel costs in terms of price and volume, and towards reducing the amount of electricity that is produced but not sold. It in addition, electricity pricing will be reconsidered, increasing operations efficiency, and ensuring that the statute of JIRAMA complies with the provisions of the Law governing commercial corporations.

In order to strengthen public expenditure management, a plan to reduce fuel subsidies was established with a completion goal by end of June 2015. This will gradually bring back the petroleum prices to market based prices. Prices at the pump should thus reflect changes in world prices and exchange rates, necessarily causing a significant increase in consumer prices. Given the social implications of such increase in pump prices, the Government will put in place accompanying measures, with support by technical and financial partners, which include (i) targeted temporary subsidies for the benefit of public transport in urban areas; (ii) developing the "cash-for-work" program in rural areas; (ii) extending the pilot program of cash transfers conditional on children's school enrolment; (iv) expanding the school kits program to a larger number of regions. Information campaigns on such accompanying measures have been planned.

In order to ensure accountability of officials involved in public finances, a letter requesting the appointment of members of the Budget and Financial Discipline Council (CDBF) was sent to the Prime Minister in September 2014. The above mentioned Council will be established once the appointment of members is completed.

Implementing all the measures envisaged under the PGE will enable the Government to reignite economic activities of Madagascar in the coming years. However, taking account of limited resources, the Government is seeking financial support from the World Bank as part of emergency budget support.

The Minister of Finance and Budget

REPOBLIKAN'I MADAGASIKARA
Fitiavana - Tanindrazana - Fandrosoana

MINISTERE DES FINANCES
ET DU BUDGET

Ministre

Antananarivo, le 06 NOV. 2014

Le Ministre des Finances et du Budget

à

Dr Jim Yong Kim

Banque mondiale

1818 H Street NW, Washington DC

Lettre de Politique de Développement
Pour 2014-2015

Monsieur le Président,

Madagascar entre actuellement dans une nouvelle page de son histoire suite à la concrétisation des élections présidentielle et législative, ainsi qu'à la mise en place des Institutions de la Quatrième République. Le retour à l'ordre constitutionnel après cinq années de Transition permet ainsi, de concevoir une meilleure visibilité sur les politiques et stratégies de redressement du pays dans tous les domaines altérés.

La Politique Générale de l'Etat (PGE) qui se fonde sur la vision « Madagascar: Nation moderne et prospère », a été définie et présentée devant l'Assemblée Nationale en Mai 2014. Elle s'articule autour de trois axes prioritaires: (i) le renforcement de la Gouvernance, de l'Etat de droit et l'instauration d'une justice équitable, (ii) la reprise économique, le maintien de la stabilité macroéconomique et le rétablissement d'un climat des affaires attrayant ainsi que (iii) l'élargissement de l'accès aux services sociaux de base de qualité. Le Gouvernement s'engage, à travers cette PGE, à bâtir les piliers d'une nation moderne et prospère dans le but de lutter contre la pauvreté et d'asseoir un développement inclusif et durable. Cette vision à long terme sera soutenue par le Plan National de Développement (PND), qui est en cours de finalisation, et constitue la déclinaison à moyen terme des défis et orientations stratégiques de la PGE.

La présente lettre témoigne de la volonté à relever les défis, d'une part, d'affermir la performance des administrations fiscales et douanières pour une reprise effective de la croissance économique ; et d'autre part, d'optimiser l'allocation des ressources en faveur des secteurs ayant des impacts tangibles sur la population (éducation, santé, infrastructures).

De 2009 à 2013, Madagascar a connu une période de crise sociopolitique, entrainant le pays dans un contexte socio-économique difficile. L'activité économique s'est ralentie, la pauvreté s'est accrue, et l'atteinte des Objectifs du Millénaire pour le Développement est remise en cause. Le revenu par habitant a chuté et la croissance économique a été largement en dessous du rythme d'accroissement de la population. Cette faible performance s'est traduite par un taux de croissance estimée à 0,6% sur la période.

