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CURRENCY EQUIVALENTS

Currency Unit	=	Malagasy Franc (FMG)
US$1	=	FMG 6,734 (October 17, 2002)

GOVERNMENT FISCAL YEAR

January 1 - December 31

ACRONYMS AND ABBREVIATIONS

AAA	Analytical and Advisory Activities
AFD	Agence française de Développement
AfDB	African Development Bank
CARE	Cooperative for Assistance and Relief Everywhere
COMESA	Common Market for Eastern and South Africa
CRS	Catholic Relief Services
EERC	Emergency Economic Recovery Credit
EPZ	Export Processing Zone
EU	European Union
FAO	Food and Agriculture Organization
FNUAP	Fonds des Nations Unies pour la Population (United Nations Population Fund)
FY	Fiscal Year
GNFS	Goods and Non Factor Services
GDP	Gross Domestic Product
GNP	Gross National Product
GTZ	Gesellschaft fuer Technische Zusammenarbeit (German Technical Cooperation)
HASYMA	Hasy Malagasy (Cotton Madagascar)
HIPC	Heavily Indebted Poor Countries
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immune Deficiency Syndrome
IBRD	International Bank for Reconstruction and Development
I-CAS	Interim Country Assistance Strategy
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
INSTAT	Institut National des Statistiques
JIRAMA	Jiro sy Rano Malagasy (Malagasy Water and Electricity Utility)
NGO	Non Governmental Organization
PRSP	Poverty Reduction Strategy Paper
PSD-2	Second Private Sector Development project
SALAMA	Central d'Achats des Médicaments (Central Drug Purchasing Agency)
UNCTAD	United Nations Conference on trade and Development
UNDP	United Nations Development Program
UNFPA	United Nations Population Fund
UNICEF	United Nations International Children's Emergency Fund
USAID	United States Agency for International Development
VAT	Value Added Tax
WFP	World Food Program
WWF	World Wildlife Fund
WHO	World Health Organization

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INTERIM
COUNTRY ASSISTANCE STRATEGY
FOR THE
REPUBLIC OF MADAGASCAR

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I. INTRODUCTION

1. After having been one of the most rapidly growing African economies in recent years, Madagascar plunged into a deep political crisis at the beginning of 2002. The crisis began following contested first-round elections in December 2001. Mediation attempts of the Organization of African Unity failed and the stand-off grew more and more tense as large parts of the highlands were increasingly isolated from the coastal areas through road blockades and destruction of bridges. Two parallel Governments were established, each with its own central bank, leading to a freezing of Madagascar's assets abroad, a suspension of foreign exchange trading and a closure of the treasury bond market for several months. Economic activity fell sharply and poverty increased. Achievement of the millennium development goals, already in danger before the crisis, is now very unlikely (Table 1).

Table 1: Selected Social Indicators

	Madagascar			Sub-Saharan Africa
	Earliest year Available	**Latest year Available**	**Target**	**Latest Single Year**
(in percent, unless otherwise specified)	***1990-1995***	***1996-2000***	***2015***	***1996-2000***
Population, millions[3]	11.7	15.1		642
Population growth[3]	2.7	2.7		2.4
GNP Per Capita in US$[3]	230	260		470
GDP per capita, average growth[2]	-1.6	0.7		0.4
Millennium Development Indicators:				
Extreme Poverty rate, headcount (percent of pop.) [1]	59	62	*30*	
Child Malnutrition, Weight for Age of under five pop.[1,3]	50	49	*25*	33
Net primary school enrolment rate[1]	48	72	*100*	---
Ratio female to male enrollment in prim. & sec. School[2]	--	96	*100*	80
Under 5 mortality rate per 1000 live birth[2]	170	144	*56*	162
Memorandum items:				
HIV/AIDS prevalence rate, percent of pop.[1,2]	--	0.15		8.4
Life Expectancy at birth in years[3]	55	55		47
Illiteracy rate (1999), percent of adult pop.[1,3]	39	33		39
Poverty rate, headcount, percent of pop.[1]	70	71		---
Primary School Completion Rate[2]	34	27		51
Access to improved sanitation source, percent of pop.[1,2]	35	45		55

Sources: 1 Madagascar: Poverty and Socio Economic Developments, 1993-1999, World Bank
2 African Development Bank et al (2002), Achieving the Millennium Development Goals in Africa, Global Poverty Report 2002. For GDP per capita growth, period averages.
3 World Development Indicators 2000, World Bank

2. The political crisis ended in July, but the social and economic impact is extremely pronounced, especially on a country with a GNP per capita of US$260 (in 2000), one of the poorest in the world even before the current events commenced. The direct negative impact on national income for 2002 is estimated at half a billion dollars. The total economic cost is much larger, taking into account the loss of confidence, foregone direct investments, foregone exports and physical destruction. Activity in several sectors, including tourism, transport and export processing, came to an almost complete stop. About 150,000 workers lost their jobs in the

formal sector alone. Farm produce prices, especially in isolated areas of the country, were cut in half, causing an unprecedented drop in rural incomes and putting future production at risk. Poverty might well have increased to over 75 percent of the population since the beginning of the year, a level higher than that a decade ago and halting the mild decline in poverty witnessed during the period from 1997 to 2001 when economic growth averaged 4.6 percent (Table 2). Early warning systems indicate a significant increase in malnutrition and infant mortality rates.

Table 2: Income Poverty Developments 1993-2001, percent of population

		1993	1997	1999	2001
Poverty					
(headcount index)	National	70.0	73.3	71.3	69.2
	Urban	50.1	63.2	52.1	50.0
	Rural	74.5	76.0	76.7	74.9
Extreme Poverty	National	59.1	63.1	61.7	61.1
(headcount index)	Urban	37.6	54.0	43.2	42.5
	Rural	64.0	65.6	67.0	66.5

Source: INSTAT, Cornell University and World Bank staff estimates.

3. This interim Country Assistance Strategy (CAS) outlines the planned Bank response to the post-crisis environment. The last CAS was presented to the Board in November 1997, and a new CAS was initially planned for fiscal year (FY) 02 together with the presentation of the full Poverty Reduction Strategy Paper (PRSP). However, the completion of the PRSP was delayed due to the crisis. Thus, an interim strategy is being put in place to assist in limiting the impact of the crisis on the poor and to support Government's recovery program. A new CAS would be prepared in consultation with the Government and development partners, to be presented to the Board based on the full PRSP around September 2003.

II. THE POLITICAL CRISIS, JANUARY – JULY 2002

4. The political crisis began with first-round presidential elections on December 16, 2001. According to most electoral observers, Mr. Ravalomanana, the mayor of Antananarivo, had won a first-round victory with an absolute majority of votes. Former President Ratsiraka, however, claimed that Mr. Ravalomanana's majority fell short of the necessary 50 percent required for an absolute majority, and hence requested a second round of elections. This triggered mass demonstrations and strikes which brought the country to a standstill. A first mediation attempt by the Organization of African Union led to an agreement in Dakar on April 18, 2002. As stipulated in the agreement, the High Constitutional Court organized a vote recount and declared Mr. Ravalomanana winner, leading to his official investiture as president on May 6, 2002 and the nomination of his full cabinet. However, Mr. Ratsiraka did not accept the results of the Court and continued to press for a second round.

5. Mr. Ratsiraka's supporters organized an effective and devastating economic embargo of Antananarivo with blockades on all roads and destruction of fifteen key bridges. Violent clashes were rare but nonetheless claimed several hundred lives. Each side formed a separate government – one in Antananarivo and one in the coastal city of Tamatave (Mr. Ratsiraka's

home town). Treasury bond trading was suspended in February 2002. Two Central Banks were operating, both attempting to conduct business abroad, including continuing to issue payment orders. Consequently and pending the resolution of the stand-off, foreign banks froze Madagascar's assets abroad and the domestic foreign exchange market was suspended. Economic activity, including foreign trade, came to an almost complete standstill.

6. Mr. Ratsiraka, a native of the coast, and his supporters tried to give an ethnic color to the conflict, portraying it as a struggle between the coastal provinces and the highlands. The governors of several coastal provinces, loyal to Mr. Ratsiraka, announced secession. However, this attempt of dividing the country along ethnic lines did not work and Mr. Ravalomanana, a native of the highlands, was able to maintain his support in the coastal areas. This could be largely explained by the fact that economic development on the coast has continued to lag and poverty has continued to increase during Mr. Ratsiraka's entire term. Ethnic tensions remain a major threat to the future stability and prosperity of Madagascar.

7. As Mr. Ravalomanana's domestic support increased, his control of the country widened and foreign governments that had initially taken a neutral position began recognizing him as the legitimate President by end-June 2002. In early July 2002, Mr. Ratsiraka left the country. President Ravalomanana now has full control over the entire country, having managed to restore peace in all provinces. The economic embargo of the highland areas during the crisis has ended. Roads have been opened, ports are starting to operate, and destroyed bridges are being rebuilt. The foreign exchange market has reopened and the treasury bond market is expected to do so shortly. Integrity of the public financial system has been re-established and key public services – at a standstill during the crisis – are being restored.

8. On July 26, the new Government presented its reconstruction and development program to the 'Friends of Madagascar' conference organized by the United Nations Development Program, the European Commission and the World Bank at the Bank's Paris Office. Representatives of 17 countries and 19 organizations attended the conference. Donors expressed strong support for the economic and social program of the Government of Madagascar and underlined the importance of adhering to principles of good governance, promoting development of a strong private sector, and reducing poverty. In addition, participants emphasized the importance of formulating a poverty reduction strategy in an inclusive way. To support these objectives, donors pledged approximately US$2.3 billion over a period of four years.

III. ECONOMIC AND SOCIAL IMPACT OF THE CRISIS

Economic Impact of the Crisis

9. While recovery is slowly starting, the economic and social costs of the six-month crisis are highly visible. National income is expected to have fallen by about US$500 million for 2002 alone. The total cost to the economy in terms of foregone

Table 3: Economic Performance, 2002

	2002 (planned)	2002 (proj)
GDP growth, percent	5.8	-11.9
Inflation, percent	4.0	13.7
Revenues and grants, % of GDP	17.2	9.3
Public expenditures, % of GDP	21.0	14.8

Source: Ministry of Finance, IMF and World Bank economic activity resulting from the collapse in trade and overall confidence is undoubtedly much larger. Inflation rose to 25 percent until July, largely driven by increasing prices due to the road blockades. However, inflation is expected to come down by the end of the year because of the Government's prudent monetary policy (see table 3). Similarly, while exchange rate trading had been suspended for several months, the re-opening of the foreign exchange rate market in August did not result in the feared weakening of the Franc Malagasy. The impact of the crisis on government finance was particularly stark. As of August, domestic revenue collection was only half the level of 2001.

