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FY 90 Madagascar Title II Section 206 Program:

Vegetable Oil Sub-Sector II

September 13, 1989

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Acronyms

CASA	Agricultural Structural Adjustment Credit (World Bank)
FFPO	Food for Peace Officer (A.I.D./REDSO/ESA)
FMG	Malagasy Francs (local currency)
FOFIFA	National Center for Applied Research on Rural Development
GDRM	Government of the Democratic Republic of Madagascar
HASYMA	Malagasy Cotton (parastatal)
HCT	Tananarive Central Oil Extraction Plant (parastatal)
IRRI	International Rice Research Institute
MAMISOA	Antsirabe Soya Extraction Plant & Oil Refinery (parastatal)
MARS	Madagascar Agriculture Rehabilitation Support (USAID Project)
MT	Metric Ton
OGL	Open General Licensing System (for Foreign Exchange for Imports)
PASAGE	Economic Management & Social Action Support Project (World Bank)
PD&S	Project Development and Support Funds (A.I.D.)
SCIM	Commercial Industrial Society of Madagascar (Private Refinery)
SNHU	New Tulear Oil Extraction Society (Closed Parastatal Refinery)
SOAVOANIO	Parastatal Coconut Operation in Sambava (N.E. Region)
UMR	Usual Marketing Requirements
Vegoil	Vegetable Oil

FY 1990 Section 206 Program Proposal

I. Summary

The program goal is to improve the nutritional status of low income Malagasy consumers. The program purpose is to liberalize the import and marketing of vegetable oil. Currently, further reform in this sub-sector is dependent upon reduction in the level of tariff protection afforded to domestic refineries. A one year program is proposed at this time, to provide resources for a review of these tariff issues and to undertake the analysis needed to determine of a multi-year program to address policy issues in the sector is warranted. It is proposed that the one year program provide for the import of a mix of 2,500 tons of crude and 3,500 tons of refined soybean oil, principally conditioned on GDRM agreement to collaborate with A.I.D. to undertake a study of in-country refinery costs and profit margins, and the impact of current price structures on the nutritional status of low and middle income consumers, as the basis for a reassessment of current tariff levels on the import of refined vegetable oil. A.I.D. and the GDRM will consult with the World Bank during preparation of the terms of reference for this study, and review of its findings and recommendations. Additional self-help measures will include:
(1) follow-through on the artisanal groundnut oil study with the preparation of an action plan, (2) demonstration of continued progress towards parastatal divestiture of SOAVOANIO (the coconut oil parastatal) begun under the FY 1988 Section 206 Edible Oil Program, (3) continued reform of P.L. 480 auction and commodity import procedures, and (4) completion of a study of Madagascar's comparative advantage (or lack thereof) in producing different oilseeds, and consumer preferences for different types of oil.

The minimum bid price for both crude and refined oil imports will be based on import parity established on the Rotterdam spot oil market as the lowest price including freight to the port of Tamatave for soybean oil from any source. The import tariff rates for imported crude oil then in effect in Madagascar will be paid by winning bidders on both refined and crude oil, to reduce, but not eliminate, the degree of commercial distortions introduced by this program. These tariff rates are currently 40% of cost of commodity including freight to Tamatave. It will be necessary to waive the duty-free tax provisions of Regulation 11, in order to pay this tariff level for both crude and refined oil. To avoid contributing to current high levels of tariff protection for domestic refineries, however, with the potential effect of disadvantaging low income consumers, it is recommended that refined oil imported under the Section 206 Program only pay the tariff level in effect for crude oil imports at the time of each auction. While this approach will possibly provide a reduced price of refined oil to consumers, any reduction will not be sustainable without a reduction in the differentials between tariff rates on crude and refined oils.

There is already a large backlog of unprogrammed local currency generations from prior years' P.L. 480 programs, caused largely by the slowness of the GDRM programming process. It is proposed, therefore, that local currencies generated by the proposed FY 1990 Section 206 Program be attributed to GDRM operating and investment expenses in the agricultural sector which are already on budget. This will include the costs of agricultural research and extension, farm-to-market road improvements, and environmental action programs. In addition, counterpart generations will support the local costs of the IRRI Rice Research Project Phase III, which will begin in January 1990.

II. Statement of Critical Issues

A. An evaluation of this program undertaken by A.I.D. in March 1989, and updated by a review of progress in July 1989, revealed that the GDRM is likely to remain dependent on imported edible oil for the coming decade.

B. The best available information still indicates that low purchasing power in Madagascar is limiting per capita annual vegetable oil consumption (1 kilo/year) to levels far below international minimum nutritional standards (2 kilos/year).

C. A high level of protection is currently being afforded to domestic vegetable oil refineries by increases in import tariff rates effected on July 27, 1988. Though rates differ by type of oil, in general, crude oil is imported at total tariff rates of 35%-40%, while tariffs on the import of refined vegetable oil are assessed at the 85-90% level. This level of protection increases the cost of oil to consumers, and the GDRM has proposed to execute further increases by end of 1989, e.g. an increase in the tariff on import of refined soybean oil from 85% to 90%. This increase is being implemented within the context of the GDRM/World Bank efforts to reduce the degree of dispersion within the current tariff regime. To provide a sustainable reduction in the consumer price of refined oil, however, the current level of taxation of refined oil should be reduced.

D. Experience under the FY 1988 Section 206 Edible Oil Reform Program shows that refineries are colluding to set prices and quantities for auction bids, and the market is being divided up by region. To attempt to introduce more competition into the marketing structure, the FY 90 Program will need to import a significant share of refined oil accessible to a wider group of market agents.

E. The A.I.D. P.L. 480 Program has been the main source of vegetable oil imports for Madagascar since 1986, under Title I loans in FY 86 and FY 87, and under Title II Section 206 in FY 88. Though the FY 90 Section 206 Program will signal our withdrawal from protection of domestic refineries in favor of reduced prices for consumers, a share of imported crude oil will be needed to provide a transitional cushion for refineries as they adjust to importing their crude oil through the OGL.

III. Background

In FY 88, the first PL 480 Title II Section 206 Program was approved. It provided 5,000 tons of crude soybean oil for auction to refineries. Three auctions were held in 1989: the first in January, the second in April, and the third in September. A total of five refineries (3 private sector and 2 parastatal) have received oil under the program. GDRM performance on the five self-help measures in the FY 88 Title II Section 206 Edible Oil Sub-Sector Reform Program has been mixed. A detailed evaluation of the program was performed in March 1989, and the findings are updated below.

A. Completion of a National Vegetable Oil Master Plan: The GDRM has submitted the required plan, and it has been approved by the World Bank, in satisfaction of release of the second tranche of the Agricultural Sector Structural Adjustment Credit. GDRM commitment to implementation of the master plan is evidenced by the following measures:

- removal of all controls on retail and wholesale prices and profit margins;
- freeing of access to all marketing zones for all market agents, subject to the approval of local government authorities;
- withdrawal of the GDRM from all state investment in production and processing, and the dissolution of a structurally unprofitable state processing facility (MAMISOA);
- abandonment of State promotion of industrial production of soya; GDRM reorienting of soya research and extension towards the peasant production level, and transfer of all State plantations to the private sector;
- GDRM commitment to the commercial sale of all grant commodities, and the establishment of their prices by public auction;
- cutback of the scale of a vast perennial oilseed production project which was found to be too risky and too costly at its originally planned scale;
- GDRM support for the renewal of investment in the sector including a BTM loan for the establishment of mini-refinery at SOAVOANIO (the coconut parastatal), and the financing of both the rehabilitation of the private sector SCIM refinery in Antsiranana and the expansion of a large private coconut plantation at Sambava. Other experimental commercial investments have been made, stimulated simply by the liberalization of the sector, including investments in coprah oil extraction and the establishment of a sunflower plantation.

In the future, the GDRM plans to undertake the following actions and studies towards further implementation of the master plan:

- possible establishment of an integrated cotton-groundnut-maize production system in the Tulear region, under a HASYMA (the cotton parastatal) project;

- continued progressive withdrawal of the State from other production and processing operations;
- undertaking a study of the structure of the oil industry in 1989 under IDA financing provided by the PASAGE project. This study will include an assessment of the current status of the industry, the integration of donor gifts into the market, the appropriate level of tariff protection at all levels in the sub-sector, and prospects for a future renewal of exports.

B. Completion of a National Agricultural Research Master Plan by FOFIFA: This Master Plan was completed in 1988 and reviewed by A.I.D. and other donors; its recommendations have been incorporated in the IBRD Staff Appraisal Report for the proposed new seven year $24 million Madagascar Agricultural Research Project (which was prepared with A.I.D. participation). The Master Plan includes a groundnuts research program in its first priority research agenda, to focus on the southwest of Madagascar, where there are limited possibilities for alternative cash crops. Valencia groundnut varieties were exported as high quality confectionary nuts in the past, and the country still appears to have a comparative economic advantage in groundnut production. The proposed research will focus on varietal disease resistance, including resistance to Aflatoxin-carrying fungi. Other important research orientations will include: dormancy, oil content, grain/hull ratio, and harvest conditions. Integrated pest management will also be studied, including control of aphids and soil-borne and defoliating insects. Currently only one M.S. level researcher is working on groundnuts within FOFIFA. Under the proposed Agricultural Research project, this would increase to two M.S. level researchers by 1992. Though a lower priority, some research on coconut and oil palm may also be undertaken in the future. Performance on the implementation of the National Agricultural Research Master Plan is too long term for inclusion in the conditionality or local currency use plan for the FY 90 Section 206 Program.

C. Continued Reform of the Vegetable Oil Auction System: Performance on this FY 88 self-help measure has been mixed. The GDRM has run the auctions effectively, preparing and reviewing bid documents on time. In a market with few players, however, there is always a risk of collusion. In the first two auctions held in 1989 under the FY 88 Program, there was evidence of obvious collusion between the public and private sector refineries on auction price bids. Price differences between winning bidders only varied by 1,500 FMG/ton in the January 1989 auction and by less than 1 FMG/ton over the minimum bid price in the April 1989 auction. Though four of the refineries have performed well, by depositing local currencies on time, problems were encountered with one refinery. SOMAPALM (a parastatal refinery, and the importer under the FY 88 Program) bid for 800 tons at the first auction. Though the auction rules state that the successful bidder must pay the auction value to the Treasury before taking the goods, SOMAPALM only paid for 199 tons before processing 353 tons. Further, SOMAPALM sent one truck

load of the remaining amount won at the auction to MAMISOA Antsirabe for processing after the SOMAPALM boiler broke down, halting its own refinery operations. MAMISOA had been explicitly excluded from bidding at the auction, as this economically infeasible refinery had been slated for liquidation by the GDRM in agreement with the World Bank. Clearly, FY 90 Program design will need to include stronger controls on auction procedures, and evidence of greater GDRM commitment to their enforcement. Recently, however, some progress has been made. In the third and final auction under the FY 88 Program, in September 1989, more competitive bids were received. The minimum price was set at $594/ton, but offers ranged from a high of $784/ton to a low of $697/ton. Bids for a total quantity of 3,550 tons were received, though only 1,455 tons were available.

D. Survey of Artisanal Groundnut Oil Production: Completion of this survey was a key self-help measure for the FY 88 Program, designed to fill the gap in knowledge of artisanal groundnut oil production volumes, costs, and marketing systems. Though start-up of this study was greatly delayed, the study is now expected to be completed in October 1989. Follow-up to this study is to be included in FY 90 Section 206 Program conditionality.

E. Divestiture of Vegetable Oil Parastatals: Under the FY 88 Program, the GDRM committed itself to continuing to explore the opportunities for opening SOAVOANIO (the coconut oil parastatal) to private investment. During 1989, the GDRM approved the scope of work for a detailed study of divestiture options for SOAVOANIO under the Parastatal Studies Phase II to be funded by A.I.D.'s MARS project. Among the other refineries, the GDRM is now proceeding to divest MAMISOA, though the SNHU refinery in Tulear was found to be too obsolete for sale to the private sector.

IV. Program Description

A. Problem:

The goal of A.I.D.'s strategy in Madagascar is to increase rural incomes while improving nutritional levels and maintaining the country's natural resource base. Vegetable oil, a critical dietary element, is too costly to be accessible to most Malagasy consumers, contributing to the prevalence of chronic and severe malnutrition, even in middle income Malagasy families. High levels of import tariffs, currently protecting to Malagasy domestic refineries, are a major factor in maintaining the high cost of oil to consumers. As domestic oilseed production is not likely to increase appreciably during the coming decade, in view of current agricultural sector priorities (mainly rice self-sufficiency and export production), Madagascar will remain largely dependent upon edible oil imports for the foreseeable future. Reform of the edible oil tariff regime is critically needed to address nutritional problems, and GDRM initiative along these lines would support the broader market liberalization reforms which are central to the A.I.D. program in Madagascar.

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B. Objectives:

The program goal is to improve the nutritional status of low income Malagasy consumers. The program purpose is to liberalize the import and marketing of vegetable oil. The proposed FY 90 Title II Section 206 Program will address the problem discussed above, by opening a dialogue between A.I.D. and the GDRM on vegetable oil import tariffs, and directly importing a sufficient supply of oil to sustain current consumption levels. As the program's proposed mix of refined and crude oil imports will provide 60% of final oil sold to consumers from imports of refined oil, imported at the same tariff rate as crude oil, the program should promote a more competitive market structure, accessible to a wider group of market agents, possibly placing downward pressure on prices charged to consumers.

C. Summaries of Relevant Analyses:

1. Sectoral:

The FY 1988 Section 206 Program supported the auction of imported crude oil at import parity prices free of duty, with conditionality geared towards GDRM planning for edible oil self-sufficiency. An evaluation of this program undertaken by A.I.D. in March 1989, and updated by a review of progress in July 1989, revealed that the GDRM is likely to remain dependent on imported edible oil for the coming decade. The GDRM's new Master Plan for Agricultural Research is not likely to produce significant new oilseeds research results over this period, as only one M.S. level researcher is currently assigned to this sub-sector, and this manpower level will only double five years from now under current plans. Further, no bilateral or multilateral donor has committed itself to significant support for oilseeds research or production assistance over this period, though French cooperation continues to consider possible assistance to the cotton production parastatal, HASYMA, which might diversify its activities into groundnuts and possibly maize, potentially increasing raw material production for groundnut oil in future. To date, however, a satisfactory project proposal has not been developed for this assistance, and prospects are highly uncertain. In November 1988, however, SOAVOANIO purchased a new mini-refinery which has the capacity to produce 1,000 metric tons of crude coprah oil per year, as this coconut parastatal is producing more coprah than it can export.

2. Social:

In March 1988, UNICEF published the results of a 400 sample size household survey undertaken in collaboration with a Malagasy statistical consulting firm. Roughly half of the households were from large cities (Antananarivo and Tamatave), one-quarter from a small urban center, and the remaining one-quarter from a rural area. Key variables were stratified to identify the income levels of at-risk households, defined as those which could not satisfy their daily food needs. The following tables summarize the average monthly incomes of household heads and their spouses in at-risk families. These income levels were less than half of the average incomes of households that were not at risk.

Monthly Incomes of Household Heads (in thousands of Malagasy Francs)

	At-Risk Families	Not At-Risk Families
Large Cities	41	110
Small Cities	35	83
Rural Areas	15	37

Monthly Spousal Incomes (in thousands of Malagasy Francs)

	At-Risk Families	Not At-Risk Families
Large Cities	8	38
Small Cities	16	26
Rural Areas	5	0

The analysis of data on nutritional status of the at-risk households indicates that over half of their pre-school children suffer from chronic malnutrition, including over one-third of children with severe malnutrition in large cities. In the UNICEF survey, severe malnutrition is defined as 60-80% of reference weight for eight. For particularly low income at-risk families, at least two-thirds of their pre-school children suffer from chronic malnutrition. Incidence of severe malnutrition varies by milieu, with the greatest problems in large urban areas where over half of low income at-risk families' pre-school children suffer from acute malnutrition.

Nutritional Status of Pre-School Children by Household Income Level
(% with Chronic and Severe Malnutrition)

	Very At-Risk		At-Risk		Not At-Risk	
	Chronic	Severe	Chronic	Severe	Chronic	Severe
Large Cities	68	51	55	36	38	25
Small Cities	75	28	69	14	29	0
Rural Areas	88	0	68	0	60	0

As shown in the tables above, even the pre-school children of families with higher incomes, placed above the at-risk categories, have chronic malnutrition problems. Though there is no data on household consumption of edible oil, the best available data on domestic supplies during design of the FY 1988 Section 206 Program indicated that per capita annual consumption of edible oil in Madagascar did not exceed 1 kilo. This is far below the internationally accepted minimum standard of 2.5 kg per capita per year. Animal fat intake compensates somewhat for this dietary element, however, and it was also suspected that artisanal groundnut oil production was greatly under-estimated in Madagascar, as this is usually an informal sector activity. Data will be available by October 1989 from the artisanal groundnut oil study which was undertaken as a self-help measure under the FY 1988 Program. Nevertheless, the nutritional data reported by UNICEF support the need to reduce the cost of edible oil as much as possible, to make it more affordable to Malagasy families.

3. Food Needs Assessment:

The following tables document, first, the current calendar year balance in oil supplies needed to maintain current consumption levels of 1 kilo of crude oil per capita per year, and second, future needs for 1990 to maintain this consumption level in the face of expected population growth of 3% per year. With expected carryover of only 590 tons from the balance of 1989 imports and consumption needs, the FY 90 Section 206 Program will need to fill a gap of 5,782 tons of refined vegetable oil through PL 480 imports, even if the 1,000 tons of 1989 commercial refined oil imports are replicated in 1990.

Current Year Balance: 1989

Commodity: Vegetable Oil

Per Capita Consumption (unmilled kg/yr)	1.0
X Population (thousands)	11,205
= Total Consumption Requirement	11,205
Gross Domestic Production	3,350
- Total Non-food Use	0
= Net Domestic Production	3,350
- Net Change in Stocks	(5,844)*
- Total Exports	0
= Domestic Supply	9,194
Total Consumption Requirement (from above)	11,205
- Domestic Supply	9,194
= Import Requirement	2,011
- Total Commercial Imports (milled)	1,000
- Other Donor Gifts (milled)	1,400
Divided by .9 for Conversion to Unmilled Amount=	2,667
= Food Deficit (unmilled)	(656)
X Milling Extraction Rate	90%
= Food Deficit (milled)	590

*Note: This high carryover represents the arrival in November-December 1988 of all 5,000 tons of FY 88 Section 206 Program commodities, plus carryover of FY 87 Title I stocks.

Future Year Balance: 1990

Commodity: Vegetable Oil

Per Capita Consumption (unmilled kg/yr)	1.0
x Population (thousands)	11,541
= Total Consumption Requirement	11,541
Gross Domestic Production	3,350
- Total Non-food Use	0
= Net Domestic Production	3,350
- Net Change in Stocks	(656)
- Total Exports	0
= Domestic Supply	4,006
Total Consumption Requirement (from above)	11,541
- Domestic Supply	4,006
= Import Requirement	7,535
- Projected Total Commercial Imports (milled)	1,000
Divided by .9 for Conversion to Unmilled Amount=	1,111
= Food Deficit (unmilled)	6,424
x Milling Extraction Rate	90%
= Food Deficit (milled)	5,782

4. Economic: In view of this national dependence on imported edible oil, a reduction in tariff rates on refined oil will be necessary to produce any sustainable reduction in consumer prices. The following tables document tariff levels currently in effect for the import of different types of crude and refined oil. Annual revisions to the Malagasy budget provide the opportunity for legislative change in these tariff levels. Informal discussions with the Ministry of Finance indicate that higher tariff levels for imported refined oil will likely be put in place by the end of calendar year 1989, including at least a 5% increase from 85% to 90% on the tariff rate for imported refined soybean oil.

Import Tariff Rates for Different Edible Oils

Type of Oil	Customs Tax	Import Tax	Consumption Tax	Transaction Tax	Total Tariff
Soybean Oil:					
-- Crude	15%	0%	10%	15%	40%
-- Refined	15%	45%	10%	15%	85%
Peanut Oil:					
-- Crude	15%	0%	10%	15%	40%
-- Refined	15%	55%	10%	15%	95%
Olive Oil:					
-- Crude	15%	0%	10%	15%	40%
-- Refined	15%	55%	10%	15%	95%
Other Oils Obtained from Olives:	15%	55%	10%	15%	95%
Sunflower Oil: Crude and Refined	15%	0%	10%	15%	40%
Cotton or Corn Oils:					
-- Crude	15%	0%	10%	15%	40%
-- Refined	15%	55%	10%	15%	95%
Palm Oil:					
-- Crude	0%	10%	10%	15%	35%
-- Refined	15%	55%	10%	15%	95%
Palm Nut Oil:					
-- Crude	0%	10%	10%	15%	35%
-- Refined	15%	55%	10%	15%	95%
Coconut Oil: Crude and Refined	0%	10%	10%	15%	35%
Turnip, Rapeseed or Mustard Oils; Crude or Refined:	15%	0%	10%	15%	40%
Ranges:					
-- Crude					
o Minimum	0%	0%	10%	15%	35%
o Maximum	15%	10%	10%	15%	40%
-- Refined					
o Minimum	15%	0%	10%	15%	35%
O Maximum	15%	55%	10%	15%	95%

The following tables from the evaluation of the first FY 88 Section 206 auction show refinery costs reported by two parastatals and one private refinery, including the payment of 40% import tariffs on the cost of commodity including freight. The price paid per ton of crude oil at this auction was approximately $558/ton at then current exchange rates. On the basis of these cost and profit margins, ex-factory wholesale prices range from a low of 1,900,173 FMG/ton for the parastatal HCT through a high of 1,967,000 FMG/ton for the private SCIM refinery, though reported refinery profit margins range from a low of 5% for SCIM to a high of almost 21% for HCT. From these tables, it appears that the private sector refinery is less technically efficient, with a loss of 15% of commodity during the refining process, in comparison to only 5-7% lost in processing at the parastatals. Processing fees range from a low of 195,975 FMG/ton at HCT to a high of 356,482 FMG/ton at SOMAPALM, with the private sector refinery's fee midway between the two at 236,000 FMG/ton.

Using a 972 liters/ton of crude oil conversion figure provided by the REDSO FFPO, this produces ex-factory wholesale costs which range from 1955 FMG/liter to 2,024 FMG/liter. At present, final retail consumers pay about 2,300 FMG/liter for refined oil purchased from the drum by filling one's own container, or about 2,800 FMG/liter pre-bottled.

Refinery Costs in Malagasy Francs Per Ton of Crude Soybean Oil

	A. SCIM (Private)
Auction Price Paid	876,000
SOMAPALM Fees	211,010
Shipping Fee, Freight, Discharging Fee, Insurance & Transit to Diego	187,990
Subtotal	1,275,000
15% Oil Loss in Processing	191,000
Subtotal	1,466,000
Processing Cost	236,000
Subtotal	1,702,000
Plant Margin 5%	86,000
Subtotal	1,788,000
Consumption Tax 10%	179,000
Ex-Factory Wholesale Price/Ton	1,967,000
At 1080 Liters per Refined Ton, Ex-Factory Price for 1 Liter	1,821

