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**PRIVATIZATION AND DEVELOPMENT PROJECT
AFR/ONI PAN-AFRICA BUY-IN
PRIVATIZATION ASSESSMENT/BUSINESS EXPANSION
SERVICES AND TECHNOLOGY (BEST) PROJECT DESIGN**

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by

**Abt Associates Inc.
55 Wheeler Street
Cambridge, Massachusetts 02138
Tel: (617) 492-7100
FAX: (617) 492-5427**

EXECUTIVE SUMMARY

Introduction

Madagascar, because of the recent democratic reforms it has made, as well as what is generally agreed to be a human and natural resource endowment that give it good prospects for future development, is considered an important country by USAID and other donors. There is a general perception on the part of most donors, as well as a significant number of investors, both foreign and domestic, that properly designed development projects in Madagascar have the potential to generate real economic growth and a rapid improvement in people's standard of living. It is widely agreed, moreover, by the Government of the Republic of Madagascar (GRM) as well as by donors and investors, that the country's future development will depend on the rapid growth of the private sector. Most development projects, either in progress or at the design stage, take this as their point of departure and focus, in various ways on removing existing constraints to private sector development, whether due to macroeconomic factors, legal and regulatory constraints, or inadequacies in infrastructure, information, training or capital.

The primary objective of this study was to assist USAID in design of a project, entitled Business Expansion Services and Technology (BEST), which is intended to address perceived legal and regulatory constraints to private sector development and to improve the quality, availability and delivery of business services to the private sector. The study team was requested to prepare a document to serve as the basis of a Project Identification Document (PID) for this project.

The study was conducted during November 1993 under the technical direction of USAID-/Madagascar, and was funded by USAID/AFR/ONI via the Privatization and Development (PAD) Project. Price Waterhouse is the prime contractor on the project, operating through its International Privatization Group. Abt Associates is a member of this group, and a subcontractor on the overall project. A study team consisting of Charles Krakoff (Abt Associates), Team Leader; Nilgun Gogkur (Abt Associates Consultant), Privatization Expert; and Pierre Gianni (Abt Associates Consultant), Legal Expert, visited Madagascar from November 2 to November 18, 1993, and presented a draft report and debriefing to the USAID Mission prior to departure. Some additional technical input was provided by Mara Fellouris and Deborah Dangay of Price Waterhouse.

Because this study was funded through the PAD Project, a more thorough review of the GRM's privatization program was conducted than would otherwise have been the case. In addition, USAID/Madagascar allowed substantial latitude to the study team to make design recommendations for a project based upon their best assessment of the economic and political situation in Madagascar and of the needs of the Malagasy private sector, as well as on their understanding of the strategies and distinctive strengths of A.I.D. and USAID/Madagascar. This report provides a menu of possible assistance components.

The report is divided into two parts. Part I is an assessment of the GRM's privatization program and of the major constraints to private sector development in Madagascar. Part II is a draft Project Identification Document (PID) for the BEST Project, based on the Abt team's analysis, the New Project Document (NPD), and the USAID/Madagascar Country Program Strategic Plan (CPSP), and which provides a menu of options for BEST Project Activities.

The study team would like especially to thank USAID/Madagascar and, in particular, George Carner, Mission Director, and Joseph Carroll, Private Sector Officer, for providing the opportunity to undertake this assignment. Thanks are also due to Marguerite Davis for invaluable informational and technical support, while Viviane and Sylvie deserve thanks for their logistical and secretarial support.

Assessment of the Problem

Madagascar, despite its potential, is one of the world's poorest countries, a country with a declining economy, a crumbling infrastructure, a declining educational base, which is saved from total bankruptcy only by the continued injections of credit by international donors. Perhaps the most telling statistic is that per capita GDP today is 40% less than in 1972, when the socialist government of President Didier Ratsiraka came to power. The most ambitious and optimistic projections of future performance call for per capita GDP to rise to its 1972 level within 10 years. Other projections, not necessarily the most pessimistic that have been produced, estimate that this level will not be achieved for another 70 years.

The reality no doubt lies somewhere in the middle. As the pace of technological change in the developed world increases, countries that cannot achieve very rapid economic growth are destined to fall further and further behind. This outcome is not fore-ordained, however, and there is much Madagascar can do, with the judicious help of donors such as USAID, to embark and stay on a more hopeful course. For Madagascar, this means achieving a rate of annual GDP growth of at least 6%, although much faster growth is possible, as countries such as Thailand, Korea, and, now, China, demonstrate.

This growth can only come through a very rapid growth in private investment, both foreign and domestic, and a rapid growth in exports. Foreign investment can be leveraged to generate rapid development of the domestic private sector, fulfilling its role as a catalyst to investment, technology transfer, market access, and financial and managerial know-how. This is likely to require an aggressive effort to develop backward linkages between foreign investors, particularly those investing under the Zone Franche or Investment Code legislation, and small and medium enterprises (SMEs) that currently operate wholly or mainly in the domestic economy. These linkages could be based initially on the increased local sourcing of goods and services, and increased local subcontracting, by Zone Franche companies. Ultimately, these linkages can enable local SMEs to begin exporting in their own right. It is only through development of such linkages that the employment and income multiplier effects of foreign investment can be maximized. For this scenario to be realized, however, numerous problems must be addressed.

Our analysis identified a number of critical constraints to the growth of investment and the development of the private sector. These include:

- Inadequate infrastructure and costly services, particularly in the telecommunications and air transport sectors, due to monopoly power exercised by State-owned Enterprises (SOEs), and the consequent lack of investment, innovation and competition;
- A persistent inability to control budget deficits and the public investment budget, resulting in inadequate investment in essential infrastructure;
- Poor functioning of the justice system, due to:
 - i. inadequate publication and dissemination of laws;
 - ii. failure of those responsible for administering and enforcing the laws to adopt attitudes more favorable to the private sector;
 - iii. ineffective methods for adjudicating commercial disputes and a failure of the system to pronounce fair, impartial and generally uniform sentences;
 - iv. inability of the law as it stands to provide a framework for development of modern financial markets;
 - v. the outmoded and inconsistent character of many parts of the law that were passed during the socialist period (e.g., company law, which still includes "socialist enterprises").
- A need for reform of fiscal policy, which places inordinate tax burdens on the minority of enterprises registered in the formal sector and provides a powerful disincentive for informal operators to enter the formal sector;
- A general lack of macroeconomic policy coordination.
- Insufficient access to credit for domestic enterprises, due largely to:
 - i. insufficiencies in laws regarding bank security, making it difficult for banks to recover collateral and thus making them unwilling to lend, especially to small enterprises;
 - ii. underdevelopment of instruments such as leasing and hire-purchase, which would make it easier for small enterprises to acquire capital equipment and for households to acquire consumer durables;

- Insufficient information on export markets and a lack of knowledge on the part of domestic companies on how to market to Zone Franche companies (i.e., a failure of the Zone Franche companies to develop backward linkages with the domestic private sector);
- A lack of any tradition of advocacy, and a corresponding lack of any ability on the part of private business associations to conduct a dialogue with Government that can lead to positive policy change;
- Inadequacy of business services and training, as provided by training institutions and private consulting firms;

This is by no means a comprehensive list. It does, however, represent a set of problems that:

- a. can be at least partially resolved within the scope of a five-year \$14 million project;
- b. fit the strategy of A.I.D. and USAID/Madagascar;
- c. are areas in which American experience and skills may have some distinctive advantages; and,
- d. are not currently being dealt with in an adequate fashion by other donors.

Recommendations for BEST Project Activities

The study team has therefore made design recommendations for a project that, despite the many different areas of focus, nonetheless responds to a well-defined need with a coherent strategy that can be implemented within the parameters (budget, time) defined by USAID, and which involves many mutually-reinforcing and synergistic aspects that argue in favor of undertaking these activities within a single project rather than piecemeal.

The principal areas proposed for BEST Project activity are:

- Technical assistance in the deregulation and opening to competition of telecommunications, air transport, and other priority sectors that may be identified;
- Technical assistance in restructuring and/or privatizing strategic public enterprises (PEs) and assistance in articulating and implementing overall strategies for PE reform and privatization;

- **Providing technical support in the revision of certain laws, mentioned above, and in the publication and dissemination of legal texts and concise summaries that can be readily understood by the general public;**
- **Training of judges and magistrates, through observation of the U.S. legal system and focused training modules, seminars, and courses delivered in collaboration with Malagasy training institutions and the University;**
- **Provision of long-term technical assistance in macroeconomic and private sector policy, probably through one or more of the the policy units in the Ministry of Finance and the Ministry of Economy;**
- **Assistance to private business associations in developing their capacity to advocate policy change, and in establishing a forum or fora for policy dialogue between the GRM and the private sector;**
- **Improving the ability of private business associations to disseminate information and transfer technology to their members;**
- **Assisting local training institutions in the design and delivery of ccourses responding to specific private sector needs (e.g., course on how to market to Zone Franche companies);**
- **Upgrading the capacity of private business service providers to respond to private sector needs and promoting the development of a fee-for-service culture in the Malagasy private sector;**
- **Promoting contacts, exchange of information, transfer of technology and credit, through seminars and other methods, between Zone Franche companies and domestic private enterprises, with the aim of establishing and reinforcing backward linkages.**

Level of Effort

The BEST Project, as presented here, is a five-year, \$14 million project involving the fielding of:

- 1) **three long-term expatriate advisors (Chief of Party/Advocacy Advisor; Macroeconomic Policy Advisor; and, Business Services Advisor); and,**
- 2) **302 person-months of short-term technical assistance; and,**

the provision of:

- 1) \$1,000,000 in business association grants;**
- 2) \$1,000,000 in co-funding of feasibility and market studies and market development activities;**
- 3) \$1,000,000 in seminars, U.S. short-term study, and observation tours;**
- 4) \$1,000,000 in material and equipment (computers, software, vehicles, etc.).**

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PRIVATIZATION/PRIVATE SECTOR ASSESSMENT

The Abt Associates team examined in detail the economic, legal, regulatory, and institutional constraints to private business expansion in Madagascar, with particular attention paid to the effects of the state enterprise sector on competition and competitiveness in the private sector.

A. Background

Madagascar is both a least-developed country - one of the 15 poorest in the world - and a country in the midst of a profound political and economic transition from autocratic socialism to democratic capitalism. It is also a country in profound economic crisis. Per capita GDP was 40% lower in 1992 than in 1970. Government revenues average less than 10% of GDP, in contrast to most African countries, where the average is about 15%. External debt is some 120% of GDP, while accumulated arrears on the debt will reach nearly \$1 billion at the end of 1993. In spite of seven reschedulings and the forgiveness of a significant portion of the debt owed to France, the current debt service ratio is approximately 70% of Madagascar's exports. The government budget deficit is expected to reach 9% of GDP in 1993.

With a domestic savings rate of barely 10% of GDP, one of the lowest in the world, and a gross domestic investment rate that averaged 10.6% of GDP during 1985-1989 against 14.6% for Sub-Saharan Africa, savings and investment are barely sufficient even to maintain per capita income at its current level. The World Bank estimates that for Sub-Saharan African countries the minimum investment needed to replace depreciated capital alone is about 13% of GDP, while an investment rate of about 25% of GDP is required to achieve annual GDP growth of 5 to 6%.¹ Given the rate of population growth, this is the minimum level required to achieve any measurable increase in per capita GDP. However, GDP is expected to grow by only 1.9% in 1993, less than the rate of population growth. According to the most optimistic scenarios, it will take at least 10 years for per capita GDP to reach the level of 1970. According to other, possibly more realistic, projections, this may not occur until the middle of the next century.