10. Table 4 presents the main direct impacts of the crisis by sector and lists the likely short- and medium-term consequences in the absence of Government action (see Annex C1 for a complete sector analysis). The economic blockade of specific regions of the country led to an almost complete collapse of trade in goods, both within the country and abroad. Transport, tourism, construction and industrial production operated at less than a third of their capacity. In particular, export processing zone (EPZ) enterprises, situated mostly in the highland area, were unable to either import raw materials or export their finished products. Most EPZ firms declared technical unemployment and shut down their plants. Firms expect that new orders will only resume for the spring season of 2003. Until then, the EPZ sector is likely to operate at below 50 percent of capacity. Of the total loan portfolio of private banks, about 10 percent are estimated to be unrecoverable and an additional 10 percent will have to be rescheduled. The private banks have managed their operations and assets during the crisis well, though, and the deteriorating loan portfolio does not fundamentally endanger their financial health. Meanwhile, to quickly increase credit availability for the private sector, guarantee schemes are being considered to share risks for new loans between enterprises, the commercial banks, and the Government with the help of selected donors.

11. Farmer's incomes were significantly affected by price developments stemming from the crisis. With transport prices skyrocketing (petroleum prices increased by 500 percent), producer prices were heavily depressed, up to 50 percent in isolated communities. In parallel, prices for products of basic needs (salt, sugar, vegetable oil, lamp petroleum) increased drastically so that the agricultural terms-of-trade deteriorated strongly (Graph 1) with the effect increasing with distance from urban centers. As with industry, recovery risks for the sector are substantial.

Graph 1: Developments of Paddy and Vegetable Oil Prices, Rural Madagascar

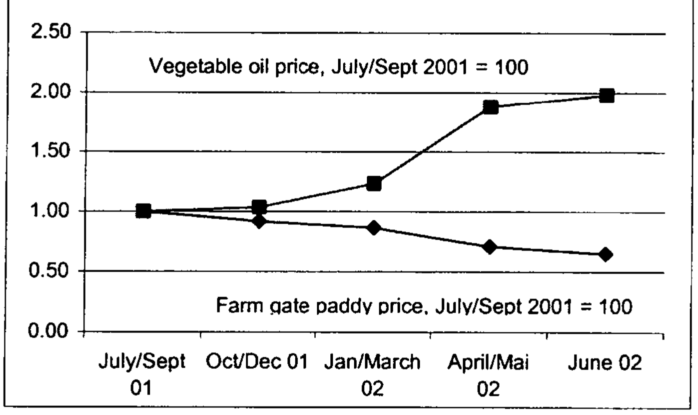

Table 4: Crisis Impact, Selected Sectors

Sector	*Direct Crisis Impact*	*Crisis Consequences if No Action Taken*
Agriculture/ Rural	▪ decrease of farm prices for traditional products ▪ anti-locust campaign halted ▪ harvest collection disrupted (no credits for collectors) ▪ several agro business enterprises stopped production	▪ productivity decrease & lower output due to lower agricultural input use and decayed infrastructure ▪ locust invasion leading to widespread harvest destruction ▪ bankruptcy of agro-business
Education	▪ teaching interruption, teacher absenteeism, urban school drop-out ▪ inability of families to pay for school material	▪ no return of students to school due to low family income ▪ parents cannot finance school material for next school year
Health, HIV/AIDS, nutrition	▪ availability of basic medicines and immunization down, health utilization down (15%) ▪ delayed epidemiological assessment of STI/HIV/AIDS and delayed effectiveness of anti-HIV/AIDS project ▪ retail price increases for basic food stuff	▪ low demand for health services due to lower household revenues ▪ increased threats of (i) communicable diseases; (ii) infant and maternal mortality; (iii) spread of HIV/AIDS ▪ breakdown of generic drug distribution system ▪ increase in food insecurity
Industry	▪ 150.000 additional unemployed (of which 100.000 in export processing zone) ▪ delays in VAT reimbursement	▪ lacking investor confidence ▪ further bankruptcies of firms in debt ▪ slow economic recovery, inducing low investments
Mining	▪ illegal mining activity and export slows down somewhat ▪ large planned mining investments put on hold	▪ large planned mining investments are withdrawn ▪ delay in establishing good governance in sector
Public sector	▪ revenue collapse till July 2002 and public investment program at standstill till August 2002 ▪ treasury bond trading suspended ▪ intergovernmental financial circuit interrupted ▪ foreign exchange trading suspended by Central Bank till August, 2002	▪ fiscal gap not financed leading to cuts in basic social services and/or inflation/depreciation ▪ internal revenues remain low ▪ absorption of public sector cannot be increased in short run ▪ net withdrawal of treasury bonds by private banks
Tourism	▪ 95 percent collapse of tourist travel in 2002 until September	▪ slow restoration of oversees confidence ▪ Air Madagascar difficulties limit tourist travel
Transport, trade	▪ petroleum price in blockaded areas increased 500% ▪ 23 bridges destroyed in crisis and due to cyclone Kesiny ▪ lack of routine maintenance of roads, railways ▪ Air Madagascar stopped most services ▪ External trade down 50 percent	▪ slow reconstruction of vital infrastructure ▪ under-funding of road maintenance work leading to further decay of infrastructure ▪ delays in finalizing concession of Northern Railway ▪ increased isolation of rural communities

Social Impact Of The Crisis

12. The economic collapse and discontinuation of many public social services caused widespread social suffering. Based on simulations using the results of the latest household survey, UNDP estimate that that income poverty has risen sharply by as much as 6 percentage points since 2001, reaching 75 percent of the population. School drop-out rates have risen to 14 percent during the past school year, and health service utilization declined by 36 percent in rural areas and 14 percent in urban areas. Especially worrisome is the decline in assisted birth rates (16 percent) and prenatal care for pregnant women (drop of 9 percent). In a survey conducted during the crisis, both urban and rural families reported that they decreased food consumption, reducing the intake of meat (up to two thirds for the extremely poor). Malnutrition rates of children under five, already one of the highest in Sub-Saharan Africa, are in danger of climbing even further.

13. The crisis had a particularly stark impact on three groups. First, *rural poor farmers, especially those isolated from markets:* qualitative and focus group discussions have revealed that rural incomes of communities far from the market have declined by as much as 50 percent due to lower farm prices and a sharp reduction in informal sector activities in villages (16 percent of rural communities report an entire collapse of non-agricultural activities). Additionally, consumer prices of basic manufactured life necessities increased strongly, further reducing real incomes. More and more families became heavily indebted during the crisis to finance family expenses. During the crisis, the percent of families which could not finance even the most basic food items, increased from 32 percent before the crisis to 42 percent. Communities also reported that cattle and crop theft increased strongly in the first half of 2002. Second, *those in extreme poverty before the crisis in urban areas*: the population that was in extreme poverty in urban areas before the crisis was particularly hurt by lower demand for their informal sector activities, like petty trade and contract work in the construction industry. Increases in prices of basic life necessities including salt, sugar and rice reduced real incomes even further. Demand for public water facilities as well as for basic health services dropped sharply as a consequence of this real income reduction. Third, *the newly unemployed in the formal sector:* about 150,000 urban workers lost their jobs, most of them in the export processing zone which had provided a high number of jobs for the not formally skilled workforce. With 150,000 men and women losing their work, about half a million members of the urban population were suddenly deprived of their main family income source. Since the crisis ended, industry is slowly restarting production but activity is far from pre-crisis levels.

IV. GOVERNMENT'S RECONSTRUCTION STRATEGY AND MACRO-ECONOMIC OUTLOOK

Government's Reconstruction Strategy

14. The new Government presented a short- and medium-term recovery plan to the international community at a 'Friends of Madagascar' meeting in Paris in July 2002. Emergency measures will (i) support the most vulnerable in society; (ii) assist private sector firms to restart production and create employment; and (iii) ensure adequate public services. Good governance is an important medium-term goal towards which Government has already started working. Government response to the above identified consequences of the crisis is shown in Table 5 (see Annex C2 for a matrix of Government response, donor support and mapped World Bank activities for all sectors).

15. <u>Supporting the Most Vulnerable</u>. The emergency program focuses on (i) free access to basic social services, and (ii) targeted assistance to those affected by the crisis. In response to the alarming reduction of social service delivery to the poor, the Government decided to temporarily lift user charges in the social sectors. Since September, primary school student matriculation fees have been suspended. Schools will get reimbursed for the revenue shortfalls from the central budget in November, 2002. Also, those parent associations that pay teachers salaries (FRAM schools) will get compensated for salaries paid since September. In the health sector, the assistance focuses on the national generic drug distribution agency, SALAMA, which distributes medicine to more than 2100 health centers in the whole country. The waiver of cost

recovery created a depletion of the health centers' medicine stock which was compounded by government arrears to SALAMA. As a priority activity, SALAMA will be recapitalized, arrears be cleared and additional transfers be made to ensure sufficient availability of medicines in the county.

Table 5: Government Response to Crisis

Sector	*Crisis Consequences if No Action Taken*	*Government Response / Strategy*
Agriculture/ Rural	a. productivity decrease & lower output due to lower agricultural input use and decayed infrastructure b. locust invasion leading to widespread harvest destruction c. bankruptcy of agro-business w/ arrears to farmers	a. anti-locust plan developed, partly funded from HIPC resources b. agricultural inputs tax exempt; distribution of semen planned; storage fund established c. repayment of arrears to farmers in cotton and sugar sector
Education	a. no return of students to school due to low family income b. parents cannot finance school material for next school year	a. fee waiver for primary schools (year 2002/2003), partly financed from HIPC b. school support in remote areas (nutrition, supplies)
Health, HIV/AIDS, Nutrition	a. low demand for health services due to lower household revenues b. increased threats of (i) communicable diseases; (ii) infant and maternal mortality; (iii) spread of HIV/AIDS c. breakdown of generic drug system d. increase in food insecurity	a. cost recovery partially waived (medicines, services), financed partly from HIPC b. prioritization of budget to fully finance necessary recurrent costs; speed-up of effectiveness of HIV/AIDS project c. SALAMA refinanced (HIPC, budget) d. social safety net operations (HIPC, FID, AGETIPA, SEECALINE)
Industry	a. lacking investor confidence b. further bankruptcies of firms in debt c. slow recovery, inducing low investments	a. promotion visits abroad, new public/private committee on private sector policy b. guarantee fund c. tax breaks, repayment of TVA arrears to enterprises
Mining	a. planned mining investments are withdrawn b. delay in establishing good governance in sector	a. promotion activities b. illegal licenses withdrawn, mining governance project prioritized
Public Sector	a. fiscal gap not financed leading to cuts in basic social services and/or inflation b. internal revenues remain low c. absorption of public sector cannot be increased in short run d. withdrawal of bonds by private banks e. communities not receiving vital central transfers	a. budget prioritization 2002/2003 b. collection of outstanding tax debt ongoing c. emergency budget execution measures agreed on; each ministry has coordinator for all projects and programs to increase absorption d. backing of treasury bond market by central Bank credit e. budget prioritization to at least partly compensate communities
Tourism	a. slow restoration of oversees confidence b. Air Madagascar difficulties limit tourist travel	a. promotion trips abroad; join private/public sector committee b. management contract for Air Madagascar signed
Transport, Trade	a. slow reconstruction of vital infrastructure b. under-funding of road maintenance work leading to further decay of infrastructure c. delays in finalizing concession of railway d. increased isolation of rural communities	a. priority reconstruction/ rehabilitation plan b. funding of road maintenance fund through HIPC c. railway concession agreement finalized and signed d. speed-up of rural roads investment program

16. The emergency program also includes a number of measures to help those most in need. First, with support from many of its development partners, the Government has set up social safety net operations, especially for the extreme poor and newly unemployed in urban areas. The safety net operation combines food/cash-for-work in labor-intensive construction with nutritional supplementation in community centers. Second, in the remaining budget for 2002, the Government will prioritize central Government transfers to poor rural communes which are

dependent on such transfers for maintenance of basic services. Third, the Government also plans to pay the arrears of the public cotton and sugar enterprises to ten thousands of small-holder farmers so that they can purchase needed inputs for the next agricultural season.

17. Restoring Public Services. The emergency program focuses on (i) the rehabilitation of destroyed infrastructure, in particular roads and bridges, and (ii) the support of strategic public enterprises which are now under management contract. The reconstruction of dynamited of bridges and the rehabilitation of infrastructure destroyed by cyclone Kesiny has already been completed. However, major efforts and investments are needed to maintain roads which were poorly serviced before the crisis and received no maintenance during the crisis.

18. The priority program also includes support to the national airline and the northern railway system. Air Madagascar had already been in serious financial difficulties before the crisis started but the suspension of most services during the crisis, including the exclusion from the international airline association IATA (due to non-payment of dues) brought the company to near collapse. The new Government took the important decision to sign a performance-based management contract with a reputable international consulting firm with the aim to restructure Air Madagascar and bring it to the point of privatization within two years. An audit and business plan have been established and a creditors conference will be convened in November, 2002, to settle a minimum of debts of the company, for which financial support is necessary.

19. The rehabilitation of the northern railway, which has not been operational since 2001 is key for further business development in Madagascar as it connects the industrial area around Antananarivo with the major port of Tamatave. No planned maintenance and investment works occurred during the crisis which have caused a further delay and additional costs until trains can start running again. The Government signed a concessioning agreement in October and is making priority payments to finance salary arrears, a social plan, and the first-year investments.

20. Assist Private Sector Recovery. The Government program includes a number of measures to support the private sector in Madagascar, comprising (i) immediate tax relief and delay of tax payments for value added tax and profit taxes; (ii) suspension of value added tax on investment products, fertilizer and cement until the end of 2002; (iii) setting customs duties on all textile inputs (used mainly in EPZ firms) at zero and setting up a system to allow EPZ firms value-added tax credit against future exports; (iv) establishment of a guarantee fund operated by private banks to provide new credits for the sector; (v) creation of a consultative committee between the public and private sector to design business-friendly policies and monitor recovery; and (vi) active promotion tours of the consultative committee abroad to attract potential investors.

21. Macro-economic and fiscal policies. In addition to the above emergency measures, the Government is committed to macro-economic stability through (i) prudent monetary and exchange rate management; (ii) restraint in public expenditures while protecting anti-poverty expenditures; and (iii) special efforts in tax recovery of previous year debt and new obligations.

22. Focus on Governance: the new Government will place specific emphasis on improving governance in the country. Over the past years, lacking or insufficient internal controls led a significant number of public fiscal transactions to be non-regular. For example, a review of

budget expenditures in 2001 showed that significant overspending of the president's special fund occurred (US$27 million compared to a budgeted amount of US$400,000). Similarly, an audit by the European Commission in the year 2000 established that existing budget procedures and laws were not consistently applied to public financial transactions. Perceived corruption in Madagascar is extremely high. In a survey conducted before the crisis, Transparency International (2002), ranked Madagascar ranked 98th of 102 in its Corruptions Perception Index. Cumbersome budget procedures as well as a disparate budget planning process have remained one of the key bottlenecks limiting Madagascar's capacity to effectively utilize available donor support and local funds. In September 2001, an action plan was developed with Government as part of the HIPC expenditure tracking assessment (see Annex C3). This action plan is about to be implemented.

23. The new Government is moving ahead in implementing an anti-corruption agenda for which it is seeking support from the Bank. An anti-corruption task force is being established with terms of reference for a fully independent corruption investigating agency, development of an ethics code and preparation of anti-corruption legislation. Further, public and elected officials will be required to regularly declare all their assets and those of their close relatives, regardless of where those assets are held. Lastly, the Government has announced its plans to reform budget procedures, financial controls and customs administration.

24. Cost and Financing of the Reconstruction Program. The recovery program (presented in Annex Table C2) is estimated to cost around US$540 million between August 2002 and December 2003. The expected financing of the program is shown in Table 6. Internal financing would amount to roughly US$120 million which would include re-prioritization of the budget, including support from debt service savings from the HIPC initiative. Donor support linked to the recovery program until December 2003 would amount to about US$420 million. Table 6 includes a breakdown of the programmed support by partner country and organization. IDA's support for the Government's reconstruction program would include one new project, the proposed Emergency Economic Recovery Credit (US$50 million) and disbursements from the existing portfolio totaling US$67.2 million.

Table 6: Financing of the Recovery Program, August 2002 – December 2003
(US$, million)

Madagascar	120.0
African Development Bank	60.0
European Union	94.4
France	70.0
Germany	14.0
IDA	117.2
- adjustment support	*42.2*
- EERC	*50.0*
- Project support after restructuring	*25.0*
Japan	19.0
Switzerland	9.0
UNICEF	8.5
UNDP	9.0
USA	5.0
UNAIDS	2.0
UNFPA	3.5
WFP	8.4
TOTAL	540.0

Macroeconomic Outlook

25. Implementation of the above strategy over the next year and beyond will crucially depend on the maintenance of macro-economic stability. While the country is in a deep recession, an adequate macro-economic framework is in place. The IMF visited Madagascar in October, concurs with this assessment and is preparing a revised PRGF program with new benchmarks to

for IMF board presentation in December, 2002. Monetary management during the crisis was prudent because neither of the two competing governments had access to the foreign reserves. The current increase in the price level (around 25 percent since beginning 2002) is expected to be reversed somewhat by year end (end-year inflation is expected to be around 14 percent). Before reopening the foreign exchange market, the Central Bank devalued the Franc Malagasy by about 15 percent against the Euro, thus decreasing the gap between the official and the market exchange rate to less than 5 percent. Since the reopening of the market, the exchange rate appreciated slightly.

Table 7: Madagascar: Key Macroeconomic Indicators

(in percent of GDP, unless otherwise indicated)

	2000	2001	2002 (proj.)	2003 (proj.)
GDP growth, percent p.a.	4.8	6.0	-11.9	7.8
Primary sector growth, percent p.a.	1.0	4.0	-1.4	-1.8
Secondary sector growth, percent p.a.	5.6	7.6	-25.1	24.3
Inflation, e.o.p., percent p.a.	8.7	4.8	13.7	6.2
Gross Investment	15.0	15.5	11.5	14.8
Gross National Savings	9.4	13.7	7.8	9.7
Revenues and Grants	15.3	14.0	9.3	14.5
Expenditures	15.9	17.6	14.8	17.6
Overall Fiscal Deficit (cash basis)*	-3.3	-4.4	-5.4	-4.8
Current Account Balance*	-5.6	-1.3	-4.5	-5.7

* After 2001: not including post-crisis program financing

Source: Ministry of Finance, IMF, World Bank

26. The macroeconomic outlook for 2003 is positive but recovery will occur from a very low base as GDP is expected to shrink by 11.9 percent in 2002. Table 7 includes key macroeconomic indicators for the years 2002 and 2003. Industrial activity is forecast to bounce back next year but a negative production impact of the crisis in the forestry sector would likely lead to a further decline in activity in the secondary sector. Both revenues and expenditures of the public sector would be close to pre-crisis levels in 2003, as would the fiscal deficit.

27. Sufficient support to meet the external financing gap for both 2002 and 2003 has been pledged during the Paris meeting. Table 8 shows that, due to the crisis, trade flows declined strongly; compared to 2001, exports are set to shrink by 45 percent, imports by 35 percent. Strong declines in project grants and project financing as well as a collapse of direct investment flows results in an external financing gap in 2002 of US$117.8 million. The European Union, France, Mauritius and the IMF are expected to provide balance-of-payments support. For IDA, restructuring and disbursement of the Second Structural Adjustment Credit contributed US$42.2 million to closing the gap and the proposed Emergency Economic Recovery Credit would supply another estimated US$20.0 million. For 2003, IDA's contribution would consist of the remaining disbursement of the EERC (US$30.0 million) while other major contributors would be the African Development Bank, the European Union, France, Japan and the IMF.

Table 8: Balance of Payments and the External Financing Gap
(in USD, million)

	2001	2002 (originally planned)	2002 (proj.)	2003 (proj.)
Exports (goods and services)	1,316.5	1,262.0	759.1	1,026.8
Imports (goods and services)	1,462.1	1,716.5	1,020.8	1,414.0
Factor services, net (due basis)	-59.5	-61.2	-77.0	-71.3
Current Transfers*	145.9	166.1	96.5	138.0
Current Account Balance*	-59.1	-349.5	-242.1	-320.4
Capital (project) Grants	112.8	192.7	52.3	84.0
Foreign Direct Investment	93.1	59.8	21.6	41.0
Long-term disbursements	114.8	180.9	99.2	146.9
Projects	76.9	138.5	61.3	139.0
Program (pre-crisis)	34.1	35.8	37.9	0.0
Other	3.8	6.6	0.0	7.9
Repayments (due)	87.4	122.4	103.1	94.0
Net Flows on Long-term Debt (due basis)	27.4	58.5	-3.9	53.0
Other Private Flows and Reserve Accumulation	-245.1	-37.4	-20.0	-67.4
Debt Relief (Paris Club)	71.0	75.8	74.4	66.4
External Financing Gap*	0.0	0.0	117.8	143.5
Post-crisis BoP support:			117.8	143.5
IDA			62.9	29.3
Third Tranche of Struc. Adjust. Credit II			42.2	0.0
EERC			20.7	29.3
IMF			14.7	30.0
AfDB			0.0	20.0
European Union			33.5	33.6
Bilateral donors (including France, Japan, Mauritius)			6.7	30.5

* Not including/before post-crisis program financing
Source: Ministry of Finance, IMF, World Bank

V. PLANNED INTERIM SUPPORT STRATEGY

28. The Bank's objective is to assist the Government to mitigate the impact of the crisis on the poor by supporting selected areas of the Government's program. Bank instruments used in response to crises include : portfolio restructuring, new lending (including an emergency credit) and policy dialogue. The mix of these instruments is determined by (i) the Bank's objective of limiting the impact on the poor; and (ii) the activity of other partner organizations in Madagascar. Table 9 outlines the planned instruments by objective.