B. HCT (Parastatal)

Auction Price Paid	876,500
Custom Fees	220,000
Transport (Tamatave to Antananarivo)	38,000
Bank Fees for 2 months at 20%	37,816
Subtotal	1,172,316
Cost Per Ton of Refined Oil at 95% Milling Rate	1,234,017
Processing Fees	195,975
Subtotal	1,429,922
Consumption Tax 10%	142,999
Cost Per Ton of Refined Oil	1,572,991
Plant Margin of 20.8%	327,182
Ex-Factory Sale Price	1,900,173
At 1080 Liters per Refined Ton, Ex-Factory Sale Price per Liter	1,759

C. SOMAPALM (Parastatal)

Auction Price (CIF Value)	875,500
Discharging, Customs, Transit Fees	185,000
Subtotal	1,060,500
Total Cost of Raw Material at 93%	1,140,300
Discount	29,936
Commission	38,700
Processing Fees	356,482
Cost without Tax	1,488,018
Consumption Tax	148,802
Subtotal	1,636,820
Plant Margin 18%	294,628
Ex-Factory Price/Ton	1,931,448
At 1080 Liters per Refined Ton, Ex-Factory Price Per Liter	1,788

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In FY 90 USDA costs will increase. The import of pre-refined oil at current USDA prices will produce a lower wholesale cost per liter than the import of crude oil for processing in country. The wholesale cost of imported refined oil may be calculated as follows:

$732	Cost per Ton at USDA Price
143	Estimated Freight Cost/Ton
350	Tariff at 40% CIF Cost
48	Insurance/Discharge/Storage/Commissions
$1,273	Minimum Bid Price per Ton

This would result in a 1,939 FMG/liter wholesale cost at the port at current foreign exchange rates, using the 1080 liters/refined ton conversion figure provided by the REDSO FFPO. In comparison, at the FY 90 USDA price of $688/ton of crude oil, the ex-factory cost per liter for domestically refined oil will be much higher at 2,781 FMG/liter. During implementation, this cost will be lowered further by using the import parity price for refined soybean oil, obtained on the Rotterdam spot oil market, as the basis for calculating the minimum bid price. Though we do not have a current Rotterdam quotation for refined oil, the June 1989 price for crude soybean oil on the Rotterdam market was only $456/ton excluding freight, while FY 90 USDA prices for the same commodity are quoted at $688/ton excluding freight. We would thus expect a considerable price reduction for the minimum bid price of refined oil from the use of import parity pricing.

There is a risk that cost savings from reduced costs for the oil itself and the reduced tariff charges on refined oil will not be passed on to consumers by winning bidders. In this event, the purchasers of FY 90 Section 206 refined oil would accrue windfall profits. This is a major issue that will be monitored during program implementation.

D. Program Elements:

1. Commodity Selection/Levels:

At current USDA prices, crude vegoil in 55 gallon drums will cost $688/ton and refined vegoil will cost $732/ton. In the FY 1991 ABS, $5 million was requested for the FY 1990 Title II Section 206 Program. The following mix of crude and refined soybean oil is proposed for a $4,282,000 million program in view of 1990 projected food needs:

2,500 MT of crude soybean oil, total cost of $1,720,000, plus
3,500 MT of refined soybean oil, total cost of $2,562,000.

This proposed level for our assistance will encourage the continuation of commercial imports at the 1989 level of 1,000 tons.

2. Self-Help Measures:

Five self-help measures are proposed as follows:

(a) The program's principal conditionality will require GDRM agreement to collaborate with A.I.D. to undertake a study which reassesses current tariff levels on the import of refined vegetable oil, in view of the impact of current price structures on the nutritional status of low and middle income consumers, in comparison with in-country refinery costs and profit margins. A.I.D. will make PD & S funds available for external consultants to assist with this study. A.I.D. and the GDRM will consult with the World Bank during preparation of the terms of reference for this study, and review of its findings and recommendations. In line with Section 206 Program guidelines, this self-help measure will initiate a policy dialogue between the GDRM, A.I.D., and the World Bank on the appropriate tariff regime for the vegetable oil sub-sector.

(b) The GDRM will also agree to prepare an action plan for assistance to artisanal groundnut oil production, based on review of the findings of the artisanal oil study expected by October 1989. For example, GDRM training in improved groundnut storage might be needed, to improve the health standards of artisanal oil, by reducing the risk of Aflatoxin contamination. This study was a self-help measure under the FY 1988 Section 206 Program.

(c) The GDRM will also be required to demonstrate continued progress towards parastatal divestiture of SOAVANIO (the coconut oil parastatal) begun under the FY 1988 Section 206 Edible Oil Program.

(d) GDRM agreement to continued reform of P.L. 480 auction and commodity import procedures will be required. For example, to avoid the irregularities experienced during implementation of the FY 1988 Section 206 Program, the oil will be auctioned in advance of its delivery, so that winning bidders can take possession of their oil at the port, and arrange for their own storage contracts if needed. SOMAPALM has taken unfair advantage of its position as importer in the past, and the program should no longer support this special advantage for SOMAPALM in future. As no secure alternative storage contractor is likely to be available, the Mission hopes to avoid the need for a designated importer, by holding the auctions in advance of commodity delivery. The Ministry of Commerce will designate a consignee of last resort, to avoid demurrage charges to USDA, in the event that a winning bidder cannot take possession of its full share of commodities upon arrival at the port.

(e) As outlined in the FY 88 Section 206 Program document, Madagascar produces a variety of oilseeds: palm nut and kernel, coconut, sunflower, groundnut, and cotton seed. The GDRM will follow through on the National Vegetable Oil Master Plan, by undertaking a study of Madagascar's comparative advantage (or lack thereof) in producing different types of oilseeds, and consumer preferences for different types of oil. Again, A.I.D. will make PD & S funds available for external consultants, if needed.

3. Local Currency Uses:

As only half of the FY 1987 Title I local currency generations have been programmed to date, there is already a large backlog of unprogrammed local currency generations from prior years' P.L. 480 programs. It is proposed, therefore, that local currencies generated by the proposed FY 1990 Section 206 Program be used first to support the local costs of IRRI Rice Research Project Phase III, with the remainder attributed to GDRM operating expenses in the agricultural sector which are already on budget. This approach is consistent with A.I.D.'s policy of collaborating with the IMF to use local currency generations in a non-inflationary manner, and it is also consistent with A.I.D.'s policy of minimizing Mission management burden in the programming and monitoring of local currencies. A similar approach of agricultural sector and transportation sector budget attribution was recently approved by AID/W in the programming of local currencies to be generated under the Mission's major portfolio element- the Madagascar Export Liberalization Program (687-T-603). The Mission will also consider providing counterpart funding from the FY 90 Program for additional studies including the comparative advantage study to investigate the economic viability of future investments to increase local vegetable oil production. Implementation of the parastatal divestiture plan for SOAVANIO, the coconut oil parastatal, may also absorb additional local currencies. During design of the new World Bank National Agricultural Research Project, the Mission will explore whether counterpart funding will be needed for these project activities. Since FY 90 local currency will not be available in time, prior PL 480 local currency generations will fund the local costs of the study of vegetable oil import tariffs, which will include a survey of the impacts of the current price regime on the nutritional status of low income consumers.

V. Financial Plan

Arrangements used in the FY 88 Section 206 Program will be continued. Specifically, no deposits will be required with auction bid submission, but winning bidders will be required to make payment in full before taking possession of their commodities. The Director of the Treasury and the Central Bank of Madagascar are responsible for the management of counterpart funds. As with past programs, a separate special account will be established in the Central Bank for the FY 90 Program. This account will receive deposits from successful bidders prior to their collection of commodities. Tariffs will be paid to Customs directly by winning bidders, (i.e. the 40% tariff on CIF commodity price paid at auction). The Central Bank provides the Treasury with a weekly summary of account activity. Interest will not be generated, as this would involve the GDRM paying itself interest. The A.I.D. Mission Director's determination that interest need not be paid is attached as an annex to this program proposal.

One of two local currency disbursement cycles are in effect, depending upon type of recipient. For projects managed by non-governmental organizations (PVO's, IRRI, etc.), funds may be transferred quarterly into a special project bank account on a revolving fund basis, though special approval for use of this mechanism is required in each instance. Government-managed projects operate on a reimbursement cycle based upon a vouchering system with transactions initiated by the implementing ministry.

The Minister of Plan is responsible for submitting an annual budget to the Minister of Finance for government-managed projects. As in the past, Mission approval for the overall allocation is required prior to submission. Every effort will be made to complete the budget process within a timely manner, but at present, only half of the FY 87 Title I local currency generations have been programmed, and none of the the FY 88 Section 206 counterpart has been programmed. To accelerate the programming process under the FY 90 Section 206 grant, agricultural sector budget attribution will be used to the extent possible.

A.I.D. PD & S dollar resources will support external consultants needed for the tariff reform, nutrition, and oilseed cost/benefit studies. The local costs of these studies will be paid by prior PL 480 counterpart. The MARS Project in A.I.D.'s portfolio pays for the technical assistance costs of the Parastatal Divestiture Phase II study of SOAVOANIO.

VI. Bellmon Analysis

The FY 1988 Section 206 Program document's Bellmon analysis does not require updating, as no conditions have changed. However, during implementation of the past Section 206 Program, it was found that SOMAPALM's port storage capacity cannot easily be replaced by

If USDA can accommodate the requested shipping dates, the following schedule for program implementation is proposed:

Signature of Transfer Agreement	October 1989
Preparation of Terms of Reference for Import Tariff Study, Cost/Benefit Studies of Oilseeds, and Nutritional Study	October 1989
Public Advertisement for First Auctions, and Bid Reviews	November-December 1989
First Quarterly Implementation Report	January 1990
Arrival of First Half of Crude & Refined Oil	January 1990
Review of Findings of Studies	February 1990
Second Quarterly Implementation Report	April 1990
Public Advertisement & Bid Review for Second Auctions	April-May 1990
Arrival of Second Half of Crude & Refined Oil	June 1990
Third Quarterly Implementation Report	July 1990
Program Evaluation	July 1990
Fourth Quarterly Implementation Report	October 1990