Le taux de pauvreté est passé de 69% en 2005 à 71% en 2013. La crise politique a aggravé les indicateurs sociaux de Madagascar, 90% de la population vie en dessous de 2$ par jour en 2012. L'accès limité aux ressources de santé de qualité a accru la mortalité maternelle. En parallèle avec le problème chronique de sous-nutrition, les impacts de la crise se sont également manifestés par l'augmentation de la malnutrition aigüe. De même, dans le secteur de l'éducation, les inscriptions en primaire stagnent à 4,3 millions d'élèves depuis 2009, malgré une croissance démographique estimée soutenue. En effet, le déficit en termes de nombre d'enfants non scolarisés issu de la crise est estimé entre 400 000 et 600 000.

L'affaiblissement de l'Etat de droit, l'insécurité grandissante, la mauvaise gouvernance dans l'exploitation des ressources naturelles (bois de rose, or, pierres précieuses), les progrès limités sur le front anti-corruption et la faible transparence dans la gestion des ressources publiques sont des problèmes que la crise n'a fait qu'aggraver. Les problèmes de longue durée en matière de gouvernance à Madagascar ont été exacerbés.

Durant cette période, les investissements public et privé ont chuté notablement tournant autour de 16% du PIB contre 35% du PIB en 2009. La suspension des financements extérieurs ainsi que la faiblesse des flux des Investissements Directs Etrangers (IDE) expliquent en partie cette détérioration. En effet, la baisse des IDE a été importante suite à l'achèvement de la mise en place des grandes infrastructures minières.

Au niveau des Finances Publiques, la suspension des aides budgétaires contraint les autorités à appliquer la politique d'austérité. De plus, la performance des recettes fiscales, qui est structurellement faible, a été aggravée suite au ralentissement des activités économiques. Le taux de pression fiscale est passé de 13% du PIB en 2008 à 10,5% du PIB en 2013. Ainsi, les dépenses publiques relatives aux infrastructures et aux dépenses sociales ont été fortement réduites et les arriérés budgétaires se sont accumulés. En outre, face aux volatilités des prix pétroliers internationaux, le Gouvernement a procédé à une politique de subvention des prix à la pompe afin de maîtriser une poussée d'inflation sous- jacente. Toutefois, grâce à la mise en œuvre de politiques budgétaire et monétaire prudentes, la stabilité macroéconomique a été maintenue : l'inflation a été maitrisée et le déficit budgétaire contenue à un niveau inférieur à 3% du PIB sur la période 2009-2013.

Suite aux élections présidentielle et législative, ainsi qu'à la formation du nouveau Gouvernement, le retour à l'ordre constitutionnel a été acquis. Le dialogue avec les Partenaires Techniques et Financiers a repris et le Gouvernement est déterminé à affronter les défis économiques et sociaux urgents du pays. Les actions visent, avant tout, à asseoir les bases d'un développement inclusif et durable. Le Gouvernement est convaincu que la reprise économique est possible par la mise en œuvre de la PGE. Cet engagement du Gouvernement est appuyé par les Partenaires Techniques et Financiers par le retour progressif des financements extérieurs.

En 2014, la reprise des activités économiques reste encore fragile et les performances par branches d'activités demeurent mitigées. Elles traduisent une prudence d'investissement des opérateurs dans les activités économiques ainsi qu'une faiblesse de l'offre. Néanmoins, l'économie nationale estime maintenir un taux de croissance à 3,0%. Malgré l'invasion acridienne, l'insuffisance des pluies et l'ensablement des rizières, le secteur primaire conserve un taux de croissance de 1,5%. Le secteur secondaire continue de propulser l'économie nationale avec un taux de croissance de 8,6% grâce notamment aux industries extractives, énergie, et des boissons. Le tertiaire entend pour sa part atteindre une croissance de 2,5%, avec le développement de la branche Bâtiments et travaux publics (BTP), et le dynamisme du tourisme malgré les difficultés rencontrées dans le secteur du Transport aérien.

L'inflation est évaluée à 6,9%. Il résulte du retour progressif à la vérité des prix à la pompe sur les produits pétroliers qui se répercutera sur les prix à la consommation. La dépréciation continue de la monnaie nationale joue aussi un rôle déterminant dans l'évolution des prix des produits importés.

Un taux de pression fiscale de 11,6% est escompté pour l'année 2014 dont 54,2% de recettes fiscales intérieures et 42,8% de recettes douanières. Afin d'optimiser la qualité d'allocation des dépenses publiques, la politique de dépenses reflète la volonté de l'Etat de répondre aux nouveaux défis et priorités qui sont définis dans la Politique Générale de l'Etat. L'orientation des dépenses se focalise sur les secteurs sociaux (santé, éducation et protection sociale) ainsi que sur la réhabilitation et/ou reconstruction des infrastructures de base. La Loi de Finances Rectificative 2014 a procédé à une augmentation des dépenses d'infrastructure et de services essentielles tout en priorisant les dépenses liées à l'éducation, la santé et la nutrition par rapport à la Loi de Finances Initiale 2014.

Les prévisions pour l'année 2015 affichent un taux de croissance de 5,0%. L'investissement et les exportations devront soutenir cette croissance pour amorcer la relance économique. Le secteur secondaire demeure le moteur de la croissance économique avec un taux de 11,4%, soutenu principalement par le dynamisme de la branche industries extractives (28,1%). Pour le secteur primaire, la croissance s'établira à 2,0%. Cette situation résultera des actions entreprises par le Gouvernement en faveur du développement de la branche « Agriculture ». Concernant le secteur tertiaire, une croissance de 4,7 % est attendue. Les activités accrues dans les branches « BTP » (13,1%), « auxiliaire de transport » (17,4%) et « services rendus aux entreprises et aux ménages » (3,3%) conduisent à cette performance

En intensifiant davantage la mobilisation des ressources intérieures, la pression fiscale escomptée en 2015 sera de 12,3% du PIB. Les actions seront axées sur l'élargissement de l'assiette fiscale via la fiscalisation des secteurs d'activités qui évoluent dans l'informel, l'intensification du système de contrôle et de vérification, et la limitation des exonérations fiscales. Un plan d'actions prioritaires pour augmenter les recettes intérieures a été élaboré et mis en œuvre à cet effet. Au niveau des recettes douanières, les contrôles aux frontières nationales et la lutte contre les importations frauduleuses seront renforcées. Un centre de suivi et de coordination des opérations commerciales sera ainsi crée.

Un redressement des investissements totaux est escompté. Ainsi, le taux d'investissement est estimé à 19,1% du PIB dont 14,6% du secteur privé et 4,5% du secteur public. Par rapport à la LFR 2014, les dépenses d'investissements publics connaitront une augmentation de 7,1% en 2015.

Les dépenses publiques seront axées, non seulement sur les activités contribuant à la croissance économique, mais surtout sur celles qui auront des impacts tangibles sur la vie de la population. Ainsi, parmi les priorités de l'Etat, figurent : (i) Le renforcement de la gouvernance, de l'Etat de droit et l'instauration d'une justice équitable ; (ii) Le raffermissement de la sécurité des biens et des personnes ; (iii) Le soutien au développement rural ; (iv) Le développement des infrastructures ; (v) Le renforcement de la sécurité alimentaire ; (vi) La facilitation de l'accès aux services sociaux de base (santé, éducation) ; (vii) La revitalisation du secteur énergie et la promotion des énergies renouvelables ; (viii) Le rétablissement d'un climat des affaires attrayant ; et (ix) le développement des activités favorisant la création d'emploi.

Le Gouvernement s'engage également à éviter l'accumulation des arriérés intérieurs et à apurer le stock existant d'arriérés dans un délai approprié à la capacité du gouvernement. Étant donné le montant du stock existant, un plan d'action assorti d'un calendrier pour rembourser les arriérés existants (TVA, créances fournisseurs) a déjà été établi. Le remboursement a déjà commencé en 2014. Parallèlement, un audit des arriérés relatifs aux dépenses extrabudgétaires des années antérieures sera effectué.

Dans le cadre de l'objectif à long terme de redressement et de réforme du système de Gestion des Finances Publiques (GFP), le Gouvernement accentuera son effort pour augmenter l'efficacité et la transparence des Finances Publiques. Pour répondre aux priorités identifiées, le plan d'actions de réforme prendra en compte des recommandations, d'une part, de l'autoévaluation PEFA élaborée en 2013 et d'autre part, des missions d'évaluation des Partenaires Techniques et Financiers.

Au niveau du commerce extérieur, le déficit de la balance commerciale se creusera de 12,2% par rapport à celui de 2014 à cause d'une progression des exportations moins importante (4,5%) que celle des importations (6,5%). Le taux de couverture des exportations par rapport à l'importation diminuera ainsi de 73,3% contre 74,6% en 2014.

A moyen terme, la politique macroéconomique devrait soutenir l'efficacité des mesures et actions sectorielles. Elle devrait tendre vers l'amélioration de la prévisibilité en offrant aux opérateurs économiques un cadre d'interventions stable. En outre, le Plan National de Développement, qui est actuellement en cours de finalisation, reflétera la vision « Madagascar : Une nation moderne et prospère » et les orientations fondamentales de la PGE. Ce plan définira les grands axes de la stratégie à suivre ainsi que les voies et moyens de mise en œuvre requis pour sa réalisation.

Une stratégie à moyen terme relative à l'investissement et à la gestion de la dette sera élaborée afin d'assurer que les emprunts publics et extérieurs restent dans des limites qui garantissent la viabilité de la dette. A cet effet, les financements extérieurs aux conditions concessionnelles seront privilégiés. Le recours à des emprunts extérieurs non concessionnels serait justifié par les retombées socio-économiques non négligeables du projet et par son importance. Pour le cas des emprunts intérieurs, un nouveau titre sera mis en place sur le marché intérieur en 2015, et les efforts seront concentrés sur le développement du marché intérieur pour les années à venir.

Le Gouvernement continuera les réformes pour renforcer la performance des administrations fiscales et douanières en vue de mettre en place un système fiscal efficace et équitable tout en tablant sur l'amélioration et la sécurisation des recettes fiscales. La politique budgétaire sera axée sur l'augmentation des recettes, l'allocation optimale des ressources en fonction des priorités préalablement établies, ainsi que sur la maîtrise du déficit. A court terme, l'accent sera mis sur l'augmentation des recouvrements fiscaux et la correction des dysfonctionnements, sources de distorsion et de déséquilibre.

Afin d'optimiser la qualité d'allocation des dépenses publiques, la Loi de Finances Rectificative 2014 a procédé à une augmentation des dépenses d'infrastructure et de services essentielles tout en priorisant les dépenses liées à l'éducation (+5,5%), la santé (+22%) et la nutrition par rapport à la Loi de Finances Initiale 2014. Cette optimisation de la qualité d'allocation des dépenses publiques sera poursuivie dans l'avenir commençant par la Loi de Finances 2015.

En effet, le secteur social détiendra une enveloppe de 32,6% du Programme d'Investissement Public dans la Loi de Finances 2015. Ce secteur soutiendra principalement les activités concernant la dotation de kits scolaires, la poursuite de l'insertion et réinsertion des enfants en âge scolaire, la dotation des tables bancs, la construction des nouvelles salles de classe, la création de nouveaux établissements et leurs approvisionnements en nouveaux matériels et outillages (lycées et Centres de Formations Professionnelles). Par ailleurs, une stratégie de financement appropriée au secteur santé y sera développée, visant à améliorer l'accès au service dans ce secteur.

En matière de gouvernance, les efforts entrepris pour le renforcement des dispositifs pour lutter contre la corruption et le trafic illicite des bois précieux seront poursuivis. Le gouvernement a mis en place un comité interministériel, présidé par le Premier Ministre, qui définira un plan d'action pour l'assainissement de la filière bois précieux. Le plan d'action inclura les opérations d'application de la loi dans et autour des zones de coupes potentiels, ainsi que le marquage, le transport, la sécurisation et la liquidation des stocks de bois précieux conformément aux obligations internationales. Un plan d'utilisation des stocks sera soumis pour approbation par le CITES en Décembre 2014. En outre, un quota « 0 » d'exportations sera prévu jusqu'en août 2015. Le plan d'action pour l'assainissement de la filière sera mis en œuvre sous l'égide d'un Secrétariat Exécutif basé à la Primature. Une ligne budgétaire sera prévue pour assurer le fonctionnement du Secrétariat Exécutif.

Concernant la prévention de corruption, sous le leadership du Premier Ministre, les membres du gouvernement ont déjà tous manifesté leur volonté dans la déclaration de patrimoine. Le Bianco a déjà publié sur son site la liste nominative de ces ministres. La déclaration des fonctionnaires occupant des postes à haute responsabilité et des magistrats sera également attendue.

