PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

September 9, 2016
Report No.: 108803
(The report # is automatically generated by IDU and should not be changed)

Operation Name	MG – Fiscal Sustainability and Investment DPO
Region	AFRICA
Country	Madagascar
Sector	General public administration sector (50%); Central government administration (50%)
Operation ID	P160866
Lending Instrument	Development Policy Lending
Borrower(s)	Republic of Madagascar
Implementing Agency	MINISTRY OF FINANCE AND BUDGET (MFB)
Date PID Prepared	9-Sept-2016
Estimated Date of Appraisal	11-Oct-2016
Estimated Date of Board Approval	22-Nov-2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

Madagascar returned to constitutional order when a duly-elected government took office in 2014, after a five-year long political crisis. The crisis had devastating effects on the economy, poverty and social outcomes. The return to constitutionality was an event welcomed by all, but only the first step towards putting the country back on track for sustainable development. A number of tangible progress has been made since: a new National Development Plan and its implementation strategy were elaborated; the establishment of the Senate in early 2016 completes the set of institutions required by the Constitution; and the government has presented an articulated medium-term socio-economic reforms that permitted to advance the concretization of the supports from technical and financial partners.

While the establishment of the Senate has somewhat rebalanced the political influence between the government and opponents, the political situation remains challenging and the risk of social instability is high.

Amid this uncertainty, the government managed to advance reforms in critical area. The introduction of flexible pump pricing mechanism in March 2016 resulted in the elimination of subsidies on pump price that represented on average 1.2% percent of GDP in 2013 and 2014. Combination of custom administration reforms starts to yield tangible result witnessed by the exceeding tax revenues collection compared to the target in 2015 and the first half of 2016; and the government introduced several measures aiming at improving the efficiency of commercial justice and preserving financial stability in order to address weak business environment.

Madagascar has one of the highest levels of poverty in Africa, with extreme poverty, measured by per capita consumption under US$1.9 purchasing power parity 2011 – PPP – per day, having increased from 68.7 percent in 2001 to 77.8 percent in 2012 (the latest data available). The efforts in fiscal revenue collection needs to be increased to cope with the huge needs of the country. Expenditure management remains challenging as mounting transfer to state-owned enterprises continue to drain a significant share of the budget. These poorly-targeted expenditures are competing with the financing needed for public investment in order to catch up with the years of underinvestment during the crisis and for social spending. An enhanced public investment management strategy is also required to increase the efficiency of spending on public investment.

II. Proposed Objective(s)

22. The program development objectives of the proposed operation are to strengthen Madagascar's fiscal framework and enhance the environment for investment. The proposed operation is the first in a series of two programmatic operations aimed at accompanying the government's efforts to accelerate Madagascar's recovery.

It supports the "macroeconomic stability" pillar of the government's national development plan most directly, and the "inclusive growth" pillar indirectly. The two pillars were selected as the priority 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. The other three pillars, "governance," "human capital development" and "natural resources and resilience against catastrophes," are supported by complementary investment and technical assistance operations,

III. Preliminary Description

1. The actions supported by this operation are arranged around two pillars: (i) strengthening fiscal management; and (ii) improving the environment for investment. The first pillar seeks to improve fiscal management by increasing revenues, reducing non-targeted expenditures and strengthening priority spending for investment. The second pillar aims to improve the environment for investment by supporting structural reforms in the electricity sectors, and by addressing weaknesses in the business environment.

IV. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

1.**The policies supported by this DPO are likely to contribute to poverty reduction and positive social impact**. The fiscal space that would result from the actions designed to improve fiscal revenues and improve expenditure composition are expected to contribute to poverty reduction in the future, as it allows the government to reallocate expenditures toward pro-poor spending and investments and thus to alleviate poverty. The revenue measures pursued under this DPO are designed to narrow the tax leakages by focusing on tax administration improvement and thus do not affect directly the tax burden of the poor.

2. **Subsidies on fuel prices are regressive and their removal is expected to have indirect positive poverty and social impact in the long term.** The 2010 Household Survey shows that the two top quintile (richest) of household consume up to 96% of fuel products. Thus the subsidies benefited mostly these households who capture a greater share of the benefits of fuel subsidies than households in lower quintiles. They capture most of the direct benefits from gasoline and diesel subsidies (97 percent), as well as the indirect effect on public transportation cost (76 percent). The removal of subsidies would affect the cost of living of every household but the burden will be mostly borne by the richest quintiles, while the government can enhance the benefits of the saving on the poorest by well-targeted expenditures, such as safety nets.

3. **The pension reform supported by this program contributes to supporting the sustainability of the public pension schemes, which may have social and poverty impact.** The reform on pension consists in removing "ghost pensioners" from the roster of pensioners and will not affect legitimate beneficiaries. Therefore, this measure is expected to contribute in ensuring the financial sustainability of the pension schemes and widening fiscal space for targeted expenditures.

4. **The prior action targeting the improvement of the procurement process of JIRAMA will not have any direct poverty and social impact, and is likely to have progressive distributional impacts indirectly in the long run**. The intended impact is that JIRAMA secures advantageous contracts in power supply, which in turn should improve its finances and allow the State to reduce subsidies to the company. International evidence shows that improved financial soundness of the electricity provider would in the long run result in expansion of service and greater reliability of existing service. This could result in a more stable power provision for the private sector. In addition, electricity coverage is very low and excludes most of the poor[1]. Since electricity usage, and therefore explicit and implicit subsidies, are highly regressive, reduction of subsidies to JIRAMA would have progressive impacts.

5. **The prior actions on commercial justice and banking supervision complement the improvement in Jirama's electricity supply in enhancing the attractiveness of the business environment.** These measures address some of the most pressing constraints to operations and growth identified by formal entrepreneurs. Improving commercial justice would provide equal playing field for private operators while a stable financial sector would translate into a solid financial sector able to accompany the economic growth. A more dynamic private sector would increase productive employment opportunities which would benefit the general population, including the poor.

Environment Aspects

The policy actions supported by this operation are not expected to have any direct impact on environment.

[1] Only 14 percent of the population had access to electricity in 2010, and new connections have been expanding this figure at approximately 1 percentage point per year.

V. Tentative financing

Source:		($m.)
BORROWER/RECIPIENT		0
International Development Association (IDA)		65
Borrower/Recipient		
IBRD		
Others (specify)		
	Total	65

VI. Contact point

World Bank

Contact: Faniry Razafimanantsoa
Title: Economist
Tel: 5339+6031 / 261-20-225-6000
Fax:
Email: frazafimanantsoa@worldbank.org
Location: Antananarivo, Madagascar (IBRD)

Borrower

Contact: Mr. Gervais Rakotoarimanana
Title: Minister of Finance
Tel: 261 20 22 646 81
Email:rfrancoismm@gmail.com

VII. For more information contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop