Madagascar

2011

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Madagascar

Overview

Madagascar inched back to growth in 2010, with the country still suffering in the political fallout from the 2009 *coup* that ousted president Marc Ravalomanana and compounded the impact of the 2008-09 global slump. The economy expanded 0.3% last year after shrinking 3.7% in 2009. This was achieved despite donor countries cutting the development aid that has traditionally funded public investment in infrastructure. The international community does not recognise the political normalisation programme of the current government and so development aid is not expected to return to pre-crisis levels in the short term, with growth expected to be slower as a result.

Growth in 2010 was driven by the extractive industries, with production scaling up at large foreign-owned mines, and by a recovery in tourism. Agricultural output expanded slowly despite good weather while construction and the textile industry continued to contract.

The government has adopted a tight fiscal policy. As revenues fell due to the slowdown in economic activity and aid flows, most ministries suffered cuts that helped contain the budget deficit at a remarkably low 1.6% of gross domestic product (GDP). However, this was achieved at the expense of infrastructure development and maintenance, and threatens to compromise growth prospects in the medium term. At the same time, the Central Bank of Madagascar adopted a prudent monetary policy stance, holding inflation at 9.6% despite a 14% rise in food prices and keeping its key interest rate unchanged in spite of the sluggish economy. In coming years, the main challenge will be to ease constraints on economic growth without generating unsustainable fiscal deficits and excessive inflation.

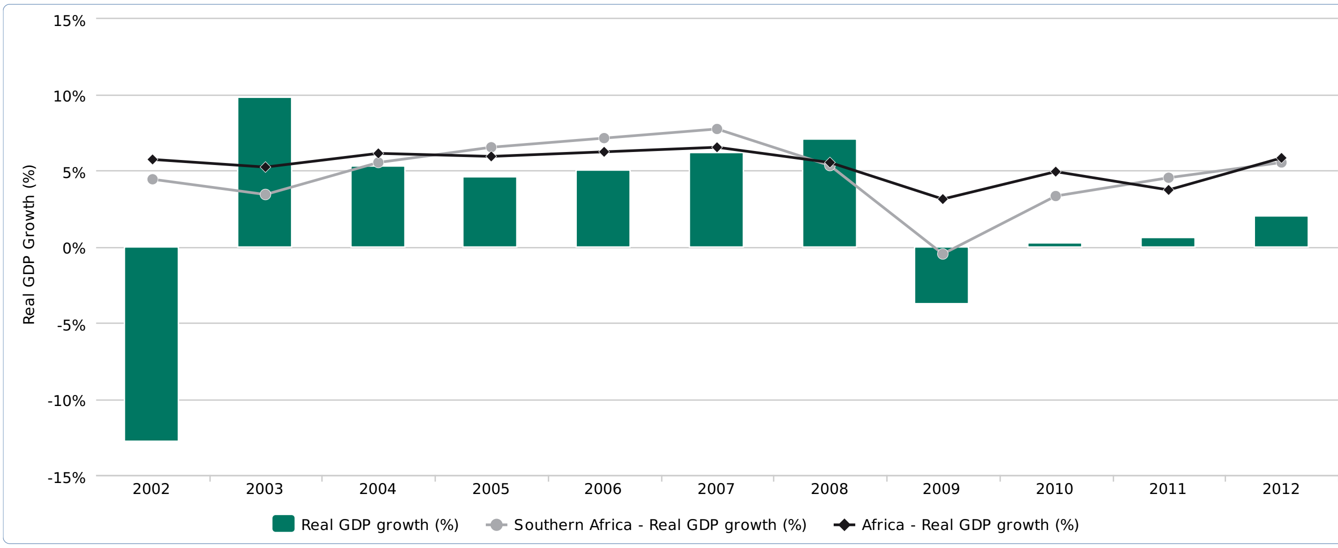
Economic activity in the private sector remains constrained by the lack of clarity on future political developments. Foreign investment suffers from concerns over the ultimate legal standing of contracts and concessions signed by the current government and from the revision of contracts signed by the previous government. In addition, with political efforts concentrated on establishing the Fourth Republic, very little is being done to reform the business environment.

The informal sector of the economy has grown as the government cut public spending, private investment remained low and companies in export processing zones closed. Although updated estimates on progress towards the Millennium Development Goals (MDGs) are not available, it is most likely that the incidence of poverty has increased since the *coup* of 2009.

The November 2010 referendum amending the constitution makes it possible that Andry Rajoelina, who seized power in 2009, will be elected president in 2011, although his candidacy is yet to be confirmed. The political environment remains uncertain as both the opposition and most of the international community have not recognised the validity of the referendum while efforts to broker a settlement appear to be making no progress.

In this context, emerging economy partners represent an opportunity for Madagascar. Although China has not recognised the current government, some Chinese companies have continued to sign contracts with it. In 2010, the Chinese group Wuhan Iron and Steel Co (WISCO) made an advance payment of 100 million US dollars (USD) for an iron ore concession. If the iron ore reserves prove to be as large as hoped, the resulting investment may amount to USD 8 billion, by far the largest single foreign direct investment ever made in the country. Given widespread corruption, the challenge is to transform this investment opportunity into development, ensuring the payment of fair royalties and the creation of linkages with the local economy.

Figure 1: Real GDP growth (S)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Table 1: Macroeconomic indicators

	2009	2010	2011	2012
Real GDP growth	-3.7	0.3	0.6	2
CPI inflation	8.5	9.6	10.1	9.8
Budget balance % GDP	-2.5	-1.6	-1.3	-1.2
Current account % GDP	-20.9	-17	-15.9	-15.3

Source: National authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Recent Economic Developments and Prospects

Table 2: GDP by sector (in percentage)

	2005	2009
Agriculture, forestry, fishing & hunting	28.3	28.8
Agriculture, livestock, fishery, forestry and logging	-	-
of which agriculture	-	-
of which food crops	-	-
Mining and quarrying	0.2	0.2
Mining, manufacturing and utilities	-	-
of which oil	-	-
Manufacturing	14.5	14.7
of which hydrocarbon	-	-
Electricity, gas and water	1.1	1.2
Electricity, water and sewerage	-	-
Construction	3	4.2
Wholesale and retail trade, hotels and restaurants	14	13.5
of which hotels and restaurants	-	-
Transport, storage and communication	19.1	20.1
Transport and storage, information and communication	-	-
Finance, real estate and business services	1.1	0.4
Financial intermediation, real estate services, business and other service activities	-	-
General government services	4.3	4.4
Public administration & defence; social security, education, health & social work	-	-
Public administration, education, health	-	-
Public administration, education, health & other social & personal services	-	-
Public administration, education, health & social work, community, social & personal services	-	-
Public administration, education, health & social work, community, social services	-	-
Other community, social & personal service activities	-	-
Other services	14.4	12.5
Gross domestic product at basic prices / factor cost	100	100

Source: AfDB Statistics Department; INSTAT.

Figures for 2010 are estimates; for 2011 and later are projections.

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Madagascar's economy grew by a modest 0.3% in 2010 after contracting 3.7% in 2009 following the *coup* that brought Rajoelina to power. The return to growth was largely due to the expansion of extractive industry production and a recovery in tourist flows. Due to continued political uncertainty, it is expected that development aid will not revert to pre-crisis levels and that Madagascar will continue to experience slow economic growth. For 2011, growth is projected at 0.6%, rising to 2.0% the following year.

Agriculture, forestry and fishing accounted for 28.8% of GDP in 2009, with the main food crops being rice, maize, beans, manioc and sweet potato.

Despite favourable climatic conditions, the agricultural sector registered slow growth in 2010. In 2011, the government plans to maintain tax exemptions on agricultural inputs and capital goods. Jointly with the expansion of arable land area, the emergence of new entrepreneurs and the rehabilitation of irrigation systems, this is expected to produce 2% growth in the sector.

The government's efforts to put an end to illicit forestry exploitation hit the industry badly, with growth slumping from 30.4% in 2009 to just 0.1% in 2010. This negative trend is expected to continue in 2011, when forestry value added is likely to contract by 20%.

The secondary sector accounted for 20.3% of GDP in 2009.

Strong growth in the extractive industries contributed to the rebound of the secondary sector. Large foreign direct investment (FDI) slowed but did not stop during the global financial crisis. Scaling up of production at the ilmenite mine run by QIT Madagascar Minerals (QMM) drove the sector's value added up by 121% in 2010 after 14% in 2009. In 2011, further expansion by QMM and the beginning of production at the cobalt and nickel mine run by Sherritt International should lead to faster growth in excess of 200%.

Value added in the export processing zones dropped 5% in 2010, repeating the negative performance of 2009. The textile industry accounts for about 95% of the firms in these zones, with ownership largely foreign – French, Mauritian and Chinese.

In the aftermath of the 2009 *coup*, the suspension of the US African Growth and Opportunity Act (AGOA) providing preferential access to the US market resulted in the loss of some 40 000 formal sector jobs – 20% of the total in 2008. The outlook remains negative. A law approved under former president Ravalomanana in 2008 at the request of the International Monetary Fund said the export processing zones would close in early 2011. The implementation of this law, which has not been cancelled by Rajoelina's High Transition Authority, could further damage the prospects of the textile sector. In addition, given that the current government is not recognised by most international partners, Madagascar may be unable to sign a preferential trade agreement with the European Union as scheduled in 2011. Against this backdrop, the sector could shrink by about 10% in 2011.

Construction and public works accounted for 4.2% of GDP in 2009. In 2010, the sector contracted 17.5%, repeating the negative performance of 2009 as development aid dried up. Donor countries provide most of the funding for infrastructure development and maintenance and so the future depends on how the political crisis is resolved. Public works are likely to see negligible growth over the next few years. The sector may find some support from foreign investment, such as the beginning of mine construction work by the Chinese company WISCO.

The tertiary sector performed well in 2010, thanks to a recovery in tourism. The transportation sector, which captures some tourist activities and accounted for 20.1% of GDP in 2009, recorded 5% growth in 2010 after shrinking 10% in 2009. The number of visitors was estimated at 180 000, up from 125 000 in 2009. Although this does not mark a complete recovery compared with 365 000 arrivals of 2008, the performance was very satisfactory during the second half the year, with occupancy rates in tourist hotels of up to 70% – compared with 80% in 2008 and 30% in 2009. On the other hand, occupancy rates remained low in business travel hotels.

On the demand side, private consumption contracted by 2.3% in 2010, reflecting the loss of formal sector jobs and the increase in informal activity. Private investment also fell as large mining projects approached completion or entered the production stage. This was only partly offset by the opening of a large brewery, the Nouvelle Brasserie de Madagascar with a USD 15 million investment; and of telecoms operator Madamobile, representing a USD 47 million initial investment in 2010. Private consumption is expected to shrink a further 1.3% in 2011 and then return to growth of 1.6% in 2012.

Public investment contracted due to the reduction in development aid, which resulted in new projects being cancelled, except for humanitarian operations. Public consumption declined 8.1% as the government cut spending.

The continuing fallout from the 2009 *coup* means development aid is not expected to return to pre-crisis levels. FDI may be hampered by the fear that contracts signed with the current government may not be honored in the future. Growth prospects therefore remain bleak.

Table 3: Demand composition

	Percentage of GDP (current price)		Percentage changes, volume			Contribution to real GDP growth		
	2002	**2009**	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Gross capital formation	13.4	32.1	-8.4	0	0.3	-2.6	0	0.1
Public	3.9	4.1	-18	0	3	-0.7	0	0.1
Private	9.5	28	-7	0	0	-1.9	0	0
Consumption	95.6	93.9	-2.9	-1.2	1.5	-2.7	-1	1.3
Public	8.4	11.9	-8.1	0.4	1	-0.8	0	0.1
Private	87.3	82	-2.3	-1.3	1.6	-1.9	-1.1	1.3
External sector	-9	-26.1	-	-	-	5.5	1.6	0.5
Exports	16	24.7	5.7	2.9	3.8	1.5	0.8	1.1
Imports	-25	-50.7	-8.1	-1.8	1.2	4	0.8	-0.5
Real GDP growth rate	-	-	-	-	-	0.3	0.6	2

Source: Data from INSTAT; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Fiscal Policy

The government adopted a tight fiscal policy in 2010. Tax revenues amounted to 9.7% of GDP, down from 10.5% in 2009. Slowing economic activity in the real sector combined with the decline of external trade and the reduction in foreign aid resulted in a fall in public revenues to an estimated 11.4% of GDP in 2010 from 12.1% the previous year. The original 2010 budget issued at the end of 2009 estimated public revenues at 2 117 billion Malagasy ariaries (MGA) but the government revised the figure down to MGA 1 905 billion in June 2010.

Most of the revision was driven by lower than expected external financing. In the first 2010 budget, the government expected to receive MGA 957 billion of aid but actual flows amounted only to MGA 587 billion MGA 321 billion in grants and MGA 266 billion in loans. The public finances got an unexpected boost from the USD 100 million advance payment by China's WISCO for its iron ore concession at Soalala.

The revised June 2010 budget made significant spending cuts but the Ministries of Defence and Internal Security, the High Transition Authority and the Presidency all received increased allocations. The Presidency's budget increased seven times between 2009 and 2010. Investment carried out through the presidency accounted for almost half of public investment in 2010.

Public debt and public sector wages were paid regularly with no accumulation of arrears. Public sector wages rose 10% in nominal terms to maintain their real value in the face of inflation. To contain public expenditure, the block on the replacement of retiring staff was maintained.

The government's austerity policy contained the overall budget deficit to 1.6% of GDP, compared with an initial estimate for a 3.2% shortfall. The deficit is projected at 1.3% in 2011 and 1.2% in 2012. In 2009 and 2010, the government made up for the reduction in external revenue by cutting public investment, mostly in basic infrastructure and in social sectors such as education, healthcare and culture. Public investment fell a dramatic 55% in real terms between 2008 and 2010.

In 2011, the government is expected to continue to implement a strict fiscal policy to contain the budget deficit. Available resources will be channeled towards establishment of the Fourth Republic and some overdue infrastructure investment.

Table 4: Public finances (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Total revenue and grants	10.2	16	17.5	12.1	11.4	11.3	11
Tax revenue	7.7	11.4	13	10.5	9.7	9.5	9.3
Oil revenue	-	-	-	-	-	-	-
Grants	2.2	4.3	4.3	1.1	1.3	1.4	1.3
Other revenues	0.3	0.3	0.3	0.5	0.5	0.5	0.5
Total expenditure and net lending (a)	15.7	18.7	19.5	14.6	13	12.6	12.2
Current expenditure	10.3	11	10.9	10.3	9.7	9.4	9
Excluding interest	8.1	9.9	10.1	9.5	8.8	8.5	8.2
Wages and salaries	4.6	5.2	4.7	4.7	4.5	4.1	3.9
Goods and services	2.5	3.1	4.6	3	2.6	2.7	2.7
Interest	2.2	1.1	0.8	0.8	0.9	0.9	0.9
Capital expenditure	4.8	7.6	8.6	4.3	3.3	3.2	3.2
Primary balance	-3.3	-1.6	-1.2	-1.7	-0.6	-0.4	-0.3
Overall balance	-5.5	-2.7	-1.9	-2.5	-1.6	-1.3	-1.2

a. Only major items are reported.
Source: Data from INSTAT; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Monetary Policy

The Central Bank of Madagascar adopted a prudent monetary policy, containing inflation at 9.6% in 2010 against an expected 13.6%. Inflation was driven by higher than average increases in prices for manufactured goods, private services, housing rentals, petroleum products and food – which alone jumped 14%.

The Central Bank kept its main interest rate steady at 9.5% while commercial banks' reserve requirements were also left at 15%, a level unchanged since 2004. Beyond the interventions of the Central Bank, the relatively low inflation rate is explained by the depressed economy, with a contraction of consumption and investment both in the public and private sectors.

The Central Bank is expected to maintain a conservative monetary policy stance over the next few years. Modest growth prospects should help to dampen price pressures but the outlook for key oil and rice prices is uncertain after recent sharp rises and inflation for 2011 is now expected to be higher than 2010 at 10.1%.

External Position

The trade deficit fell from 19.3% of GDP in 2009 to 17.4% in 2010. A further improvement to 16.9% is projected for this year, falling to 16.6% in 2012. The mining sector – mainly mica, quartz and ilmenite – drove export growth while traditional exports such as agricultural and textile products fell dramatically. From January to August 2010, exports of mineral products jumped 76.2% compared to the same period in 2009, reflecting soaring prices, especially for mica and quartz. Madagascar's main export markets in order of importance were France, Germany, Côte d'Ivoire, the United States, India, Canada, China and the United Kingdom. The improvement in the trade balance also reflected a fall in imports, with capital goods purchases down due to the end of construction at large mining projects. Imports of petroleum products rose considerably as oil prices increased.

On the services account, imports fell 6.7% and exports increased 19.2%, with the sector deficit improving from 4.1% of GDP in 2009 to 1.2% in 2010.

The current account deficit dropped to 17.0% of GDP in 2010 from 20.9 % in 2009 and is projected to improve to 15.9% this year and 15.3% in 2012 as mining exports rise. The overall balance of payments deficit rose sharply, reflecting the fall in development aid and FDI.

The ariary remained stable in real terms compared to major currencies. Its value vis-à-vis the IMF SDR decreased 2% in 2010. Available foreign exchange reserves total about USD 800 million, covering three months of imports.

Madagascar's main development partners are the European Union, Germany and France. In June 2010, the European Union suspended all budget support, with the exception of humanitarian and emergency aid. Programmes already underway were expected to continue, except for activities with direct government involvement. At the same time, Germany decided to limit its development assistance to the environmental field. The African Development Bank and the World Bank continue ongoing projects but halted fresh initiatives.

For 2011, Madagascar's relations with the European Union are likely to remain on hold until an agreed path out of the country's political crisis can be found.

Madagascar's 2010 external debt obligations amounted to MGA 86.8 billion of principal and MGA 47.9 billion of interest, minus MGA 16.6 billion in deductions provided by multilateral creditors under the Heavily Indebted Poor Countries (HIPC) debt reduction initiative.

Table 5: Current account (percentage of GDP)

	2002	2007	2008	2009	2010	2011	2012
Trade balance	-2.6	-13.6	-20.2	-19.3	-17.4	-16.9	-16.6
Exports of goods (f.o.b.)	10.9	16.8	13.9	12	12.1	12.3	11.7
Imports of goods (f.o.b.)	13.6	30.5	34.1	31.2	29.5	29.2	28.3
Services	-3.9	-2.4	-3	-4.1	-1.2	-1.1	-0.5
Factor income	-1.6	-0.8	-0.5	-1.1	-1.5	-1.3	-1.4
Current transfers	2.2	4.9	5	3.5	3.1	3.5	3.2
Current account balance	-6	-11.9	-18.7	-20.9	-17	-15.9	-15.3

Source: Data from INSTAT; estimates (e) and projections (p) based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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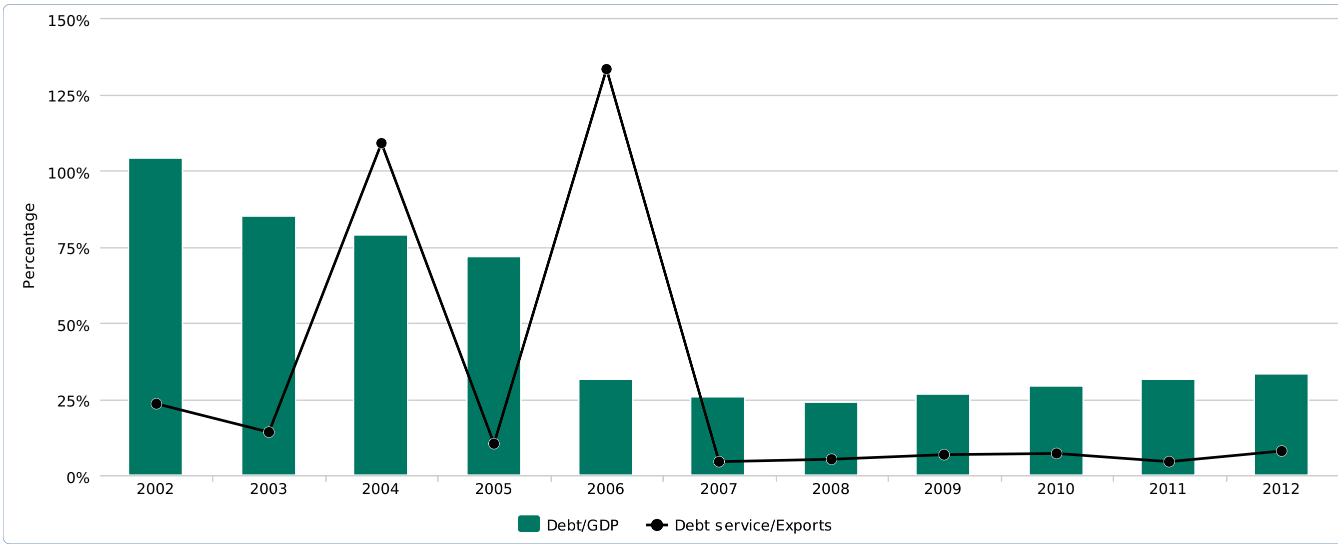
Figure 2: Stock of total external debt (percentage of GDP) and debt service (percentage of exports of goods and services)



Source: IMF and local authorities' data; estimates and projections based on authors' calculations.

Figures for 2010 are estimates; for 2011 and later are projections.

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Structural Issues

Private Sector Development

The political and economic uncertainty weighing on Madagascar since the 2009 political crisis has produced a "wait and see" attitude among private investors. While some believe this is the moment to enter the market, most entrepreneurs are afraid that new contracts and concessions may not be recognised by a future government. This is particularly true for foreign investors.