Both the Government of the Republic of Madagascar (GRM) and the Malagasy people appear to have realized that major reforms are required just to stop the precipitous economic decline the country has experienced over the past 20 years, and that any measurable improvement in people's standard of living will require a vigorous and sustained reform effort. Starting in the early 1980s Madagascar, one of the most highly restricted economies in the world, began to undertake significant reforms aimed at developing the private sector and reducing the involvement of the State in the economy. From 1982 to 1986, reforms concentrated on major macroeconomic indicators. These included:

¹ *Madagascar: Financial Policies for Diversified Growth*, Washington, D.C., The World Bank, 1993.

- Devaluation of the Malagasy franc (FMG) to its 1980 level;
- Reduction in the current account deficit from 13.1% of GDP in 1982 to 9.1% in 1986;
- Reduction of the budget deficit from 8.8% of GDP in 1982 to 4.2% in 1986; and,
- Reduction of the inflation rate from 24.5% in 1982 to 14.1% in 1986.

Since 1986, overall macroeconomic reforms as well as specific sectoral reforms continued. Among the positive achievements of the reform program have been:

- Further devaluation and continued effective management of the FMG;
- Liberalization of imports, introduction of an open general license for most items, and reduction and rationalization of tariffs;
- Liberalization of exports and elimination of export duties, elimination of floor and ceiling prices for many products, and abolition of controls on production and domestic and foreign marketing of all crops except vanilla;
- Elimination of price controls in the industrial sector;
- Opening of the banking sector to private banks, and the partial privatization of two major state-owned banks;
- Introduction of a new investment code and establishment of free trade zone legislation; and,
- Introduction of a privatization program and the liquidation or sale of more than 70 public enterprises.

Progress has been difficult to sustain in many areas. Some of the earlier achievements have been eroded, particularly in the current account and budget deficits. The current account deficit remains at 9 or 10% of GDP, while the government budget deficit is projected to climb to 9% of GDP in 1993, more than double its 1986 level. The privatization program was suspended in July 1993, pending the GRM's review of the program and its overall privatization strategy. Nonetheless, Madagascar has come a long way in the past 10 years. Among the most impressive achievements has been the country's ability, in spite of continuing constraints imposed by macroeconomic conditions, inadequate infrastructure, and deficiencies in the legal and regulatory environment, to attract substantial investment, most of it foreign. It is estimated that new investment has created more than 9,000 new jobs annually

since the passage of a new investment code and the establishment of industrial free trade zone legislation in 1989, with about 300 new companies investing more than \$80 million under these laws. The Free Trade Zone system (Zone Franche - ZF), created in late 1989, has attracted some 40 companies that have already begun production, employing around 17,000 workers, with as many as 40 more companies expected to become operational during the course of 1994, generating more than 10,000 additional jobs. An estimated \$22 million in cumulative investment by ZF companies is projected by the end of 1993, an amount expected to double during 1994. These companies generated exports of some \$19 million in 1992, with projected exports expected to rise to more than \$55 million in 1993.

With an estimated annual growth of the urban work force between 100,000 and 140,000, Madagascar cannot rely on the ZF to generate the required number of new jobs. As a point of comparison, Mauritius, which has what may be the most successful ZF program in the world, has managed to generate fewer than 100,000 ZF jobs in the dozen years since the inception of the program. Mauritius has, however, been able to use the ZF as a catalyst to wider economic development. Employment and income have been created through the development of enterprises providing services and inputs to ZF companies, while the salaries earned by ZF workers have had an important multiplier effect throughout the economy, creating demand for domestic goods and services of all kinds and generating significant investment in companies that can satisfy that demand. In Madagascar, which has far more natural and agricultural resources than Mauritius and could, for example, ultimately supply significant amounts of cotton to garment companies in the ZF, the potential multiplier effect is, if anything, greater. The ratio of manufacturing job creation to formal service sector job creation (excluding government but including construction and public utilities) is estimated at 1:3 in Madagascar. Additional employment creation in the agricultural and manufacturing sectors, and in the informal sector, is unknown, but is likely to be significant.² The World Bank estimates that each new job created will result in increased domestic purchasing power of about six times the actual salary paid.³ Thus, each ZF job created at the average annual wage of \$300 can potentially contribute from \$1,800 to more than \$5,000 annually in increased purchasing power (combining formal service sector job creation with estimated purchasing power and informal sector job creation multipliers).