Table 9: Government Strategy and Bank Instruments

	Support to Most Vulnerable	*Assisting Private Sector in Recovery*	*Ensuring Minimum of Public Service Delivery*	*Improving Governance and reducing corruption*
Portfolio Restructuring	Child Nutrition, Community Development, Micro-finance	PSD-2, Transport	Health, Education, Rural Development	Second Structural Adjustment Credit
New Lending	Rural Transport ($80 million)	EERC ($50 million)		Mineral resource governance project ($30 million)
Policy Dialogue/ ESW	Rural Development and Poverty, Poverty monitoring w/ partners	Tourism Sector Note, EPZ study	Decentralization Study	Country Procurement Assessment, Country Financial Accountability Assessment

Impact of the Crisis on the Bank's Portfolio in Madagascar

29. The Bank's portfolio consists of 19 projects with total commitments of around US$816 million, of which about US$338 million was disbursed as of end-September 2002. Of total commitments, 36 percent are in the social sectors, 20 percent in infrastructure, transport, energy and mining, 16 percent in rural development and environment, 10 percent in institutional development, and 18 percent correspond to macro-economic adjustment. In December 2001, before the crisis started, implementation of all projects but one was rated satisfactory.

30. Portfolio implementation during the crisis greatly suffered because: (i) counterpart funds were not available; (ii) procurement of certain goods and works was stopped due to problems within the relevant Government agencies; (iii) decision-making authority was unclear; (iv) sector ministries were unable to function; and (v) project activities could not be carried out in certain areas of the country. As a result, by the end of July 2002, the implementation performance of 16 projects out of 19 was rated unsatisfactory, and among them, five projects were unlikely to achieve their development objectives. In addition, two projects: (i) Second Private Sector Development Project and (ii) Multisectoral HIV/AIDS Prevention Project failed to be made effective due to unclear decision-making authority. Five projects – Capacity Building, Energy II, Environment, Social Fund, and Urban Infrastructure – had to have their closing dates extended so as to be able to complete implementation.

Restructuring Projects and Improving Implementation

31. Given the importance of the portfolio as an effective and rapid tool to support the Government during the transition period the Bank, as the first step in its interim strategy, is restructuring the country portfolio to reflect the country's new realities and emerging priorities.

32. Support to Most Vulnerable. Work began during the crisis with the use of the *Nutrition* and *Community Development* projects to finance emergency social safety net activities implemented by CARE and Catholic Relief Services. In addition, the *Community Development* Project is being restructured to add a new component to provide a more permanent social safety

net mechanism. Under this new component, reputable NGOs could apply for financing to undertake social safety net activities that create short-term employment and provide revenues for poor families. The *Second Community Nutrition Project* has also been expanded to include urban sites where focus will be placed on providing young children and pregnant and lactating women in the hardest hit areas with supplementary feeding and counseling on more appropriate coping mechanisms. In partnership with the health project, recuperation centers for severely malnourished children are being improved and re-equipped as well as provided with food supplies. The *Micro-finance* project is being restructured to provide support to networks facing liquidity issues, with particular emphasis on the most vulnerable, mostly women unable to initially access micro finance credit.

33. Public Service Delivery. The *Second Health Sector Support* project is being restructured to put more emphasis on the development of health districts to improve service delivery, and on the purchase of needed drugs and medical supplies. The *Education Sector Development* project will finance supplemental nutrition to all children in primary schools on a regular basis. Additionally, the project would provide school pedagogic grants to cover the daily schooling costs of children, including supplies and books. In response to the declining rural incomes during the crisis, the *Rural Development Project* will help farmers' groups obtain access to inputs during the next agricultural season.

34. Private Sector Recovery. The *Second Private Sector Development* project will be restructured to address not only the privatization agenda as originally envisaged, but also the short-term requirements to re-launch private sector activity. Private sector activity is also being hampered by weak transport infrastructure, as roads and bridges were destroyed during the crisis, or were simply left to deteriorate for lack of maintenance. Hence, implementation of the *Transport Sector Reform and Rehabilitation Project* will be accelerated to ensure the rehabilitation of high priority roads.

35. Governance and anti-corruption. The *Second Structural Adjustment Credit* was restructured to reflect the new Government's emphasis on good governance and fighting corruption. The credit now focuses on a number of actions to improve the management and control of public finances, and measures to deal with corruption. First, an anti-corruption task force has been established which will develop an ethic code for public officials and prepare an array of anti-corruption legislation. The task force will draft the terms-of-reference for a fully independent corruption investigating agency. Second, the Government passed a decree which will require public and elected officials to regularly declare all their assets and those of their close relatives, regardless of where these assets are held. Third, in response to the significant overspending of the president's special fund in 2001, the Government has mandated the *Chambre de Compte* to conduct regular, semi-annual audits of all public special funds. Fourth, internal control organs are to be strengthened. To facilitate transparency and efficiency in budget planning, the Government has merged the finance and budget ministries which had been recommended by various partner organizations for several years. This will finally allow for integrated planning of investments and operating expenses.

36. Increased use of credit funds through more efficient implementation. A key objective is to accelerate implementation of project activities. The main constraint facing the Government identified during the portfolio missions in July 2002 is the lack of counterpart funding caused in

part by cash flow problems. Lacking counterpart funding is not a new problem but has substantially worsened during the crisis. In response, disbursement percentages for selected projects are being raised to 100 percent of foreign expenditures and 100 percent of expenditures net of taxes on an exceptional basis for a period starting now till end December 2003.[1]

37. Two other measures are being undertaken, where applicable. First, the special account ceiling is being increased for some projects (e.g. the Second Community Nutrition project and the Community Development Fund) in response to urgent needs, and thresholds for withdrawal applications are being lowered to ease backlogs of expenditures. Second, in terms of procurement procedures, thresholds for prior review are being adjusted in selected cases.

38. Seven projects in the portfolio are closing this fiscal year: *Mining*, the *Capacity Building Project*, the *Third Social Fund* project, the *Second Environment Project*, the *Second Energy Project*, the *Second Structural Adjustment Credit* and the *Private Sector and Capacity Building Project*. Further, the *Regional Development Learning and Innovation Loan*, has as its objective to assist the government and the country's economic regions in developing model methodologies and tools to promote regional development and facilitate investment programming. This project has not performed well since effectiveness and has disbursed little. The project will hence be closed. A separate Memorandum of the President (Report No. P7561-MAG) on the specific restructuring actions, project by project, is attached.

Policy Dialogue

39. The Bank is planning to support the new Government through analytical work and policy dialogue in several areas. Most of the studies had already commenced before the crisis and are now re-orientated to meet urgent information needs. Policy notes have already been produced on recent poverty developments, the economic cost of the crisis and priorities for reconstruction, as well as on short-term policy to strengthen communities. In addition to the ongoing work on poverty monitoring, the Bank plans to continue working on six formal analytical studies which will also feed into the preparation of the PRSP and will be future building blocks for a possible next adjustment operation. The work includes a report on rural development and poverty reduction, a decentralization study, a study on measures to revive the EPZ, a tourism study, a financial management review, and a country procurement review. A report on poverty developments was completed in FY02. Thus all of IDA's core economic diagnostic work is expected to be up to date by the end of FY03 with the exception of a public expenditure review and a Country Economic Memorandum which the Bank intends to carry out in FY04 and FY05 respectively. The program of analytical work also provides the basis for a future Poverty Reduction Strategy Credit (PRSC) which is foreseen during the CAS period following this interim CAS.

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[1] Projects benefiting from the increase in disbursement percentages include the Community Development Fund, the Sector Health Sector Support Project, the Education Sector Development Project, the Second Community Nutrition Project, the Multisectoral STI/HIV/AIDS Prevention Project, Rural Development, Rural Water Sector Pilot, Microfinance, Urban Infrastructure, Transport Reform and Rehabilitation, and the Second Private Sector Project.

New Lending

40. For the period November 2002-June 2003, this interim CAS foresees three new lending operations for a total of about $160 million. Two of the proposed lending operations, the Emergency Economic Recovery Credit (Report No. PE-PO80345 MG) and the Rural Transport Project (Report No. 23352-MG), are presented jointly with this interim CAS to the Board for approval.

41. Emergency Economic Recovery Credit (US$50 million). To address urgent financing needs for the next 12 months which cannot be provided through the existing Bank portfolio, Bank management proposes to make available US$50 million to help Madagascar re-launch its economy and support the country's most urgent needs. Disbursement will be against a positive list of imports, and it is expected that about one-third of the credit will disburse in 2002 and the remainder in 2003. The counterpart funds would be used to support the entire Government reconstruction program. This credit complements balance of payments support in 2002 and 2003 from the African Development Bank, the European Union, France, Japan, the IMF and Mauritius.

42. Rural Transport Project ($80 million). Poverty in Madagascar is more widespread in rural areas and its incidence is closely linked to isolation from markets and social services. Rural poverty worsened significantly during the crisis, largely driven by a worsening of the rural terms-of-trade due to increasing transport costs. Focus group discussions carried out in every community in Madagascar over the past months have shown that construction of roads is the number one priority of the majority of rural communities. The project will help lower the access costs of rural communities to markets, schools, health centers and other economic and social infrastructure; and enhance the mobility of the rural population to improve their quality of life. This will be done through rehabilitating rural roads, restarting the operation of the Southern Railway, and introducing alternative modes of transport. This project is part of a sector-wide program co-financed by the European Union, the African Development Bank and the Arab Bank for Economic Development in Africa.

43. Mineral Resources Governance Project ($30 million). Severe governance problems have characterized Madagascar's mining sector for years but the crisis offers the possibility to decisively reduce illegal activities in the sector. The country is very rich in minerals and precious stones and 2300 operators are active in the sector today, generating direct and stable employment for about 100,000 workers and an additional up to half a million seasonal jobs. Since 1996, official mining exports have increased from US$16 million to US$37 million, largely in precious stones trading. But poor governance and corruption in the sector have discouraged many formal investors and have led to a smuggling of precious stones out of Madagascar with very little value added being created in the country. Illegal exports are a multiple of official exports and estimates put the value of trafficking in precious stones at a minimum of US$500 million (or 10 percent of GDP) per year. As a result of the crisis as well as anti-corruption announcements of the Government, illegal activities have slowed down and there is now a short window of opportunity to reverse the situation. Quick action is necessary, though, before the illegal activities restart in full strength. Also, improving governance in the sector, and

thereby formalizing mining operations, is one of the most important actions to improve internal revenue generation in Madagascar, much needed to extend basic services and expenditures for anti-poverty programs.

44. The objectives of the Mineral Resources Governance Project are to (i) strengthen transparency and governance in the management of mineral resources, with special emphasis on small-scale and artisanal mining, (ii) support key institutional reforms for the decentralized management of mineral resources; and (iii) promote private investments and value-added in the mining sector. Central to the idea of improving governance in the sector is to formalize trading of precious stones. For this, much of the cutting and polishing of stones would need to be moved to Madagascar, including quality certification. Further, the project would support local management of mineral resources through the creation of 'Special Economic Zones' which would seek to integrate mining exploitation in a local economic, social and environmental development plan. The Zones would be administered locally and, among other tasks such as helping communities to establish land demarcations, they would also oversee the trading of precious stones. The operation is being prepared with support from USAID and the French Cooperation.

Coordination with Partners, Monitoring and Preparation of a Full CAS

45. Coordination with Partners. During the crisis and in formulating the recovery program, the Bank worked very closely with all the development partners. The Bank organized weekly meetings with all multilateral, bilateral and NGO partners to assess the impact of the crisis and debate post-crisis reconstruction tasks. Similarly, the Bank team participated in the UN working groups to draft sectoral contingency plans in the event that the crisis worsened. The emergency social safety net operation was financed and implemented jointly with the EU, Agence française de Développement, USAID, WFP, UNICEF, CARE and CRS. The Bank also co-organized the 'Friends of Madagascar' meeting jointly with the UNDP and the European Commission. The representative of countries and organizations agreed that a number of follow-up roundtables would be organized in Madagascar to coordinate Government and partner interventions at the sectoral level.

46. This Interim Strategy has been developed in close cooperation with staff of the International Monetary Fund, especially with regard to ensuring adequate financing of the Government's recovery program. An IMF mission visited Madagascar in October and is expected to present a reformulated Poverty Reduction and Growth Facility program to the IMF Board in December 2002.

47. The International Finance Corporation has recently conducted a mission to Madagascar to assess the post-crisis situation and needs of the private sector. Before the crisis, IFC had a small but growing portfolio (US$7 million, 7 projects) in Madagascar and is actively seeking to further expand its engagement. Several potential IFC projects which had been identified might require additional capitalization, given the losses most private firms have endured for the year.

48. Monitoring of the Crisis and the Interim CAS. The objective of this interim CAS is to assist the Government to limit, and if possible reverse, the impact of the crisis on the poor.

Given that the planned instruments cover most sectors, monitoring of the interim CAS is closely linked to the monitoring of key poverty and social development indicators. The following indicators will be reviewed during the I-CAS period:

(i) rate of school continuation at the beginning of the new school year (September/ October) for primary and secondary school children (target: 95 percent of all children enrolled in first to third grade in June 2002 school year to continue schooling in 2002/2003 school year);
(ii) drop-out rate during the 2003 school year (target: less than 10 percent drop-out rate in primary school during the year);
(iii) number of health consultations in formal health facilities (target: number of visits in 100 selected health facilities included in baseline survey of January 2002 which averaged 50 per week and facility);
(iv) number of health facilities offering assisted birth and number of assisted births (target: January 2002 availability in 100 selected health facilities which was 80 percent);
(v) availability of basic medicines (target: January 2002 level of availability of 16 basic drugs in 100 visited health facilities which was 89 percent);
(vi) formal industrial employment in export processing zone (target: 60,000 workers);
(vii) qualitative assessment of income development of rural households (target: focus group discussions in 72 communities -- visited during the crisis -- report significant rise in rural incomes compared to crisis period); and
(viii) rural terms-of-trade (relative price of farm produce to basic manufactured consumer items). Basic consumer items in the basket would be items as salt, sugar, lamp petroleum, and vegetable oil. Target: same relative price as in pre-crisis period.

49. The above mix of indicators would provide a good assessment of poverty and social developments over the coming year. The Bank plans to monitor primarily these as opposed to others (such as percentage of bad debts of private banks, growth of exports or industrial production) since most of the above indicators will depend on household income developments while this cannot be inferred directly from more structural or broader economic indicators. Further, the Bank will not make a distinction between country and Bank performance indicators since the time period towards the full CAS is relatively short and our overall goal is to reverse the crisis impact on the poor. In addition to the above, though, the Bank would assess macro-economic developments together with the International Monetary Fund, concentrating on the inflation rate, exchange rate developments and management of the public deficit.

50. The Bank has agreed with several institutions in Madagascar (the statistical institute INSTAT, the agricultural research institute FOFIVA, USAID, Cornell and Oxford universities) to monitor the recovery and social situation of the population closely. While fielding a full household survey would be very costly and time-consuming, the Bank will jointly prepare a rapid survey, combining the assessment of key quantitative and qualitative indicators. This rapid survey, to be undertaken in December 2002 and June 2003, would be comparable to a baseline survey conducted in June 2002.

Status of HIPC initiative and PRSP

51. Madagascar reached the decision point of the Heavily Indebted Poor Countries' (HIPC) initiative in December 2000. Then, Executive Directors approved debt relief amounting to US$252 (net present value) from IDA as part of a total debt relief of US$814 million (net present value), subject to Madagascar satisfying the completion point conditions. The debt relief had been calculated so as to bring the net present value of Madagascar's debt to export ratio to a target of 150 percent. The Malagasy political crisis with its economic and social percussions will have important consequences for the sustainable level of debt for the country. Reassessing the sustainable path of new borrowing at this point is somewhat premature, however, since macroeconomic projections as well as trade developments are very uncertain. A detailed analysis of Madagascar's external debt situation will be presented at the time of the full CAS in September 2003.

52. The new administration is committed to continuing the preparation of a full Poverty Reduction Strategy Paper. This process was started in the fall 2000 and an interim strategy was presented to the Boards of the Bretton Woods organizations in December 2000. Building on the I-PRSP, a large number of thematic and regional consultations took place in 2001 and a draft of the full PRSP was widely distributed in December 2001. The new administration has announced that it will continue the preparation of the PRSP but that it will, in view of the crisis and its poverty impact, review important priorities contained in the strategy. A new budget and action plan also needs to be drafted. This I-CAS supports the development of the PRSP, especially through the planned work on poverty monitoring and the planned analytical work in several sectors. The Government expects to present the full PRSP to the Bank and Fund Boards not later than September 2003.

Risks

53. There are four key risks facing Madagascar that could adversely affect implementation of this interim CAS: (i) renewed political instability following parliamentary elections scheduled for December 2002; (ii) insufficient financing of the program which could lead to macro-instability, large deficits and inflation; (iii) inability of Government to implement the proposed program and reforms due to weak institutions and lacking implementation capacity; and (iv) lack of private sector confidence which would delay the recovery. Table 10 outlines what efforts are planned by the Bank and its partners to mitigate these risks.

54. While the new Government has widespread popular support and is in full control of the national territory, the risk of renewed political instability cannot be ignored. Many members of the elite who benefited under the previous administration have witnessed a decline in their power and access to rents. Hence, it is conceivable that those associated with the previous regime will try to destabilize the Government in an effort to regain past privileges. To reconfirm its legitimacy, Government has called for early parliamentary elections, now set for December 15, 2002. It has promised a transparent, democratic election, and is supported in its efforts by

technical and financial help from UNDP, the EU and a number of bilateral partners. Successful completion of those elections should mark the end of Madagascar's transition to a new regime.

Table 10: Risks and Mitigating Efforts

Risk	*Mitigating Efforts*
Renewed political instability following parliamentary elections in December 2002.	• UNDP, the EU and several bilateral partners are planning to support Government in the preparation of legislative elections to ensure that they are fair and transparent.
Insufficient financing of the program.	• In October, IMF/Bank mission completed discussions with Government and other donors and ensured adequate budgetary support for 2002 and 2003.
Inability of government to implement the program due to weak institutional capacity and lacking implementation capacity.	• EU/IMF/UNDP/Bank advice on simplified budgetary procedures in post-crisis setting ongoing; • Completion of Country Portfolio Performance Review in October with decisions on disbursement percentages and disbursement/procurement procedures.
Lack of private sector confidence which would delay the recovery	• Government has created a consultative committee between the public and private sector to design business-friendly policies and monitor the recovery. (The committee will be supported by the Second Private Sector Development Project). The committee holds regular meetings to build confidence and has organized promotion tours in France, Germany and the United States • The priority recovery program supported by the Emergency Economic Recovery Credit supports actions to support private sector recovery which, when materializing, are expected to raise private sector confidence in the recovery program

55. The tight budgetary situation is another risk factor. Success of the economic recovery program will depend on Government's ability to repay arrears to the private sector, finance much needed public investments and safety net programs, as well as other priority expenditures, such as the parliamentary elections. Low revenues, resulting from the depressed economy, and slow donor disbursements could make it difficult for Government to honor its obligations, and result in a failure of its program. In order to mitigate this risk, Government has worked with the IMF on updating the PRGF. It has taken measures to improve revenue collection and cut non-priority expenditures. It has also mobilized exceptional budgetary support from the African Development Bank, the EU, France, Japan, Mauritius and the World Bank.

56. Inadequate administrative capacity and weak governance are very important risk factors. While the recovery program is well conceived and there is a clear political will at the highest levels of Government to implement it, it is not clear that Madagascar's administration which is plagued by inefficiencies and corruption will be able to follow. This is particularly true in the areas of executing the public investment program and providing an appropriate climate for private sector development. To mitigate this risk, Government is working with support of several partners on a program to streamline and improve budgetary procedures, and has launched an anti-corruption campaign. Success in putting in place a system of good governance is a pre-requisite for sustainable and rapid poverty reduction in Madagascar.

57. Resumption of growth can only occur if private sector investment, and particularly foreign direct investment, return to Madagascar. Private companies operating in Madagascar have lost important sums during the crisis and many of them have closed or have relocated elsewhere. As part of the post-crisis emergency program, Government has provided a number of fiscal incentives for private sector firms to return to Madagascar and it is seeking to expand and extend such incentives. Schemes are also being considered to share risks between the enterprises, private banks and the Government so as to facilitate the provision of credit to the private sector. Finally, the Government plans to strengthen and institutionalize the cooperation between the public and the private sector so as to obtain constant feedback and suggestions for improving the private sector investment climate.