The country's ranking in the World Bank's *Doing Business* report slipped from 134 in 2009 to 140 in 2010 out of 189 countries but this largely reflected technical changes to index methodology. Among the different categories, Madagascar performed best on protecting investors, being ranked 59; starting a business, 70; and paying taxes, 72. The worst readings were registering property ownership, 162; obtaining credit, 176; enforcing contracts, 153; and closing a business, at 183. It takes 74 days and costs 9.8 per cent of the property's value to register a property; 871 days and 38 procedures are necessary to close a business. Reforms are difficult in the current political environment and proposals with the government are processed very slowly.

Despite the unpromising conditions, new businesses are opening. In the capital Antananarivo, the number of newly registered businesses rose from 1 239 in the first quarter of 2009 to 1 942 in the corresponding quarter of 2010. Most of these investments are in the tertiary sector, with 1 724 new firms, against 18 in the primary sector and 200 in the secondary sector. Most firms are in trade-related activities, such as retailing and wholesale; and in transport, for freight and passengers. The introduction of a one-stop communication and co-ordination system (GASYNET) between customs and port operators should reduce time and costs for exporters and importers.

On the financial side, Gabon's BGFIBank started operations in Antananarivo. The financial system is limited, with only two commercial banks planning to develop a countrywide network while the others focus only on the large cities. Bank lending grew by 9% over the first eight months of 2010, compared with a 7% gain in the same period in 2009.

Credit provision to the private sector, however, slowed dramatically during the first half of 2010, increasing by only MGA 34 billion compared to MGA 304 billion in 2008 and MGA 79 billion in 2009. Net credit to the private sector grew 7.7% in 2009 after 29.5% in 2008. At the same time, problem loans increased from 9% at the end of 2009 to 11% at the end of the first quarter of 2010. The 2009 Investment Climate Assessment survey confirms that firms consider access to finance to be a major constraint on private sector development.

The number of microfinance institutions continued to grow, from 10 in 2006 to 26 in 2010. Over the same period, the coverage ratio – the number of existing clients in proportion to potential clients – has grown from 5% to 12% while the volume of loans has trebled. Part of this growth can be explained by the increasing size of the informal sector due to the economic crisis following the *coup* of 2009. Informal businesses do not have access to credit from commercial banks. At microfinance institutions, loans range between MGA 50 000 and MGA 30 million, with maturity generally below one year and never exceeding two years. A professional association of microfinance institutions was established in 2010.

Mobile phone banking was introduced in September 2010 and the volume of e-transfers over the system has reached EUR 1 million per week. A guarantee fund, Solidis, promoted by a development finance institution, has started to act as an intermediary between the commercial banks and small- and medium-sized enterprises (SMEs).

Other Recent Developments

As a consequence of the slowdown in development aid flows, there has been no infrastructure development over the past two years and maintenance has been kept to a minimum.

Installed power capacity remains incredibly low at 160 MW, especially when set against a hydro-power potential of several million MW. All development projects remain on hold. Some additional capacity should be provided in 2011 by the power plants built as part of large mining projects, with QMM supplying about 50 MW to the grid in Fort Dauphin and Sherritt supplying 15 MW in Ambatovy.

The telecommunications sector saw the entry of a new mobile operator – Madamobile, which was registered in 2008 but has only now started services. The connection of the national backbone to the Lion submarine cable in 2009, via Orange, and to the EASSy submarine cable in 2010 via Telma, one of the existing operators, has greatly improved the telecommunication infrastructure in the country. Available broadband is now 1 Mbps for residential consumers priced at about EUR 80 per month and 4 Mbps for businesses, at about EUR 1 600 per month – still very high prices for the country.

The 2011 budget envisages a 32% increase in public investment. The Public Investment Programme (PIP) aims firstly to stimulate economic recovery by building and renovating the productive and social infrastructures that have a direct impact on the population. Investment will be sustained to support the policy of decentralisation within the wider political context of the establishment of the Fourth Republic. Lastly, it aims to promote private sector development. About a third of the total budget is allocated to infrastructure development covering public works, transport, energy, water and sanitation and urban growth. An equal share goes on health, which will be granted an additional MGA 66 billion, and on education, with an additional MGA 94 billion. About 16% of the budget is allocated to productive sectors, including forestry, manufacturing, craft industry, mines, tourism and the environment. The remainder goes for administration. Some two thirds of the investment budget, however, is dependent on external financing from traditional donors. If this is not forthcoming due to the current political situation, it has been suggested that the country could look to other sources.

In 2010, the government developed a strategic vision for environmental and forestry policy with three main objectives. The first is to improve the governance of natural resource management to promote the country's sustainable development. The second is to improve the legal framework of the sector by finalising the environment charter and reinforcing the legal system governing precious woods. Finally, the government wants to make the supervisory ministry more effective by improving revenue collection in forestry administration, by training its employees and by introducing a permanent communication system with the regional directors.

Emerging Economic Partnerships

China is Madagascar's most important partner among the emerging economies. It has been a donor since the 1970s, mainly in infrastructure. Recently, however, the nature of its engagement has evolved, with increasing volumes of trade and direct investment.

China accounts for a large share of Madagascar's imports, rising from 15% in 2000 to a peak of 26% in 2008. This dropped quite dramatically to 14% in 2009 after the *coup*. China has been the main source of imports since 2004 although France remains Madagascar's main trade partner, taking 47% of its exports in 2008.

Chinese FDI amounts to about USD 200 million, 70% of which has been made in the last four years. China has invested in three sugar mills with related sugar cane plantations, one cement factory and one commercial bank. Other investment has gone into the textile industry in the export-processing zones. These investments are not large relative to those made by the country's traditional partners, especially in recent years in mining. However, in 2010, the Chinese company WISCO obtained a concession for the extraction of iron ore following an internationally competitive tender and it paid USD 100 million upfront to the government. If the reserves prove to be as large as are hoped, the project may lead to further commitments of up to USD 8 billion, making it the single largest foreign direct investment to the country.

Other emerging country partners include India, Kuwait, United Arab Emirates, Korea and Turkey but they are all significantly less important than China in terms of aid, trade and FDI. India started its first co-operation project in 2008, aimed at increasing rice productivity. Indian private enterprises have also been active in the extractive industries, although these are still at the exploration stage for oil and uranium. The telecommunications sector has attracted investment from India (Reliance), Kuwait (Zain) and the United Arab Emirates (Madamobile). In 2008, Daewoo of Korea came close to an agreement on a massive land lease for the production of export crops but the deal was hugely controversial and is widely believed to have been an important factor in undermining President Ravalomanana. Finally, Turkey has recently established diplomatic relations with Madagascar and has engaged in talks on a co-operation framework.

With the exception of China, emerging countries are still less important than traditional partners in terms of aid, trade and investment flows. For example, companies from traditional partner countries Canada and Australia have funded the major mine projects which are the largest foreign direct investments in the country to date. In 2008, emerging countries accounted for 54% of Madagascar's imports – half of which came from China – and 7% of exports. This compared with 36% of imports but 91% of exports for traditional partners. African countries accounted for only 10% of imports and 3% of exports.

Emerging country partners do not bring a new development model, rather they follow traditional patterns and operate in traditional sectors. The perceived high share of foreign workers employed in Chinese projects, especially for the construction of infrastructure, is one notable difference from traditional practice. In general, emerging country partners have the potential to play an important role in Madagascar's economic development because they complement the activities of its traditional partners and they represent an alternative, especially in this time of isolation from the international community. For example, unlike Madagascar's traditional partners, Pakistan and Turkey have recognised the Rajoelina government.

Overall, emerging country partners and their entrepreneurs appear to have a long-term commitment to the country, participating in sectors such as the extractive industry, agro-industry and telecommunications. The relatively small investments in the textile industry in the export processing zones are an exception – many such firms stopped operating in 2009-10 when Madagascar lost its US preferential trade access after the *coup* that brought Rajoelina to power.

Madagascar seeks to foster foreign engagement via multilateral forums. The main challenge is to create an enabling environment that attracts further investment from emerging country partners and increases the share of benefits accruing to Madagascar.

Political Context

In March 2009, following a wave of riots, former president Marc Ravalomanana handed power to a military board, which immediately transferred it to the then mayor of Antananarivo, Andry Rajoelina. Rajoelina, who had been leading the protests, became the President of the High Transition Authority, which has retained power since then. The opposition reorganised into three factions, each one backing one of the country's former presidents. Talks on a new political settlement led to agreements in Maputo and Addis Ababa in 2009. However, Rajoelina cancelled these agreements at the end of 2009, declaring that the crisis would be solved at the national level. The first half of 2010 was marked by rumors of attempts of military *coups*, one of which led to the dismissal of the Minister of Defence.

