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Staff Country Reports

Republic of Madagascar: Joint Staff Advisory Note of the Poverty Reduction Strategy Paper

The attached Joint Staff Advisory Note (JSAN) of the Poverty Reduction Strategy Paper for the Republic of Madagascar, prepared jointly by the staffs of the World Bank and the IMF, was distributed with the member country's Poverty Reduction Strategy Paper (PRSP) to the Executive Boards of the two institutions. The objective of the JSAN is to provide focused, frank, and constructive feedback to the country on progress in implementing its Poverty Reduction Strategy (PRS).

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THE INTERNATIONAL DEVELOPMENT ASSOCIATION AND
THE INTERNATIONAL MONETARY FUND

REPUBLIC OF MADAGASCAR

**Poverty Reduction Strategy Paper
Joint Staff Advisory Note**

Prepared by the Staffs of the International Development Association and
the International Monetary Fund

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January 26, 2007

I. OVERVIEW

1. **The government of Madagascar has prepared its second growth and poverty reduction strategy called the Madagascar Action Plan (MAP), a bold development plan for 2007–2012.** The MAP builds on the first PRSP prepared in 2003 and is underpinned by a broad consultative process. It outlines the commitments, strategies and actions that, in the government’s view, are expected to ignite rapid growth and lead to the reduction of poverty in line with the government’s national vision document (*Madagascar Naturally*) and the UN Millennium Development Goals. The MAP provides the overall strategic directions, and is complemented by more specific sector strategies and action plans. This Joint Staff Advisory Note (JSAN) highlights areas which in staffs’ view are priorities for further refining the strategies and programs supporting the MAP and assuring effective implementation.

2. **The MAP’s goals and strategies are aimed at achieving poverty reduction and improving the quality of life for all the Malagasy.** To achieve these goals, the MAP includes eight commitments: (i) responsible governance; (ii) connected infrastructure; (iii) educational transformation; (iv) rural development and a green revolution; (v) health, family planning and the fight against HIV/AIDS; (vi) high growth economy; (vii) cherish the environment; and (viii) national solidarity. For each commitment, the government has identified key challenges, goals and strategies, priority projects and activities, and a set of key monitorable indicators. The MAP also identifies six “breakthrough initiatives” or priority areas that require immediate attention: public finance reform; significant increase in investment to promote high growth; sowing the seeds of a green revolution; transforming public security; implementing bold new measures for health and family planning; and transforming the judiciary.

3. **The MAP was developed through a participatory process that was broader and deeper relative to that carried out for the first PRSP, with strong leadership from the Presidency.** A series of workshops was organized in all the 22 regions of the country, with wide representation from government at both national and subnational levels, private sector, non-government organizations, churches and other key civil society actors, and development partners. The preparation of the MAP was spearheaded by a steering committee, which included representatives from the Presidency, the Prime Minister's office, and the Ministry of Economy, Finance and Budget, and was discussed in Parliament along with the draft 2007 Finance Law. The MAP was formally launched at a national workshop in November 2006, has subsequently been distributed widely, and is available also on the government's website.¹

4. **In contrast to the first PRSP, the MAP is more results-oriented and prioritized.** Key monitoring indicators, most with baselines for 2005 and targets for 2012, have been selected to measure progress toward achieving the MAP's identified challenges. The 2007 Finance Law aligns the budget with the MAP commitments and presents medium-term expenditure projections for 2007–11.

5. **Relative to the first PRSP, the MAP places a high premium on capacity building and on gender equity.** The importance of developing leadership capacity, changing the mindsets and habits that impede progress, fighting corruption and developing skills are noted. To support the MAP's goals, the authorities have established a National Leadership Institute of Madagascar to develop leadership capacity in the country. The MAP discusses integrating gender in all development programs and policies and includes special focus on increasing their participation in local, regional and national institutions.

6. **The costing for the MAP is underway, but the quality varies by sector.** In some sectors, such as education (in particular, primary education), environment, roads, governance and rural water, detailed costing exists. For other key sector programs, such as health, this costing is being finalized as part of the preparation of the health sector plan. In certain other sectors, such as rural development, the costing needs further work which could be done in the context of refining the sector strategies and programs.

II. POVERTY ANALYSIS

7. **While the MAP does not include a poverty analysis section, the poverty reduction and growth strategy outlined in the MAP is informed by the poverty analysis available from the report on the 2005 household survey (*Enquête Périodique Auprès des Menages 2005*).** More than two-thirds of the population (68.7 percent) lives below the national poverty line. The poverty rate in rural areas is significantly higher than in urban

¹ The MAP website is <http://www.madagascar.gov.mg/map>.

areas, with almost three-quarters of the rural population and just over half of the urban population classified as being poor. Poverty rates also differ by region, with the highest rates in the coastal regions of the east and south, where over 80 percent of the population is poor. Poverty is lowest around the capital Antananarivo.

8. **During the period of the first PRSP, poverty declined significantly in the aftermath of the 2002 political crisis, falling more rapidly in rural areas than in urban areas.** This is in marked contrast to 1997–2001, when the small decline in poverty was largely the result of declining urban poverty. Growth during that period was driven largely by the export processing zone sector which improved job opportunities and reduced poverty in urban areas. The decline in poverty in rural areas between 2001 and 2005, however, was linked to improved access to markets through the accelerated implementation of the roads program, and higher rice prices. Also, the economic shocks in 2004/05 (strong depreciation, high international oil and rice prices) may have more adversely affected the richer segments of society. A new household survey planned for 2007 will provide updated poverty numbers that will be included in subsequent MAP updates.

9. **Poverty monitoring is hampered by the lack of an updated sample frame and, hence, the authorities should place priority on conducting a new population census.** The last census was carried out in 1993 and, over a decade later, population growth and movements have rendered it obsolete. Updating this census, while expensive, is critical for credible monitoring of key MAP indicators (e.g., income poverty, education and health statistics).

III. ACHIEVING AND SUSTAINING HIGH GROWTH

A. Macroeconomic Policies

10. **The MAP rightly places emphasis on the importance of macroeconomic stability to achieve higher economic growth and identifies the critical policy areas for reform.** In accordance with their 2006–08 economic program², the authorities plan to implement a tight monetary policy oriented towards single-digit inflation and a prudent fiscal policy aimed at preserving debt sustainability. The objectives of halving statutory advances of the central bank to the government by 2012 and increasing domestic revenue mobilization by 50 percent by 2012 would, if achieved, substantially strengthen the foundation for sustainable high growth. While a modest increase in reserve coverage is appropriate given the economy's vulnerability to terms of trade- and weather-related shocks, the MAP's planned doubling of such coverage is excessive in view of the import requirements for growth and poverty reduction.

² The program is supported by an arrangement under the IMF's Poverty Reduction and Growth Facility (PRGF).

11. **The macroeconomic framework underpinning the MAP, however, lacks specificity.** Although the MAP envisages a doubling of real GDP growth to 7–10 percent over the medium term, it lacks details regarding the precise sources of growth, the supportive policy measures required, and the domestic and external financing levels needed to place the economy on such a high and sustainable growth path. The envisaged fiscal policy over the period of the MAP, which foresees a reduction of the fiscal deficit-to-GDP ratio, may unnecessarily constrain the desired level of expenditure. Moreover, as indicated in the recent Bank-Fund Debt Sustainability Analysis, the authorities could maintain a constant fiscal deficit (as a share of GDP) without compromising debt sustainability provided that it is financed on highly concessional terms.³

12. **The authorities should continue to base their policies on the more conservative scenario underpinning their 2006–08 economic program until key policy reforms are implemented and higher external financing is identified.** All the MAP indicators are linked to the authorities' high growth scenario, which assumed significantly greater donor assistance, higher domestic revenue mobilization, and higher public and private investment than currently projected. The authorities' 2006–08 economic program, however, is based on a more realistic scenario based on identified external assistance flows and more conservative levels of domestic revenue and investment. They should use the occasion of the annual PRSP Progress Report to explicitly present both their base case and high growth case scenarios. The subsequent annual finance laws will provide an opportunity to update the medium-term macroeconomic framework in light of identified foreign assistance flows, improved domestic revenue mobilization, and progress in growth-enhancing structural reforms.