Dans le cadre des actions de redressement de la JIRAMA, le Gouvernement a mis en place un système de coloration du fuel délivré à la JIRAMA dans l'objectif de réduire les fuites de carburants, un préliminaire à l'amélioration de sa trésorerie. Un plan de revitalisation de la compagnie publique de distribution d'eau et d'électricité a également été élaboré. Une communication officielle en Conseil des ministres a été effectuée sur le sujet. Les mesures à court terme incluent la réforme de la gestion et de l'exploitation, notamment pour éradiquer les délestages. A moyen terme, le Gouvernement prévoira de prendre des mesures qui tendent vers la maîtrise des charges de carburant en termes de prix et de volume, et vers la réduction de la quantité d'électricité produite et non vendue. Il examine, par ailleurs, les questions liées à la tarification de l'électricité, à l'augmentation de l'efficacité des opérations et à l'orientation des statuts de la JIRAMA pour être conformes aux dispositions de la Loi sur les Sociétés Commerciales.

Dans le but de renforcer l'assainissement de la gestion des dépenses publiques, un plan de réduction des subventions pétrolières a été établi avec l'objectif de l'achever avant fin juin 2015. Ce qui ramènera progressivement à la vérité des prix de produits pétroliers. Les prix à J la pompe devraient ainsi inclure la variation des cours mondiaux et des taux de change, suscitant impérativement une hausse sensible au niveau des prix à la consommation. Compte tenu des implications sociales découlant de cette augmentation du prix à la pompe, le Gouvernement mettra en place des mesures d'accompagnement, avec le soutien des Partenaires Techniques et Financiers, qui comprennent (i) les subventions temporaires ciblées au profit du transport public dans les zones urbaines ; (ii) un développement du programme « Argent contre Travail » dans les zones rurales ; (iii) une extension du programme pilote de transferts monétaires conditionnels, subordonné à la scolarisation des enfants ; (iv) un élargissement du programme de kits scolaires à un plus grand nombre de régions. Des campagnes d'informations sur ces mesures d'accompagnement ont été programmées.

Afin de responsabiliser les acteurs budgétaires, une lettre demandant la nomination des membres du Conseil de Discipline Budgétaire et Financière (CDBF) a été envoyée par la Primature aux entités concernées au mois de septembre 2014. L'établissement dudit conseil sera effectif, une fois que la nomination des membres, actuellement en cours, sera achevée.

La mise en œuvre de toutes les actions envisagées dans le cadre de la Politique Générale de l'Etat permettra au Gouvernement de relancer les activités économiques de Madagascar dans les prochaines années. Toutefois, compte tenu des ressources limitées, le Gouvernement sollicite l'appui financier de la Banque Mondiale dans le cadre de l'appui budgétaire d'urgence.

Le Ministre des Finances et du Budget

MINISTERE DES FINANCES ET DU BUDGET

Pr. Jean RAZAFINDRAVONONA

Annex 3: Fund Relations

IMF Executive Board Approves US$47.1 Million Disbursement Under the Rapid Credit Facility for Madagascar

Press Release No. 14/287
June 18, 2014

The Executive Board of the International Monetary Fund (IMF) today approved emergency financial assistance under the Rapid Credit Facility (RCF) in the equivalent of SDR 30.55 million (about US$47.1 million) for Madagascar to enable the authorities meet their urgent balance of payment needs.

The IMF financial assistance is in support of a set of economic and structural policies and measures the authorities plan to implement in order to restore macroeconomic stability, provide a favorable environment in support of inclusive growth and poverty reduction, and to strengthen the capacity of the Malagasy government. The Executive Board's approval of the RCF disbursement will also enable the authorities to engage in discussions with development partners' regarding further assistance. The Board's approval enables the immediate disbursement of the full amount, which is equivalent to 25 percent of Madagascar's quota in the IMF.

After several years of reasonably strong economic growth, output contracted in 2009 and remained weak over several years, given a high level of political and economic uncertainty that impacted investment decisions. Over this period, Madagascar also experienced dwindling financial support from development partners and enduring fiscal deficits that became progressively more difficult to finance. Supported by large mining projects that are reaching commercial production, recovering rice production, and a less uncertain political environment, growth is projected to increase to 3 percent in 2014.

The RCF provides immediate financial assistance with limited conditionality to low-income countries with an urgent balance of payments need. In this context, the economic policies of a member receiving RCF financing are expected to address the underlying balance of payments difficulties and support policy objectives including macroeconomic stability and poverty reduction. Financing under the RCF carries zero interest (until end 2014), has a grace period of 5.5 years, and a final maturity of 10 years. The Fund reviews the level of interest rates for all concessional facilities every two years.

