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Staff Country Reports

**Republic of Madagascar: Poverty Reduction Strategy Paper—
Annual Progress Report— Joint Staff Advisory Note**

The attached Joint Staff Advisory Note (JSAN) on the Poverty Reduction Strategy Paper Annual Progress Report 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 Annual Progress Report 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 Annual Progress Report
Joint Staff Advisory Note**

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

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I. INTRODUCTION

1. **This JSAN provides feedback from World Bank and Fund staffs on the first and second progress reports on the Madagascar Action Plan (MAP), the poverty reduction and growth strategy for 2007-12.**¹ The first progress report (PR) covers 2007² and the second PR covers the first half of 2008.³ They report on key indicators and measures for achieving the MAP's 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) environmental protection; and (viii) national solidarity.

II. PROGRESS IN IMPLEMENTING THE POVERTY REDUCTION STRATEGY

A. Economic Performance and Macroeconomic Policies

2. **The PRs highlight appropriately the policies taken to safeguard macroeconomic stability and strengthen growth.** Although both PRs accurately describe macroeconomic performance, the 2008 PR provides a more complete and coherent description of the

¹ IMF Country Report No. 07/59, Republic of Madagascar: Poverty Reduction Strategy Paper (<http://www.imf.org/external/pubs/cat/longres.cfm?sk=20422.0>).

² Republic of Madagascar: Poverty Reduction Strategy Paper—2007 Progress Report (forthcoming).

³ Republic of Madagascar: Poverty Reduction Strategy Paper—First Semester 2008 Progress Report (forthcoming).

macroeconomic context and risks. As discussed in the PRs, strong growth benefited from the construction of two large mining projects. Overall inflation has increased since April 2008 on account of an acceleration of food and energy prices, but this increase has been less pronounced than in many other low-income countries. The current account deficit has widened owing to imports for the large mining projects under construction and to the sharp increase in fuel and food prices. This has been financed by foreign direct investment and concessional public debt, and has allowed for an increase in foreign exchange reserves. Fiscal policy has improved tax revenue, increased spending in the priority sectors identified by the MAP, and kept domestic financing at a very low level. Monetary and exchange rate policy has been appropriately geared towards containing inflation and preventing excessive volatility of the exchange rate.

3. **Future PRs could usefully include a forward-looking discussion of the evolving macroeconomic framework and the financing of the MAP, especially given the current volatile international environment.** This could include a discussion of how to address several of the key macroeconomic challenges, including: sustained implementation of tax and customs administration reforms, entrenching single digit inflation; and continuing prudent borrowing that would rely on concessional terms to maintain a low risk of debt distress.

B. Progress in Poverty Reduction

4. **The MAP PRs do not provide a detailed update on poverty trends but the authorities' decision to conduct a new demographic census in 2009 is welcome.** The latest household survey conducted in 2005 indicated that about two thirds of the population was living below the national poverty line, with a higher proportion in rural areas. Yet, progress associated with intermediate indicators (such as access to basic services) suggests an improvement in living conditions for the majority of the population over the past few years. Following the recommendation formulated in the last JSAN,⁴ the new demographic census will provide an updated basis for monitoring the MAP implementation and its impact on the level and distribution of poverty within the country.

C. Sectoral Policies

Policies for strengthening governance

5. **Broad-based public financial management reforms are critical to improving budget execution and the quality of public expenditures.** As reported in the 2008 PR, the May 2008 Public Expenditure and Financial Accountability (PEFA) report highlighted progress in revenue administration but noted persistent weaknesses in monitoring and

⁴ IMF Country Report No. 07/240, Republic of Madagascar: Joint Staff Advisory Note of the Poverty Reduction Strategy Paper (<http://www.imf.org/external/pubs/cat/longres.cfm?sk=21185.0>).

controlling budget execution. To address these weaknesses, the authorities need to continue implementing their ambitious reforms for streamlining all phases of the expenditure chain, which include measures for advancing budget preparation, improving budget monitoring, streamlining financial controls, strengthening procurement practices, and improving expenditure tracking. The 2008 PR reports that the budget information system (SIGFP) is operational in all central ministries and institutions; the authorities should now give priority attention to its deployment in regional and local administrations and its use to monitor budget execution and tax collection. To accelerate the decentralization process that has been extremely slow (with less than 5 percent of the overall budget under the responsibility of local governments), it is necessary to support capacity building of local administrations to ensure that their budget allocation is well spent. Developing a clear strategy would ensure maintaining macroeconomic control while increasing spending the delivery of services to the local level. In view of the potentially large impact of the oil and mining sectors on the economy, staffs welcome the authorities' intention to align the mining and oil legislative and administrative frameworks on the principles of the Extractive Industry Transparency Initiative (EITI).