James D. Wolfensohn
President

By Shengman Zhang

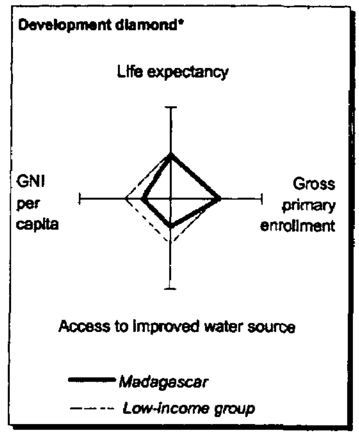
Washington, D.C.
October 23, 2002

Annexes

Madagascar at a glance

10/22/02

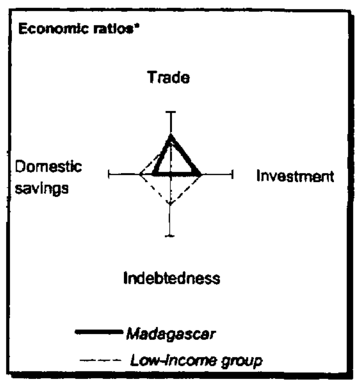
POVERTY and SOCIAL	Madagascar	Sub-Saharan Africa	Low-Income
2001			
Population, mid-year *(millions)*	16.0	674	2,511
GNI per capita *(Atlas method, US$)*	260	470	430
GNI *(Atlas method, US$ billions)*	4.2	317	1,069
Average annual growth, 1995-01			
Population *(%)*	3.1	2.5	1.9
Labor force *(%)*	3.1	2.6	2.3
Most recent estimate (latest year available, 1995-01)			
Poverty *(% of population below national poverty line)*	..	..	..
Urban population *(% of total population)*	30	32	31
Life expectancy at birth *(years)*	55	47	59
Infant mortality *(per 1,000 live births)*	92	91	76
Child malnutrition *(% of children under 5)*	40	..	..
Access to an improved water source *(% of population)*	47	55	76
Illiteracy *(% of population age 15+)*	33	37	37
Gross primary enrollment *(% of school-age population)*	102	78	96
Male	104	85	103
Female	100	72	88



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

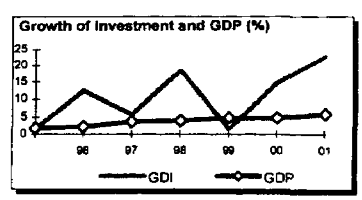
	1981	1991	2000	2001
GDP *(US$ billions)*	..	2.7	3.9	4.5
Gross domestic investment/GDP	..	8.2	16.2	17.9
Exports of goods and services/GDP	..	18.1	30.4	29.3
Gross domestic savings/GDP	..	-0.3	6.5	10.6
Gross national savings/GDP	..	0.1	8.1	12.5
Current account balance/GDP	..	-7.1	-5.6	-1.3
Interest payments/GDP	..	2.5	..	..
Total debt/GDP	..	147.3	106.2	91.5
Total debt service/exports	27.4	29.1	..	..
Present value of debt/GDP	..	..	..	..
Present value of debt/exports	..	..	..	..

	1981-91	1991-01	2000	2001	2001-05
(average annual growth)					
GDP	1.8	2.9	4.8	5.9	..
GDP per capita	-0.9	-0.2	1.6	2.8	..
Exports of goods and services	1.7	4.5	15.4	6.0	..

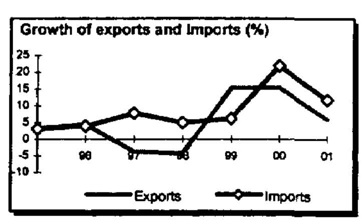


STRUCTURE of the ECONOMY

	1981	1991	2000	2001
(% of GDP)				
Agriculture	33.1	29.7	27.1	25.2
Industry	14.1	13.1	12.1	12.3
Manufacturing	..	11.0	10.3	10.2
Services	52.8	57.2	60.9	62.5
Private consumption	..	91.5	85.7	80.8
General government consumption	..	8.8	7.9	8.6
Imports of goods and services	..	26.7	40.2	36.5



	1981-91	1991-01	2000	2001
(average annual growth)				
Agriculture	2.7	2.0	1.0	4.0
Industry	2.5	3.2	7.1	7.4
Manufacturing	1.5	2.9	5.6	9.4
Services	0.8	3.3	4.8	5.9
Private consumption	0.1	2.8	4.9	3.7
General government consumption	0.3	1.3	4.6	15.7
Gross domestic investment	6.8	7.9	14.8	22.6
Imports of goods and services	-3.3	6.6	21.9	11.8



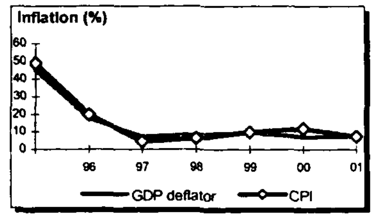
Note: 2001 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Madagascar

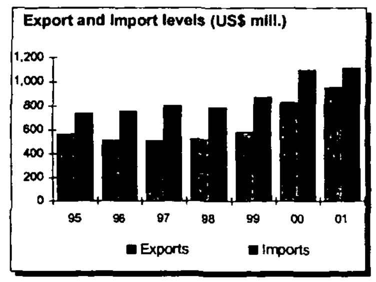
PRICES and GOVERNMENT FINANCE

	1981	1991	2000	2001
Domestic prices				
(% change)				
Consumer prices	..	8.5	11.9	7.4
Implicit GDP deflator	..	12.9	7.1	7.4
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	10.1	12.4	11.6
Current budget balance	..	-0.1	3.2	1.3
Overall surplus/deficit	..	-6.6	-5.7	-6.8



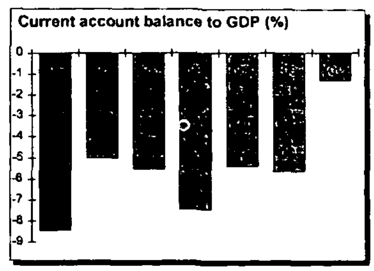
TRADE

	1981	1991	2000	2001
(US$ millions)				
Total exports (fob)	313	334	829	953
Coffee	112	28	8	3
Vanilla	9	47	58	164
Manufactures	..	153	618	557
Total imports (cif)	608	518	1,098	1,118
Food	99	35	77	84
Fuel and energy	127	71	212	168
Capital goods	191	165	149	144
Export price index *(1995=100)*	123	97	108	132
Import price index *(1995=100)*	..	89	92	94
Terms of trade *(1995=100)*	..	108	117	140



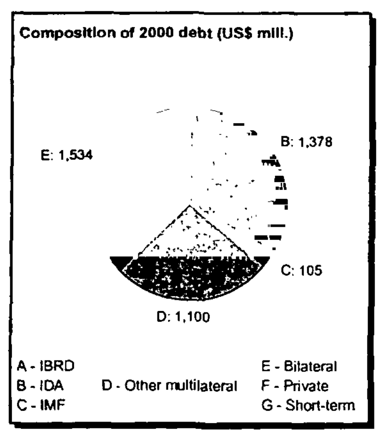
BALANCE of PAYMENTS

	1981	1991	2000	2001
(US$ millions)				
Exports of goods and services	394	480	1,186	1,317
Imports of goods and services	785	681	1,467	1,462
Resource balance	-391	-200	-280	-146
Net income	N/A	-167	-74	-59
Net current transfers	12	179	135	146
Current account balance	N/A	-188	-219	-59
Financing items (net)	..	205	247	157
Changes in net reserves	N/A	-17	-28	-98
Memo:				
Reserves including gold *(US$ millions)*	N/A	90	301	396
Conversion rate *(DEC, local/US$)*	271.7	1,835.4	6,767.5	6,587.2



EXTERNAL DEBT and RESOURCE FLOWS

	1981	1991	2000	2001
(US$ millions)				
Total debt outstanding and disbursed	1,613	3,908	4,117	4,147
IBRD	31	23	0	0
IDA	155	881	1,378	1,409
Total debt service	110	161	..	..
IBRD	3	5	2	0
IDA	1	9	27	20
Composition of net resource flows				
Official grants	59	113	147	145
Official creditors	189	161	..	..
Private creditors	63	-11	..	..
Foreign direct investment	..	..	..	..
Portfolio equity	..	..	..	..
World Bank program				
Commitments	30	51	..	..
Disbursements	34	106	94	97
Principal repayments	1	6	17	10
Net flows	34	100	77	87
Interest payments	3	8	12	11
Net transfers	30	92	65	76



Madagascar - Key Economic Indicators

Indicator	Actual 1996	1997	1998	Estimate 1999	2000	2001
National accounts (as % of GDP)						
Gross domestic product[a]	100	100	100	100	100	100
Agriculture	32	32	31	30	35	35
Industry	14	13	14	14	13	13
Services	55	55	56	56	52	52
Total Consumption	93	95	93	93	92	92
Gross domestic fixed investment	12	13	15	15	15	18
Government investment	7	7	8	7	7	8
Private investment	5	6	7	8	8	10
Exports (GNFS)[b]	20	22	22	24	31	24
Imports (GNFS)	25	30	29	32	38	34
Gross domestic savings	7	5	7	7	8	8
Gross national savings[c]	7	7	7	10	9	10
Memorandum items						
Gross domestic product (US$ million at current prices)	4001	3546	3739	3721	3878	4523
GNP per capita (US$, Atlas method)	250	250	260	250	260	270
Real annual growth rates (%, calculated from 1984 prices)						
Gross domestic product at market prices	2.1	3.7	3.9	4.7	4.8	5.9
Gross Domestic Income	2.7	2.5	4.0	4.1	6.4	7.7
Real annual per capita growth rates (%, calculated from 1984 prices)						
Gross domestic product at market prices	-1.0	0.5	0.8	1.5	1.6	2.8
Total consumption	-1.9	1.0	-1.5	0.8	5.1	3.6
Private consumption	-8.2	2.6	-1.0	2.1	5.4	7.2
Balance of Payments (US$ millions)						
Exports (GNFS)[b]	796	774	805	910	1186	1321
Merchandise FOB	512	507	522	584	829	947
Imports (GNFS)[b]	998	1061	1095	1198	1467	1668
Merchandise FOB	629	682	672	742	930	1067
Resource balance	-202	-286	-290	-288	-280	-346
Net current transfers	159	182	85	129	135	172
Current account balance	-201	-196	-278	-201	-219	-265
Net private foreign direct investment	10	14	16	58	70	112
Long-term loans (net)	..	..	..	..	..	..
Official	98	219	45	-14	..	..
Private	..	..	..	..	..	..
Other capital (net, incl. errors & ommissions)	..	..	..	..	..	..
Change in reserves[d]	-134	-54	104	-46	-28	-80
Memorandum items						
Resource balance (% of GDP)	-5.1	-8.1	-7.8	-7.7	-7.2	-7.7
Real annual growth rates (YR84 prices)						
Merchandise exports (FOB)	2.7	7.2	-1.5	16.0	33.8	13.9
Primary	3.4	-23.1	-7.4	25.0	-13.6	-11.4
Manufactures	12.8	11.2	17.9	19.6	-2.2	..
Merchandise imports (CIF)	16.7	5.5	-14.4	19.9	16.7	8.3

Madagascar - Key Economic Indicators (Continued)

Indicator	Actual			Estimate		
	1996	1997	1998	1999	2000	2001
Public finance (as % of GDP at market prices)[e]						
Current revenues	10.1	11.8	10.9	12.1	12.4	11.6
Current expenditures	14.4	10.9	10.5	9.3	9.2	10.3
Current account surplus (+) or deficit (-)	-4.4	0.9	0.4	2.8	3.2	1.3
Capital expenditure	7.1	6.5	9.4	8.5	9.0	7.3
Foreign financing	8.5	7.0	5.1	4.1	5.6	4.6
Monetary indicators						
M2/GDP	19.8	21.3	20.5	21.3	22.5	24.7
Growth of M2 (%)	18.1	19.8	8.4	19.5	18.8	24.4
Private sector credit growth / total credit growth (%)	346.0	196.6	1.7	-22.7	31.2	36.9
Price indices(YR84 =100)						
Merchandise export price index	93.4	86.2	90.2	86.9	92.2	92.5
Merchandise import price index	54.4	54.5	62.8	57.9	58.4	57.4
Merchandise terms of trade index	171.8	158.1	143.6	150.2	157.8	161.3
Real exchange rate (US$/LCU)[f]	53.9	48.5	48.9	47.6	52.4	56.7
Real interest rates						
Consumer price index (% change)	19.8	4.5	6.2	9.9	11.9	7.4
GDP deflator (% change)	17.8	7.3	8.4	9.8	7.1	7.3

a. GDP at factor cost
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Consolidated central government.
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Madagascar - Key Exposure Indicators

	Actual						
	1995	1996	1997	1998	1999	2000	2001
Total debt outstanding and disbursed (TDO) (US$m)[a]		4433	3857	3983	4047	4117	4147
Net disbursements (US$m)a (Due basis)		-37	82	-31	14	70	6
Total debt service (TDS) due (US$m)a		338	218	223	155	154	144
Adjustment to scneduled debt service (US$m)[b]		253	10	68	60	69	71
Debt service paid		85	207	155	95	84	73
Debt and debt service indicators (%)							
TDO/XGS[c]		551.1	485.8	480.7	434.8	340.7	309.4
TDO/GDP		110.8	108.8	106.5	108.8	106.2	91.5
TDS/XGS (Due basis)		42.0	27.5	26.9	16.7	12.7	10.7
IBRD exposure indicators (%)							
IBRD DS/public DS		5.9	1.9	1.4	0.6	..	..
Preferred creditor DS/public DS (%)[d]		86.5	59.4	56.6	47.4	..	..
IBRD DS/XGS		0.6	0.5	0.2	0.1	0.2	0.0
IBRD TDO (US$m)[e]		7	3	1	0	0	0
IDA TDO (US$m)[e]		1147	1212	1317	1415	1378	1409

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. Includes debt rescheduling, changes in arrears, and other debt adjustments

c. "XGS" denotes exports of goods and services, including workers' remittances.

d. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

e. Includes present value of guarantees.

Madagascar
Statement of IFC's
Held and Disbursed Portfolio

As of 6/30/2002
(In US Dollars Millions)

		Held				Disbursed			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1991	BNI	0	2.61	0	0	0	2.61	0	0
2000	BOA-M	0	0.82	0.56	0	0	0.82	0.56	0
1983/89	Nossi-Be	0	0.14	0	0	0	0.14	0	0
1990/91	AEF FIARO	0	0.19	0	0	0	0.19	0	0
1997	AEF GHM	0.67	0	0	0	0.67	0	0	0
1995	AEF Karibotel	0.22	0	0	0	0.22	0	0	0
1992/93/95	AQUALMA	0.71	0	0	0	0.71	0	0	0
	Total Portfolio:	1.6	3.76	0.56	0	1.6	3.76	0.56	0

Approvals Pending Commitment

	Loan	Equity	Quasi	Partic
2001 Besalampy	15233.24	0	0	0
2001 COTONA III	7764.75	0	0	0
Total Pending Commitment:	22997.99	0	0	0

Madagascar

Operations Portfolio (IBRD/IDA and Grants)

As of date 10/22/02

Closed Projects 69

IBRD/IDA *

Total Disbursed (Active)	203.74
of which has been repaid	0.00
Total Disbursed (Closed)	1,518.89
of which has been repaid	184.18
Total Disbursed (Active + Closed)	1,722.62
of which has been repaid	184.18
Total Undisbursed (Active)	408.94
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	408.94

Active Projects

		Last PSR Supervision Rating			Original Amount in US$ Millions					Difference Between Expected and Actual Disbursements a/	
Project ID	Project Name	Development Objectives	Implementation Progress	Fiscal Year	IBRD	IDA	GRANT	Cancel.	Undisb.	Orig.	Frm Rev'd
P040019	CAPACITY BUILDING	S	U	1997		13.83			0.000404	0.9	0.8374077
P055166	COMMUNITY DEVELOPMENT PROJECT	S	S	2001		110			99.35171	7.3	
P001559	EDUCATION SECTOR DEV	S	U	1998		65			42.0622	43.7	5.5592411
P001537	ENVIRON. II	U	U	1997		30			1.033319	3.4	
P040596	ENVIRONMENT II	U	#	1997			12.8		3.692312	1.8	
P051922	MG - Rural Development Support Project	S	U	2001		89.05			86.50417	-4.6	
P001533	MG ENERGY SECTOR DEVELOPMENT PROJECT	U	U	1996		46			8.108937	11.9	
P052186	MICRO FINANCE	S	U	1999		16.4			9.012426	5	
P056487	MINING PROJECT	S	U	1998		5			0.832409	0.8	0.8482816
P072987	Multisectoral STI/HIV/AIDS	S	S	2002		20			20.78131		
P001568	NUTRITION II	S	S	1998		27.6			9.289585	4.3	
P001555	PRIV SECT DEV & C.B.	S	U	1997		23.8			1.240749	2.2	2.134881
P001564	RURAL WATER SEC.PILO	S	S	1998		17.3			10.38084	11	
P062628	Regional Development	HU	HU	2000		4.6			4.077682	3.3	
P051741	Second Health Sector Support Project	S	U	2000		40			29.47687	9.6	
P072160	Second Private Sector Development Projec	S	U	2002		23.8			25.23865	6.5	
P052208	Transport Sector Reform and Rehabilitat.	U	U	2000		65			44.32782	12	
P048697	URBAN INFRASTRUCTURE	S	S	1997		35			17.21967	18.7	
Overall result				Result		632.38	12.8		412.6311	137.9	9.3798113

ANNEX C1: MADAGASCAR: CRISIS IMPACT

Sector	*Direct crisis impact*	*Consequences if No Action Taken*
Agriculture/ Rural	▪ production stable but significant decrease of farm prices for traditional goods (up to 50 percent in isolated communities) ▪ disruption of maintenance of infrastructure (irrigation) ▪ anti-locust campaign halted ▪ harvest collection disrupted (no credits for collectors) ▪ several agro business enterprises (e.g., in the cotton sector HASYMA) stopped production ▪ increase of crop and livestock theft	▪ locust invasion leading to widespread harvest destruction ▪ productivity decrease & lower output due to lower input use and decayed infrastructure (due to revenue loss for farmers and lacking credit) ▪ bankruptcy of agro-business
Banking and finance	▪ deterioration of credit portfolio (10% unrecoverable, 10% in need of rescheduling) ▪ no access to treasury bond holdings as bond trading suspended ▪ unmet foreign exchange demand with closure of market ▪ micro-finance institutions report significantly lower savings and credit repayment rates	▪ liquidity shortage if Central Bank maintains reserve ratios ▪ high risk for new credit provision in current economic situation ▪ increased incidence of water-born diseases
Basic services (water, electricity, sanitation)	▪ no major cuts in electricity and water supply but build-up of significant arrears of JIRAMA as local governments and universities could not pay water/electricity consumption ▪ urban pay-for-water wells/latrines much less frequented ▪ water contamination in Toamasina after cyclone Kesiny	▪ insolvency of JIRAMA ▪ increase of water-born diseases as fewer households can afford to pay for water services / public latrines
Education	▪ teaching interruption: average 40 days urban, 26 days rural ▪ urban school drop-out increased, to 14 percent per class ▪ teacher absenteeism increased, especially in rural areas where teachers paid by parents' associations ▪ inability of 17% of families to pay school material	▪ no return of students to school year in September/October due to inability of families to pay school fees ▪ parents cannot finance school material for next school year
Environment / Forestry	▪ illegal logging license provision by sub-national governments ▪ illegal export of endangered species ▪ increased production of charcoal	▪ further de-forestation due to illegal wood export and increased poverty ▪ further threat to bio-diversity
Fisheries	▪ illegal license distribution by sub-national governments	▪ over-harvesting of shrimps
Health, HIV/AIDS	▪ availability of basic medicines of health centers down 15% ▪ immunization service down 6%; interruption of cold chain ▪ health utilization down 36% rural, 14% urban. Important drop for prenatal care (9%) and assisted births (16%) ▪ delayed epidemiological assessment of STI/HIV/AIDS and delayed effectiveness of anti-HIV/AIDS project	▪ low demand for health services (in cost recovery setting) due to lower household revenues ▪ increased threats of (i) communicable diseases; (ii) (ii) infant and maternal mortality; (iii) spread of HIV/AIDS ▪ breakdown of generic drug distribution system
Industry	▪ massive firm shut-down, 150.000 additional unemployed (of which 100.000 in export processing zone) ▪ delays in VAT reimbursement ▪ accumulation of debt of firms towards private banks	▪ slow pick-up of orders in EPZ ▪ lacking investor confidence ▪ further bankruptcies of firms in debt ▪ slow economic recovery, inducing low investments
Informal sector	▪ significantly lower demand for informal services in urban areas ▪ micro-finance credit dried up ▪ collapse of rural informal sector in 20% of communities	▪ slow demand recovery for informal sector activities ▪ slow recovery in trade and commerce
Mining	▪ strong increase in illegal mining activity and export ▪ large planned mining investments put on hold	▪ large planned mining investments are withdrawn ▪ delay in establishing good governance in sector
Nutrition and Food Security	▪ transport and trade in basic foodstuff interrupted ▪ price increases: salt, sugar, vegetable oil: +100%, rice: +30% ▪ for rural poor: meat consumption down 75%, rice 25%	▪ increase in food insecurity ▪ increase in malnutrition rates
Public sector	▪ large part of central government not working for three months ▪ revenue collapse till July 2002: 50 percent ▪ public investment program at standstill till August 2002 ▪ treasury bond trading suspended ▪ financial circuit interrupted: US$15 million paid by Central Bank in Tamatave in non-regular way ▪ foreign exchange trading suspended by Central Bank	▪ fiscal gap not financed (2002, 2003) leading to cuts in basic social services and/or inflation/depreciation ▪ internal resource generation remains low with trade at low levels and company activity low (TVA, IBS) ▪ absorption of public sector cannot be increased in short run ▪ net withdrawal of treasury bonds by private banks
Tourism	▪ 95 percent collapse of tourist travel in 2002 until July	▪ slow restoration of oversees confidence ▪ Air Madagascar difficulties limit tourist travel
Trade	▪ estimated reduction of 50 percent of trade till July 2002 ▪ no participation in COMESA's joint economic partnership	▪ low confidence in future of Madagascar's exports ▪ slow economic recovery
Transport	▪ 90 percent of lorry fleet immobilized due to roadblocks ▪ petroleum price in blockaded areas increased 500% ▪ 15 bridges dynamited ▪ lack of routine maintenance of roads, northern railway ▪ Air Madagascar stopped most internal and external services ▪ cyclone Kesiny: 8 bridges destroyed; hundreds of landslides	▪ slow reconstruction of vital infrastructure ▪ under-funding of road maintenance work leading to further decay of infrastructure ▪ delays in finalizing concession of Northern Railway ▪ increased isolation of rural communities