The international community has not established a common position on Madagascar. New partner countries Pakistan and Turkey have recognised Rajoelina and while China did not, it continued to sign trade agreements with Madagascar.

In March 2010, the African Union Commission (AUC) imposed individual sanctions on 109 personalities linked to the government. Major donors meanwhile ended all but emergency assistance to Madagascar and the United States suspended the country's AGOA preferential status for exports to the US market. The Southern African Development Community (SADC) considers the government to be illegitimate and calls for an inclusive transition process based on the Maputo charter.

South Africa and France brought all four sides together in Pretoria in April 2010 but without success. The failure of this meeting reinforced Antananarivo's determination for a "home-grown" solution which it put to the referendum in November as a first step towards elections in 2011. The government's main political opponents called for a boycott of the vote and a group of military officers attempted an unsuccessful military coup the day before the referendum. The referendum approved the constitutional arrangements put forward and lowered the minimum age for presidential candidates from 40 to 35, thereby allowing Rajoelina to run in the next elections. Recently, the SADC has proposed a road map to end the political crisis but the three opposition factions have expressed disagreement or reservations.

Corruption has become worse since the onset of the crisis. Transparency International's corruption perception index – in which lower values indicate higher levels of corruption – fell from 3.4 in 2008 to 3.0 in 2009 and 2.6 in 2010. Rajoelina has acknowledged the existence of corruption in the public administration and ordered an audit in June 2010.

Social Context and Human Resource Development

Over the last 40 years, there has been a steady deterioration in living standards as the economy has grown more slowly than the population. Madagascar's GDP per capita is very low, at USD 972 on a purchasing power parity basis. More than two-thirds of the population lives in extreme poverty – less than USD 1.25 per day. The incidence of malnutrition is particularly high, at 35% of the population. The last national report by the United Nations Development Programme (UNDP) to track progress towards the Millennium Development Goals (MDGs) was published in 2007 and no reliable data concerning these targets is available for 2009-10.

The *coup* of 2009 has undercut economic growth and a resulting increase in the size of the informal sector has likely pushed up poverty rates. Some 400 000 people enter the labour market each year, adding to the pressures – unemployment and underemployment were estimated at 30% for 2010.

Those aged under 15 make up 47% of the population, presenting a huge challenge for the future as they come onto the labour market. Among other acute problems, Madagascar faces a lack of formal sector jobs; low skills, labour mobility and productivity; insufficient support for job seekers and poor working conditions. Poverty is often associated with subsistence farming or informal non-agricultural employment. Poverty reduction is therefore dependent on increasing earnings in these areas as the public sector is unlikely to be able to take up the slack in the near future while wage employment in the formal sector is the preserve of highly skilled individuals.

Health spending accounted for 2.7% of the country's GDP in 2007, according to the UNDP. The country nonetheless compares favourably with other African countries on life expectancy at birth, 61 years, and on infant mortality, 106 per thousand live births. Madagascar's human development index reading of 0.435 is higher than sub-Saharan Africa's average of 0.389 but it ranks only 135 out of 169 countries in all continents.

HIV prevalence is relatively low but it is believed that official statistics underestimate the real number of cases as the incentive for testing is reduced by the poor healthcare available to HIV-positive individuals. Supplies of anti-retroviral treatments are not consistent and there have been cases of distribution of medications past their expiry date.

Madagascar has a fast-growing population, with the increase put at 2.7% in 2010. Over the past two decades, the fertility rate has dropped from 6.8 to 4.7 children per woman in 2010, with the highest reduction recorded among women with secondary and tertiary education. Adolescent fertility rates are high – 133 births for women aged 15-19 years per thousand births – reflecting low levels of urbanisation and education. In 2010, 20% of Malagasy women were illiterate and 50% had completed only primary education.

Public spending on education as a percentage of total expenditure has fallen from 18.9% in 2005 to 13.4% in 2008. As a percentage of GDP, it dropped from 3.2% in 2007 to 2.9% in 2010. Net school enrolment remains low at 24% for secondary education and 3% for tertiary education. The combined gross enrolment ratio for all grades and both sexes was 61% in 2010. Compulsory education lasts from 6 until 14 and on average children are schooled for 10.2 years.

According to the Demographic and Health Survey 2008-09 conducted by Madagascar's National Institute of Statistics, only 41% of the population had access to improved water sources, divided between 87% in urban areas against 33% in rural areas.