Following the Executive Board discussion on Madagascar, Mr. Min Zhu, Deputy Managing Director and Acting Chair, said:

"Madagascar's re-engagement with the Fund marks the end of a difficult period of economic disruption in which economic activity slowed, investment stagnated and social and governance indicators weakened. Last year's elections, and subsequent widespread recognition of the new government by the international community, are helping to set the stage for a revival of the economy, but large balance of payments and fiscal gaps need to be filled in order not to jeopardize the economic recovery and to begin to address social needs.

"With support under the Fund's Rapid Credit Facility, the government intends to implement macroeconomic policies and structural reforms to correct macroeconomic imbalances, shore up growth and begin tackling high rates of poverty. Key challenges for fiscal policy in 2014 include easing disorderly spending compression, increasing outlays on infrastructure and essential government services, and developing a multi-year strategy to clear domestic budgetary arrears. Steps to boost fiscal revenues through improved tax and customs revenue administration and a broadened tax base, phased elimination of general fuel subsidies, and elimination of low-priority expenditures are key to creating room for more productive infrastructure and better targeted social spending. Exchange rate flexibility will be an important element in safeguarding and facilitating a steady rebuilding of foreign exchange reserves.

"Revitalizing structural reforms is a priority for fostering sustained growth and lasting reductions in poverty, with key areas being: public financial management, domestic revenue mobilization, and enhancing financial inclusion and deepening. Governance improvements will require building stronger institutions, enabling a level playing field for the private sector, creating incentives that reinforce proper conduct, and providing adequate resources for the control and audit of public entities.

"The Fund will continue to play a key role in facilitating international efforts in the provision of financial and technical assistance to support the government's reform strategy."

IMF COMMUNICATIONS DEPARTMENT

Public Affairs	**Media Relations**
E-mail: publicaffairs@imf.org	E-mail: media@imf.org
Fax: 202-623-6220	Phone: 202-623-7100

Annex 4: Poverty and Social Impact

Prior Action 1: All ministers of the Recipient's Cabinet have filed an asset declaration with the Independent Anti-corruption Bureau

The intended result is to take a step towards compliance with the rule of law. Given that there is no prohibition of conflicts of interest in Madagascar, it is difficult to say whether this action is on its own will provide for greater political stability, stimulate significant growth, or change the distribution of the benefits of any growth.

Prior Action 2: An interministerial committee is established to improve governance and transparency in the securing and disposing of the seized stockpile of precious woods

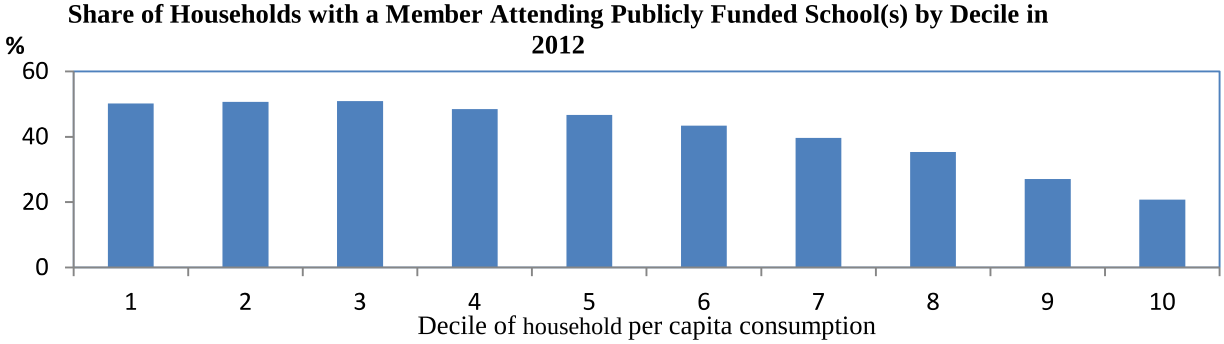
The intended benefits of this action are to allow the transparent disposal of precious woods stockpiles, while also resulting in additional public revenues. The distributional consequences of additional fiscal resources are not clear without further analysis of the incidence of public expenditures (as will be available with the forthcoming Public Expenditure Review.) There are no data available which would permit an empirically-based projection of the distributional consequences in the event of transparent disposal of seized stockpile leading to reduced smuggling. The action could have short term negative impacts on livelihoods of the poor.