13. **Going forward, the authorities need to further specify the policies and domestic and external financing requirements for achieving the MAP's high growth scenario and assess its macroeconomic implications.** Given the high levels of projected growth relative to the past, the authorities could have been more explicit about the specific sources of such growth and the policies required to achieve these levels, as well as their commitment to non-concessional borrowing, strengthened debt management practices, and utilization of debt relief in support of priority spending. In order to attain the ambitious tax revenue-to-GDP ratio envisaged, reform of the tax and customs codes will also be essential. Such reforms will require moving away from special tax regimes and fiscal incentives in order to simplify the system and broaden the tax base. Improved revenue performance will also require steadfast implementation of customs and tax administration reforms. In light of the extensive tax policy and administrative reform agenda at the central level, the authorities should proceed cautiously with their objective to decentralize tax collection given institutional capacity constraints. They should also assess the potential implications of additional borrowing

³ IMF Country Report No. 06/306, Appendix I—Madagascar: Joint Bank-Fund Debt Sustainability Analysis.

required to sustain the projected high levels of growth over the medium term, including with regard to debt sustainability.

B. Structural Policies for Growth and Investment

14. **Staffs agree with the importance attached in the MAP to improving the investment climate in order to achieve the high growth rates envisaged.** Enhancing the business environment requires first and foremost improved governance (Section V). It also requires a transparent and efficient set of rules and procedures and the recently created Economic Development Board of Madagascar (EDBM) should help to facilitate and promote both domestic and foreign investment in the country. In this regard, the authorities should finalize and submit to Parliament an investment facilitation law which excludes fiscal incentives and which minimizes administrative discretion in line with international best practices as soon as possible.

15. **Staffs concur with the priority identified in the MAP to restructuring and rehabilitating the public energy and water utility company (JIRAMA) which will be essential to increasing growth.** Without the steadfast implementation of the company restructuring plan, JIRAMA's inefficiencies will continue to disrupt economic activity and increase the cost of doing business. The priorities for the period ahead should include: (i) transferring the management of the company to a long-term private concession; and (ii) allocating sufficient budgetary resources for the rehabilitation and expansion of the electricity distribution network.

16. **The MAP rightly underscores the need for financial sector reforms. With a view to creating a more competitive, efficient, and inclusive financial sector that contributes to growth, it draws on the recommendations of the joint IMF-World Bank Financial Sector Assessment Program.** Going forward, the authorities should place emphasis on: (i) recapitalizing the central bank; (ii) establishing more efficient payment and credit information systems; (iii) reforming the legal, judicial, and land and pledge registry systems; (iv) expanding access of the urban and rural poor to financial services; and (v) reforming the pension and insurance sectors

17. **Staffs concur with the importance that the MAP places on infrastructure, in particular roads, in supporting growth, but encourage the authorities to maintain the existing road network.** The program outlined is ambitious. In addition, the MAP does not adequately emphasize the institutional arrangements for the management of infrastructure. Moving forward, the authorities should place priority on operationalizing the Road Authority and assuring a better balance between rehabilitation and maintenance, and ensuring adequate financing for the maintenance of the road network.

18. **Given that the majority of the poor live in rural areas, the MAP's commitment to rural development and to improving agricultural productivity is welcome.** Generating

a green revolution, securing land tenure, promoting market oriented activities, diversification and increasing agricultural value added and promoting agri-business are indeed key priorities. Greater precision is needed, however, regarding the authorities' strategy for developing vulnerable zones and remote areas. As the existing analytical work indicates that the future of Madagascar agriculture is based on intensification not extensification, the staffs are concerned that the MAP's strategy of extension and increased cultivation could have a negative impact on the environment if marginal lands are brought under cultivation. But to attain the rural development goals, implementation will need to take an integrated, multi-sectoral approach, as outlined in the rural development sector plan, to address the multiple constraints to rural growth.

IV. IMPROVING SERVICE DELIVERY

19. **Although good overall progress was made in the social sectors under the first PRSP, progress on maternal mortality is slow and the quality of health and education services remains a concern.** More children are in school today, with net primary enrolment rates exceeding 90 percent, up from 70 percent in 2001/2, and surpassing the targets set in the first PRSP. In health, there has been a significant decline in infant mortality, and immunization coverage has expanded. This progress is partly due to the increased resources made available as a result of the Enhanced HIPC Initiative, the Education for All Initiative and the Global Fund for Tuberculosis, Malaria and HIV/AIDS. However, the lack of progress in maternal mortality and the overall quality of service delivery remain a concern.

20. **Overall, the approach laid out for the education, health, nutrition, HIV/AIDS and water sectors in the MAP is sound but needs to be further prioritized.** The MAP innovates over the previous PRSP strategy by recognizing the key role played by post-primary education and family planning in achieving the overall MAP objectives. Moving forward, the operational plans that are currently under preparation for health and nutrition should be completed in the coming months, and should include the prioritization and sequencing of the envisaged reforms as well as concrete actions to be implemented. In addition, the rationalization of the institutional framework for nutrition remains a key outstanding reform.

V. GOVERNANCE

21. **The MAP places appropriate emphasis on the need to improve public financial management and staffs encourage accelerated implementation of the ongoing reform program.** Key priorities for the period ahead should include: (i) strengthening of internal control mechanisms, in particular with regard to expenditure commitments; (ii) using the public finance integrated management information system (SIGFP) to monitor budget execution; (iii) simplifying the budget classification and the expenditure management framework; (iv) further strengthening capacity to prepare and execute the budget in priority

ministries (education, health, infrastructure); (v) improve cash planning and management; and (vi) implementing the new Procurement Code.

22. **Staffs welcome the authorities' continued commitment to reducing corruption but urge greater attention to strengthening governance in extractive industries and addressing the potential conflicts of interest of public officials.** Some progress has been made to improve the procedural and institutional framework in the fight against corruption, notably through the creation of the independent anticorruption bureau (BIANCO) and the passing of an anticorruption framework legislation. Important areas, however, remain to be addressed, such as the existing pervasive corruption in extractive and resource-based industries (e.g., mining, forestry). As the authorities have just joined the Extractive Industries Transparency Initiative, they should move quickly to set up a fully transparent structure for managing revenues expected from mining and oil, and to report this revenue in the fiscal accounts. It will also be necessary to respond to potential conflicts of interest of public and elected officials at all levels of the State.

23. **The MAP's emphasis on the need to transform the judiciary and restore its credibility needs to be backed by increased resource allocation in future finance laws.** The introduction and systematic enforcement of transparent service standards is needed to improve efficiency of the legal and judicial system. A credible reform strategy should also decisively address corruption in the judiciary which is considered pervasive based on the findings of the independent anti-corruption survey 2005/6. These activities and the ones mentioned in the MAP require a significant increase of budgetary allocation to the Ministry of Justice.

24. **The decentralization objectives of the MAP, in particular the intended increase in public spending by communes as a share of total government spending, need to be supported by capacity building of local administrations.** To move forward, it will be critical to further clarify the roles and responsibilities of the key service delivery levels (regions, communes, villages) vis-à-vis other levels of the State (central government, provinces), and to transfer authority accordingly. To ensure adequate financial resources, the authorities should quickly operationalize the Local Government Fund (FDL) which will provide investment and capacity building support to the communes and should also integrate the existing community development funding mechanisms, such as the *Fonds d'Intervention pour le Développement* (FID). Equally important, the government will need to put in place adequate safeguards to ensure that these resources are monitored and well spent.

25. **While the staffs support the government's intention outlined in the MAP to reform the public sector salary system towards a performance based incentive system, the various options and their budgetary implications should be carefully evaluated beforehand.** As a first step, the government should use its leverage within the existing regulatory framework to ensure that high performing staff are adequately rewarded. The

existing system to monitor performance and ensure discipline should also be revitalized and systematically applied to low performers or to civil servants who do not comply with basic ethical standards.

VI. MONITORING IMPLEMENTATION OF THE POVERTY REDUCTION STRATEGY

26. **The MAP appropriately outlines the implementation system, including the link between the national vision document, the MAP, national programs, annual planning through the *Politique Générale de L'Etat* (PGE) and the national budget, and monitoring and feedback.** It appropriately places greater emphasis on donor coordination and proposes an annual Donors' Conference and sector meetings to strengthen donor coordination and to better align donor assistance to the MAP goals. The government is working on elaborating the institutional structure to monitor the overall implementation of the MAP, including in the sector ministries, developing action plans for key sectors that link the activities to the MAP goals, and identifying intermediate indicators to monitor progress toward these goals. The PGE outlines the annual results agreement between the President and his ministers. Staffs fully support this important initiative and note that it is particularly important to ensure that the feedback loop between monitoring and policy implementation is taken into account.

27. **Improving the quality and timely availability of statistics is critical to monitoring implementation of the MAP.** The government is elaborating a national strategy for the development of statistics (*Stratégie Nationale de Développement de la Statistique*, SNDS) to strengthen statistical capacity, coordinate and rationalize the statistical system, improve the quality of statistics, ensure greater access and use of data for policy making, update the legal framework, and coordinate external assistance. In staffs view, finalizing the SNDS and commencing its implementation is a key priority.

VII. CONCLUSIONS AND ISSUES FOR DISCUSSION

28. **The MAP presents a blueprint to transform Madagascar and put it firmly on a path of sustained growth and poverty reduction.** As the high growth scenario underpinning the MAP assumes significantly higher than currently projected external and domestic resource flows, the authorities should base their annual finance laws on identified donor assistance and realistic revenue projections. Priority areas for strengthening the MAP and its implementation should include: (i) sustaining progress on domestic revenue mobilization and public financial management reforms; (ii) improving the investment climate, principally with regard to the legal, regulatory, and judicial system; (iii) implementing the restructuring plan for JIRAMA and transferring it to a private operator under an *affermage* contract; and (iv) improving transparency and governance in the allocation and management of extractive industries.

29. **Main risks that could hamper the implementation of the MAP include macroeconomic instability, lack of tangible progress on corruption, and low implementation capacity.** First, macroeconomic stability could come under pressure from continued low domestic revenue collection and overly ambitious expenditure programs which could limit the government's ability to implement the MAP. In addition, the MAP is also predicated on scaling up of development assistance from the development partners, which if it is not forthcoming, will similarly hamper the attainment of the government's development objectives. The government's focus on public financial management and tax reform will help mitigate this risk. Second, Madagascar is vulnerable to exogenous natural and climatic shocks, and price shocks, which could slow economic growth. This risk is mitigated by the government's efforts to develop a risk management strategy that emphasizes prevention and adaptation to risk. Third, the lack of progress on the potential conflict of interest between public office and private interests, and high levels of corruption may block the necessary investments needed for the implementation of the MAP. The government's commitment to responsible governance will help manage these risks. Fourth, low implementation capacity and weak institutions pose a continual risk for MAP implementation, but the strong focus on strengthening capacity at all levels in the MAP should help mitigate this risk.

30. **Do the Executive Directors concur with the areas identified by staffs as key for:** (i) sustaining growth, reducing poverty and attaining the MDGs; (ii) strengthening the implementation of the MAP; particularly advancing domestic revenue mobilization and public finance reforms; and (iii) managing implementation risks, particularly related to capacity, governance and macroeconomic stability.