Once USDA confirms the tonnages and shipping schedules , the GDRM will advertise publicly for bids with USAID concurrence. As in the past, the Ministry of Commerce will be the lead agency for program implementation. A first round review of financial capability by GDRM/USAID will result in the pre-qualification of bidders, but no deposits will be required with bid submission. Public auctions will be used to obtain the widest possible participation of market agents, particularly for refined oil auctions. As shown in the schedule above, the two month period prior to the arrival of each shipment will be used to complete the auction processes, to enhance the likelihood that winning bidders can take possession of their commodities upon arrival. Separate auctions will be held for crude and refined oil, and if feasible, unclaimed crude and refined oil will be stored separately, to avoid the mixing of supplies.

Winning bidders will be required to make payment in full before taking possession of commodities. Two constraints on bidders will require attention during implementation. First, FY 88 auction experience indicates that bidders' financial and transport handling capacity is limited to an average of 200 tons at a time. Secondly, commercial bank loans may not be able to fill the gap, as maximum loan amount would total 60% of commodity value. Thus, to avoid demurrage charges to USDA, one or more receivers will need to be pre-selected. The following options can be considered, and an appropriate option will be selected once the USDA shipping schedules are confirmed.

Option 1: A transit company can be selected to handle the discharge of commodities and temporary warehousing. Competitive bids can be solicited from the three major transit companies in Tamatave (SCAC, AUXIMAD, and MODRIN). The feasibility of this option depends upon: (1) the transit firm agreeing to accept payment for its services from several bidders, and (2) the pre-arrival auction resulting in the sale of all commodities.

Option 2: Each auction bidder could be required to designate one of these three transit firms as receiver for his commodities. Again, this would only be feasible if the pre-arrival auction resulted in the sale of all commodities.

Option 3: A contract for the discharge and storage of commodities could be competitively bid and awarded. This is the practice which was followed in the FY 88 Program, when three refineries were asked to bid on this contract. In the past, however, only SOMAPALM was interested in the contract. This option would be less expensive than use of a transit firm in the two options above, but risk of theft will be greater, particularly for the refined oil, though commodities will be insured under all three options. Use of this third option would also preserve SOMAPALM's favored position relative to that of other bidders.

X. Monitoring and Evaluation

The Mission's FSN Food Program Officer will monitor program progress, and prepare quarterly implementation reports. The Mission Economist will collaborate with the GDRM Ministries of Finance, Commerce, and Plan to prepare the terms of reference for the vegetable oil import tariff study, and the comparative advantage study of investments in alternative oilseed production increases. The Mission Agricultural Officer will assist with the definition of study components related to nutritional needs, consumer preferences, and oilseed production possibilities. On or about July 1990, the REDSO FFPO will participate in a Mission evaluation of program achievements.

Annex

ACTION MEMORANDUM FOR THE MISSION DIRECTOR

From: Deborah Prindle, REDSO/ESA Project Development Officer

Subject: Madagascar- FY 90 Title II Section 206 Program- Determination that Interest Need Not be Paid on Local Currency Deposits

Date: September 13, 1989

Action Requested: Your determination that interest will not be required on local currency deposits placed in a special account for subject program at the Central Bank of Madagascar.

Discussion: According to AID/W guidance (87 State 327494, para 2.80), local currencies are to be deposited in an interest-bearing account unless this requirement is waived by the senior A.I.D. officer at post. Under the FY 90 Title II Section 206 Program, as in past Title I and Title II programs, local currencies generated by the sale of USG imported commodities will be deposited in a special account at the Central Bank of Madagascar. These funds will be jointly programmed by A.I.D. and the GDRM for mutually agreed upon activities in the GDRM budget. Local currencies to be generated by the FY 90 Section 206 Program will support IRRI Rice Research Project Phase III, and public sector expenditures for agricultural research, extension, and farm-to-market road repair through a process of budget attribution.

Central Bank accounts do not pay interest. In any event, interest payments would be meaningless in this case, as the GDRM would merely be paying itself interest on public sector funds which are an integral part of the public sector budget.

Authority: According to the AID/W guidance cable on local currency programming (87 State 327494 para 2.80), "a determination not to follow A.I.D.'s preference for interest-bearing accounts may be made by the highest A.I.D. official at post."

Recommendation: By your signature below it is recommended that you determine that local currencies generated by the sale of Title II Section 206 vegetable oil imports be deposited in a special account at the Central Bank of Madagascar, without interest payment requirements.

APPROVED _____

DISAPPROVED _____

DATE September 15, 1989