Prior Action 3: The Recipient's National Assembly has adopted a Supplemental Budget Law for 2014, approximately doubling the amount of public expenditures aiming at fighting poverty compared to the original Budget Law for 2014

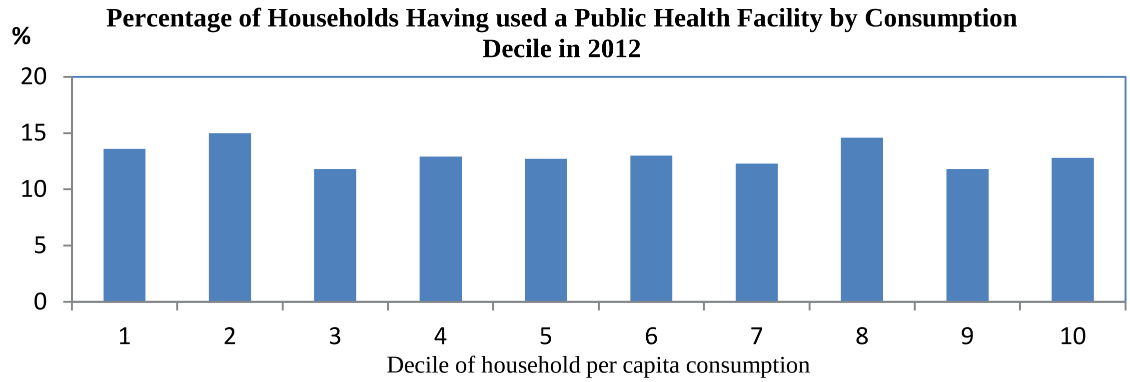
This prior action is intended to result in additional resources being used to scale up existing programs in the educational and health sectors. If the benefits accrue to households similar to (or the same as) the households currently benefitting from public education programs (including schools with private management), the expenditures will be broadly progressive (See Figure below). Although the monetary value of actual benefits cannot be computed from the data available, the distribution of households receiving some services from publicly funded schools is as shown below.

However, the rate of utilization of public health facilities, according to the available household survey data, is relatively even over the income distribution.

Share of Households with a Member Attending Publicly Funded School(s) by Decile in 2012



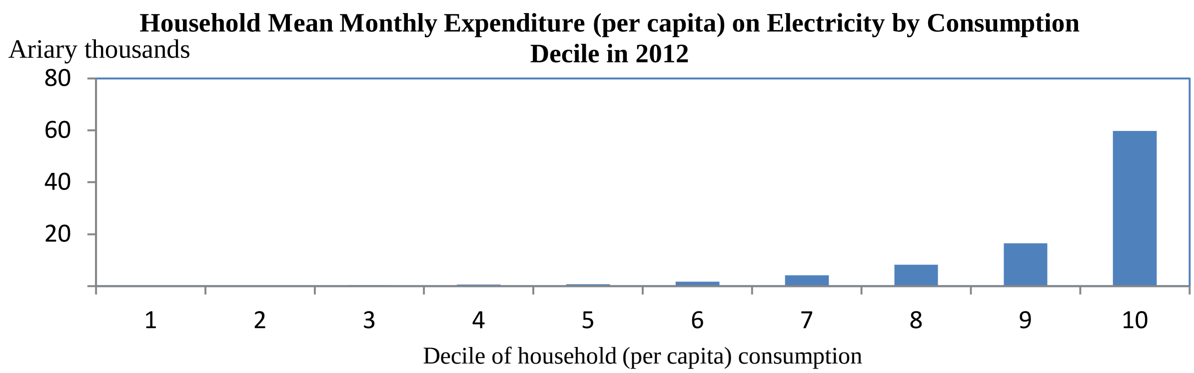
Source: ENSOMD 2012
(Note: Consumption deciles are based on preliminary consumption aggregates)



Source: ENSOMD 2012
(Note: Consumption deciles are based on preliminary consumption aggregates)

Prior Action 4: The Recipient has instituted a system of coloring diesel delivered to JIRAMA with the aim of reducing leakages as a first step towards reducing operating losses of the company

Improving financial management of JIRAMA will likely have two broadly progressive distributional impacts. First, households using electricity provided by JIRAMA will pay a higher portion of the financial cost of electricity provision: billing accuracy, receivables turnover/management, and non-technical losses generally should be reduced, even if electricity tariffs are not explicitly raised. Since electricity usage – and therefore explicit and implicit subsidies – are highly regressive, improvements to JIRAMA's cost recovery would be progressive. Second, based on international evidence, improved financial soundness of the electricity provider would in the long run result in expansion of service and more reliability of existing service. Expanded availability of more reliable power would, if achieved, primarily benefit currently un-served populations which tend to be below the top 40 percent of the consumption distribution.[22]



Source: ENSOMD 2012
(Note: Consumption deciles are based on preliminary consumption aggregates)

[22] If eventual improvements to the governance of the electricity sector are sufficient, this could result in greater productive employment opportunities, which would benefit the general population, including the poor.

Prior Action 5: The Recipient's National Assembly has adopted a law on public debt which provides a legal framework to ensure public borrowing is conducted strategically and prudently and stipulates for the preparation of a medium term debt strategy
and
Prior Action 6: The Recipient has entered, with its major creditors, into legal agreements for the clearance of its arrears to said creditors under terms and conditions compatible with the Recipient's weak revenue environment to avoid future accumulations

To the extent that the results of these actions – that public debt continues to be managed prudently, borrowing is conducted strategically with appropriate assessment of trade-offs and under a medium term framework, that arrears are converted/rescheduled and gradually reduced, and that there is improved confidence by the private sector, leading to new investments and economic recovery – provide the basic macro underpinnings to improved economic growth, they would tend to be distribution-neutral and reinforce whatever distributional pattern of growth that Madagascar achieves in the medium term.

Annex 5: PEFA Indicators, 2008 and 2014

	Indicator	2008 Score	2014 Score
A. PFM OUT-TURNS: Credibility of the Budget			
P1-01	Aggregate expenditure out-turn compared to original approved budget	D	**D**
P1-02	Composition of expenditure out-turn compared to original approved budget	A	C+
P1-03	Aggregate revenue out-turn compared to original approved budget	B	A
P1-04	Stock and monitoring of expenditure payment arrears	C+	NR
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency			
P1-05	Classification of the Budget	A	**A**
P1-06	Comprehensiveness of information included in budget documentation	C	**C**
P1-07	Extend of unreported government operations	C+	D
P1-08	Transparency of inter-governemental fiscal operations	B	C
P1-09	Oversight of aggregate fiscal risk from public sector entities	D+	D
P1-10	Public access to key fiscal information	C	C
C. BUDGET CYCLE			
C(i) Policy-based Budgeting			
P1-11	Orderliness and participation in the annual budget process	A	B
P1-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+	D+
C(ii) Predictability and Control in Budget Execution			
P1-13	Transparency of tax-payers' obligations and liabilities	B	**B**
P1-14	Effectiveness of measures for tax-payer registration and tax assessment	B	**B**
P1-15	Effectiveness in collection of tax payments	D+	D+
P1-16	Predictability in the availability of funds for commitment of expenditures	B+	D+
P1-17	Recording and management of cash balances, debt and guarantees	B	C
P1-18	Effectiveness of payroll controls	D+	**D+**
P1-19	Competition, value for money and controls in procurement	C	D+
P1-20	Effectiveness of internal controls for non-salary expenditure	C+	C
P1-21	Effectiveness of internal audit	C+	C
C(iii) Accounting, Recording and Reporting			
P1-22	Timeliness and regularity of accounts reconciliation	D+	**D+**
P1-23	Availability of information on resources received by service delivery units	D	**D**
P1-24	Quality and timeliness of annual financial statements	C+	**C+**
P1-25	Quality and timeliness of in-year budget reports	D+	**D+**
C(iv) External Scrutiny and Audit			
P1-26	Scope, nature and follow-up of External Audit	D	**D+**
P1-27	Legislative scrutiny of the annual budget law	C+	D+
P1-28	Legislative scrutiny of external audit reports	D+	D
D. DONOR PRACTICES			
D-1	Predictability of Direct Budget Support	A	NA
D-2	Financial information provided by Donors for budgeting and reporting on project aid	B+	D
D-3	Proportion of aid that is managed by use of national procedures	D	**D**

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