6. Progress on governance has been reported with improvements in the functioning of the national anti-corruption agency (BIANCO), the establishment of a financial intelligence unit, and improved national security indicators. The crime rate has declined more than initially projected in the first semester of 2008. To further improve transparency, the government will need to make an effort to secure property rights through the judicial system or alternative conflict-resolution mechanisms. The judicial system remains ineffective due to its lack of financial and human resources, requiring a greater attention from the authorities and development partners. Lastly, there is a need to improve the link between the activities of the national anti-corruption agency and the Ministry of Justice, leading to more concrete results and eventual sanctions that should be in turn communicated to the public.

Policies for promoting private sector development

7. Progress in long-delayed reform of the electricity sector needs to be sustained. The PRs acknowledge that progress in reforming the electricity sector has been slow, but do not address priorities for reform. Restructuring of the state utility company (JIRAMA) has been delayed owing to a change in the strategy for private sector involvement in September 2007. It is now expected that JIRAMA's management will be transferred to a private operator by the middle of next year under a 5-year management contract. To help alleviate the fuel price shock for the population, the authorities decided to postpone electricity tariff increases until October 2008. This delayed the return of JIRAMA to profitability and necessitated budgetary transfers equivalent to 0.5 percent of GDP in 2008. Following the tariff increase of 15 percent in October 2008, the authorities need to make sure that, going forward, electricity prices continue to be adjusted regularly to reflect the evolution of the cost of inputs. Implementing these measures will help prepare the ground for attracting the needed financing for a more fundamental reform of the electricity sector, in order to decrease the

cost of doing business. However, in order to expand power supply efficiently and in a sustainable manner, a disciplined and consistent approach to investment planning is essential. In this respect, the next PR could discuss how to strengthen the credibility and sustainability of electricity sector reforms, so that future generation investments can be based on least-cost development criteria and be developed on a transparent and predictable framework.

8. **Further reforms are needed to foster financial sector development.** The authorities have made good progress in implementing two of the five recommendations of the last JSAN: the recapitalization of the Central Bank was successful and underpinned the successful monetary policy sterilization operations; and a new payment system and new credit information system will be operational in 2009. Good progress was also made in reducing the deficit of the pay-as-you-go civil servants pension system. Dynamic microfinance institutions have expanded financial services to urban and rural poor and small and medium enterprises, but overall access remains very low. However, more progress is needed in reforming the legal and judicial systems, the land and pledge registry systems, and the insurance sector. The staffs encourage the authorities to consider independent management and aim for private financing of the development bank, under study with the assistance of Germany and South Africa.

9. **Connectivity is a key challenge of the MAP and will require significant additional resources from the public and private sectors to upgrade the transport and communication networks.** Staffs welcome progress on the rehabilitation of the national road network and on the construction of some new roads in rural areas but stress the utmost priority of maintenance, both on the national road and rural roads networks, to preserve the existing road assets. The start of the implementation of the optical fiber backbone will reduce communications costs. The modernization of the railway between Antananarivo and Toamasina (main port) is also a welcome development, offering an alternative transport mode for firms on this corridor. The mixed progress on the implementation of the institutional framework, both for roads and communication, and the weak implementation of regulations, such as axle load controls, remain sources of concern. The authorities should better identify their priorities in these two sectors through the development of national strategies that will help align budgetary resources, still short of the MAP objectives, and encourage private sector participation through greater liberalization.

Education policy

10. **Staffs welcome significant achievements in the education sector, most notably in primary education, but encourage the government to accelerate reforms in the secondary and tertiary education as well as in vocational and professional training.** The primary net enrollment rate has increased (by 1 percent) between 2007 and the first semester of 2008. Part of the success observed in this sector is explained by the adoption and implementation of a clear national strategy (Education for All/Fast Track Initiative), on

which local and external resources are aligned through clear budgetary mechanisms and coordination under the leadership of the Ministry of Education. There is nonetheless a need to strengthen capacity at the decentralized level (*Direction Régionale de l'Enseignement and Circonscription Scolaire*). In primary education, the challenge is to improve the quality of teaching through: training, incentive mechanisms, the adaptation of the primary curriculum to the needs of the local population, and teacher redeployments with the extended primary cycle. Strategies to reform secondary education have been identified and should be implemented in the near future with a clear work plan. Partnerships with the private sector, as piloted in a few sectors, should be extended to help promote vocational and professional training, which remains underdeveloped in Madagascar. Staffs welcome the government's decision to focus on the link between education and labor market reforms.