ANNEX C2: GOVERNMENT RESPONSE, DONOR SUPPORT AND SUGGESTED WORLD BANK ACTIVITIES

Sector	Consequences if No Action Taken	Government Response /Strategy	Partner Response (other than Bank)	Planned World Bank Activities
Agriculture/ Rural	a. locust invasion leading to harvest destruction b. productivity decrease & lower output due to lower agriculture input use and decayed infrastructure c. arrears build-up to farmers due to bankruptcy of agro-business (HASYMA),	a. locust plan developed, partly funded from HIPC resources b. ag inputs tax exempt; distrib. of semen planned; storage support (HIPC) c. repayment of arrears to farmers	a. AfDB, FAO (TA), EU b. AFD (rice price financed for safety net), AfDB, FAO, Switzerland	a. TA on development of anti-locust plan b. AAA work on rural development and poverty; restructuring of Rural Development Project c. proposed Emergency Economic Recovery Credit
Banking and finance	a. liquidity shortage if Central Bank maintains reserve ratios b. high risk for new credit provision in current economic situation	a. Central Bank will lower reserve ratio b. Guarantee fund for private enterprises announced	a. IMF policy advice b. AFD/European Investment Bank supported loan guarantee scheme	a. ---- b. ---
Basic Services (Water, Elect., Sanitation)	a. insolvency of JIRAMA b. increase of water-born diseases as less households can afford to pay for water / latrine	a. JIRAMA reported on debt situation; Central Gov't debt will be repaid b. Increased treatment of water, reconstruction of wells	a. --- b. AfDB, USAID, UNICEF	a. technical advice through ongoing Energy Project b. ---
Education	a. students do not return to school b. parents cannot finance school material for next school year	a. fee waiver for primary schools (HIPC) b. schools target assistance to poor children (supplies, nutr. supplements)	a. UNICEF b. AfDB, UNICEF	a. proposed Emergency Economic Recovery Credit b. restructuring of Education Project
Environment / Forestry	a. further de-forestation due to illegal wood export and increased poverty b. further threat to bio-diversity	a. illegal licenses withdrawn b. forestry sector to establish transparent license allocation	a. GTZ/WWP audit of forestry sector b. Donor group monitoring	a. extension of of First Environment Project; rural/environment AAA b. restructuring Second Struc. Adjustment Credit
Fisheries	a. over-harvesting of shrimps	a. illegal licenses withdrawn	a. EU, AFD monitoring	a. restructuring Second Struc. Adjustment Credit
Health, HIV/AIDS	a. low demand for health services (in cost recovery setting) b. breakdown of generic medicine dist. (SALAMA) c. increased threats of (i) communicable diseases; (ii) infant and maternal mortality; (iii) spread of HIV/AIDS; (iv) breakdown vaccination campaign	a. cost recovery partially waived, financed partly from HIPC resources b. SALAMA refinanced through HIPC c. prioritization of budget to fully finance necessary recurrent health costs	a. AfDB, WHO (TA) b. EU (SALAMA), AfDB, WHO, France, Germany, Switzerland (med. distrib.) c. US (vacc., condom dist.), WHO (vacc.), UNICEF (nutri. monit., school suppl.), FNUAP (HIV tests, basic med.)	a. restructuring Health Project, proposed Emergency Economic Recovery Credit b. restructuring Health Project, proposed Emergency Economic Recovery Credit c. AAA work on health
Industry	a. slow pick-up of industry, especially EPZ b. lacking investor confidence c. bankruptcies of firms in debt without new credit	a. financial tax breaks (TVA, IBS) granted b. industry promotion visits abroad c. guarantee fund announced	a. EU/IMF/France (budg. supp.) b. US, France (promotion tours support) c. AFD, European Investment Bank	a. proposed Emergency Economic Recovery Credit b. restructuring Second Private Sector Development Project c. AAA work on EPZ
Informal sector	a. slow demand recovery for informal sector activities	a. micro-finance guarantee fund in preparation	a. AfDB	a. restructuring Micro-Finance Project
Mining	a. withdrawal of large planned mining investments b. delay in establishing good governance in sector	a. promotion activities b. illegal licenses will be withdrawn	a. --- b. USAID (TA), AFD (private sector)	a. proposed Mineral Resources Governance Project b. proposed Mineral Resources Governance Project
Nutrition and Food Security	a. increase in food insecurity & and malnutrition rates	a. social safety net (in part through NGOs)	a. WFP, EU, USAID, AFD, UNICEF, CARE, CRS, Germany, Switzerland	a. restructuring Community Nutrition Project, restructuring Community Development Project
Public sector	a. Fiscal gap not financed (2002, 2003) leading to under-financing of recovery program b. Internal resource generation remains low c. Absorption of public sector cannot be increased in short run d. Net withdrawal of treasury bonds by private banks e. Communities not receiving vital central transfers	a. budget prioritization 2002/ 2003 b. collection of outstanding tax debt c. emerg. budget execution guidelines d. backing of treasury bond market through Central Bank credit e. prioritization of community transfers	a. AfDB, EU, IMF, France, Mauritius, Japan: programmed budget support b. IMF (TA) c. --- d. IMF (policy advice) e. ---	a. restructuring Second Structural Adjustment Credit, proposed Emergency Economic Recovery Credit b. -- c. Country Procurement Review d. -- e. proposed Emergency Economic Recovery Credit, decentralization and commune finance AAA
Tourism	a. slow restoration of oversees confidence b. Air Madagascar difficulties limited tourist travel	a. promotion trips abroad b. management contract Air Mad		a. restructuring Sec. Private Sector Dev. Project b. restructuring Sec. Adjust. Credit; AAA tourism
Trade	a. low confidence in future of Madagascar's exports	a. promotion trips abroad, completion of Integrated Framework report	a. UNDP, USAID, UNCTAD: compl. of Integrated Framework report	a. completion of Integrated Framework report w/ partners (managed by Bank)
Transport	a. slow reconstruction of destroyed infrastructure b. under-funding of road maintenance work leading to further decay of infrastructure c. increase in isolation of rural communities	a. priority reconstruction plan b. funding of Road Maintenance Fund (partly through HIPC) c. speed-up of rural roads investment	a. EU, US (bridges), AfDB, AFD b. EU (roads fund) c. AfDB	a. restructuring Transport Sector Project b. proposed Emergency Economic Recovery Credit c. proposed Rural Transport Project

ANNEX C3: EXPENDITURE ACCOUNTABILITY ASSESSMENT UPDATE TABLE

BUDGET MANAGEMENT		Agreed Assessment	Proposed Short-term actions (to be verified with new administration – dates added after discussion)
Formulation	**COMPREHENSIVENESS**		
	1. Budget reporting follows GFS definition of consolidated general government.	B	Donor TA assistance on full GFS application, especially integration of sub-national government units
	2. Government activities are not funded through extra budgetary sources to a significant degree.	A	
	3. Budget outturn data (levels, functional allocation) are quite close to that of the original budget.	B	
	4. Budget includes capital and current expenditure financed by donors.	A	
	CLASSIFICATION		
	5. Budget classified on an administrative, economic, functional basis.	B	
	6. Poverty-related expenditure clearly identified in the budget .	A	Incidence analysis 1999-2001; extend poverty classific.
	PROJECTION		
	7. Multi-year expenditure projections **integrated** into the budget cycle .	C	Draft plan on integrating medium-term budget planning
Execution	**INTERNAL CONTROL**		
	8. Small stock of expenditure arrears; little accumulation of new arrears over past year.	C	Review and simplify rules and regulations for the budgetary cycle; consolidate all arrears; draft plan for arrears reduction
	9. Internal audit is active.	B	Validate report on strengthening control organs; adopt ethics code and internationally accepted procedures for control organs; increase staffing of control organs
	10. Tracking surveys supplement internal control.	B	
	RECONCILIATION		
	11. Fiscal and banking reconciliation undertaken routinely.	A	
Reporting	**REPORTING**		
	12. Internal budget reports from line ministries/Treasury received within four weeks of the end of the relevant period.	C	Install computer system in all treasury offices; produce three-monthly reports on budget execution along poverty classif.
	13. Functional classification is reflected in the in-year budget reports.	C	Design and implement monitoring system along poverty classification for six ministries
	FINAL AUDITED ACCOUNTS		
	14. Closure of the accounts occurs within two months after the end of the fiscal year.	B	Gradually reduce current delay of 6 months
	15. Audited account presented to the legislature within 12 months of the end of the fiscal year.	C	Gradually reduce backlog of *Loi de Reglementation* presentation to parliament (currently 1999 discussed)

Notes: Shading: Meets benchmark

IMAGING

Report No.: 25001 MAG
Type: CAS