Policies for promoting rural development and environment protection

11. **Rural development policies have started to show results, even under difficult circumstances, but further progress will be needed to achieve the ambitious MAP goals.** Although rural development has been affected by exogenous shocks, including cyclones and high food prices on international markets, the growth rate of the agricultural sector is expected to reach 4.5 percent at the end of 2008 exceeding the population growth rate but still far below the ambitious goals set in the MAP. The authorities have adopted a set of policies, with the technical and financial support of development partners that have helped mitigate the negative impact of the above shocks on the poorest consumers. One of the key elements has been the support for a second annual harvest of rice, which has boosted output and reduced pressure on consumer prices. Staffs advise the government to continue to promote a market-driven supply chain, to better link farmers to markets for inputs and credits, introduce performing agricultural technology in irrigated areas, secure land and property rights, and develop infrastructures including irrigation, storage, processing and transport that are critical to increase agricultural production and productivity. Further clarity on the role of foreign investors, including large companies, in this sector as well as their contribution to local development is recommended.

12. **The national strategy on environmental protection, prepared jointly by the government and key development partners, needs to be finalized.** Protecting the environment is at the center of the MAP strategy. As a result, budget allocation (including external funds) has been increasing over time (up by 10 percent in real terms between the Finance Laws for 2008 and 2009). The government is also on target to augment the surface of protected areas as well as of reforested and restored areas to 6 millions hectares by 2012, beyond the targets initially set. One of the recommendations is to improve climate resilience strengthening early warning alert systems and building wind and inundation resistant housing and infrastructure in regions affected by cyclones. The government should also reinforce controls (notably on forests and pollution) and further integrate the regions and

other key ministries in the dialogue since environmental protection is a cross-cutting issue across sectors and projects.

Health policy

13. **The MAP has set ambitious targets in the areas of health that are unlikely to be met at the pace of current progress.** This risk is most apparent in the fight against malaria, leprosy, lymphatic filariasis, other epidemic diseases (e.g., bilharzias is still affecting over 2 million people in Madagascar), and maternal care. In contrast, progress has been reported in the number of children that are fully immunized, up from 53 percent in 2003/2004 to 71.5 percent in February 2008, the HIV/AIDS information and prevention campaigns as well as in the fight against malnutrition. On the basis of the revised medium-term expenditure framework, staffs recommend that the government streamline its sectoral strategy by identifying a set of clear priorities, actions, and programs that will help align better interventions, including from development partners and NGOs. The 2009 budget has allocated growing resources to the Ministry of Health (up by about 20 percent in real terms), making it even more important to rationalize internal financial procedures and, thus, increase execution rates (the execution rate of the investment budget allocated to this sector was below 15 percent in the first semester of 2008). Staffs also encourage the central authorities to empower local governments and communities, as part of the decentralization strategy, especially for the implementation and management of small community projects.

III. MONITORING IMPLEMENTATION OF THE POVERTY REDUCTION STRATEGY

14. **Monitoring the implementation of the poverty reduction strategy has been considerably improved through the establishment of the National Integrated Monitoring and Evaluation System (SNISE).** The SNISE is built on about sixty quantitative indicators that help capture progress on the MAP pillars both at the national and regional levels. Although the number of indicators should be reduced to account for the limited existing institutional capacity, staffs encourage the authorities to pursue the development of the SNISE through capacity-building programs, improved coordination among agencies, and the strengthening of the national Statistical Agency. In addition, the government needs to improve its ability to monitor the MAP implementation by addressing the two following challenges: (i) to better assess the evolution of poverty levels and distribution among households by strengthening its technical and statistical capacities; and (ii) to better align budget preparation and execution with MAP priorities and monitoring, by reinforcing communication, planning, and coordination between the Ministry of Finance and the MAP Secretariat, as well as by streamlining reporting mechanisms at the sub-national and sectoral levels.

IV. CONCLUSION

15. **The PRs provide a candid assessment of the progress made towards the MAP objectives.** As reported by the PRs, the authorities have implemented sound fiscal and monetary policies, which have contributed to good macroeconomic outcomes. The PRs also describe candidly progress in governance, policies underpinning private sector development, education and health policies, rural development, environment protection, and capacity building for monitoring MAP implementation.

16. **Future PRs could usefully include a forward-looking discussion of the remaining challenges for putting Madagascar firmly on a path of sustained poverty reduction and growth.** Strengthening macroeconomic achievements will require continued adherence to sound fiscal and monetary policies and prudent borrowing. Other 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 reforms of the electricity sector, land access and development, and the legal, regulatory, and judicial systems; (iii) enhancing resource allocation and execution within the health sector; (iv) pursuing the reforms on education to foster growth and employment; (v) reinforcing efforts to mobilize resources, including from the private sector, to finance infrastructure projects in the transport and communication sectors; and (vi) developing the ability to monitor the evolution of poverty, with a view to better target actions and reforms and thus improve access of the poorest to public services and opportunities.