This kind of outcome is far from assured, however. The private sector in Madagascar, particularly those companies that do not operate in the ZF, faces enormous challenges, many of which could limit not only the multiplier effects of ZF investment, but also direct foreign investment itself. These include: 1) inadequate and costly telecommunications, transport, utilities and other physical infrastructure and public services; 2) inadequacies and ambiguities

² Clive Gray, Stryker, J.D., and Metzler, J., The Current Macro-economic Situation and the Progress of Reform in Madagascar, 1991 (p.19).

³ The World Bank, "Aide-Mémoire de la Mission Economique du 10 au 27 août 1993," Washington, 1993 (p.6).

in the legal and regulatory environment for private enterprises; 3) insufficient access to credit; 4) a declining quality of professional, technical and basic education; and, 5) an undeveloped financial sector that is severely handicapped by public deficits and low savings and investment rates, to name just a few of the more critical problems.

B. Critical Problems in Private Business Expansion

In spite of the progress it has made towards liberalizing its economy, Madagascar remains subject to the restrictions of 1) a large and inefficient public enterprise sector; 2) a regulatory environment that inhibits the creation and expansion of private enterprises and forces the bulk of economic operators to remain in the informal sector; 3) inadequate physical infrastructure; and, 4) a declining educational and technical base.

The advances made in adopting a new investment code and Export Processing Zone legislation have been impressive, and have translated into measurable and substantial increases in inward investment and employment. Advances in this direction must be sustained. The continued challenge, however, which the BEST Project may be able to address in a useful way, is the absence of effective links between the companies in the Zone Franche and the enterprises, most of them small and most of them wholly domestic, which could play an important role in expansion of employment and generation of income if they were able to interact with Zone Franche enterprises, as subcontractors or suppliers. The absence of these links is due primarily to the restrictions enumerated above.

The public enterprise sector and its effective monopolies in many sectors stifles private initiative and deprives private enterprises of access to capital. The legal and regulatory framework also makes it difficult for private operators to obtain credit, while at the same time, the existing Zone Franche legislation serves to insulate Zone Franche companies from contact with the domestic private sector. Specifically, restrictions designed to prevent domestic sales by ZF companies prevent those companies from subcontracting intermediate production processes to local companies for further processing prior to re-export, while the lack of an effective tax rebate and duty drawback system makes it difficult or impossible for local companies to obtain tariff and tax incentives for sales to ZF companies.

Inadequate infrastructure reduces Madagascar's attractiveness to foreign investors, reduces the ability of companies to operate in multiple regions of the country, and ensures that foreign investment will continue to be concentrated in a few areas where the infrastructure is acceptable and the access to transport links is relatively unaffected by the state of most of the country's infrastructure (primarily Antananarivo with its international airport, and the port of Toamasina). Additionally, the educational system, with a few exceptions, provides little in the way of useful vocational training, while there are few structures, whether public or private, that can provide entrepreneurs with the technical assistance and training they require.

The financial infrastructure is inadequate to support private business development. As is common in Africa, banks require excessive collateral for loans, on the order of 200% of the loan amount, while inadequacies in establishing clear title to land often results in banks' refusal to lend even if the collateral requirements can be met. Moreover, the archaic and poorly-functioning legal system means that even if a borrower can provide collateral with clear title, there is no guarantee that the banks will be able to seize the collateral in the event of default. Alternative financial instruments, primarily leasing, which could avoid this constraint, are undeveloped, while the unfavorable tax treatment of dividends and the lack of any secondary market prevent the development of new equity-based methods of financing.

The identification of these problems has been made repeatedly, and numerous solutions have been proposed. The private sector, however, has been unable to establish a forum for discussion with government of essential policy issues, and has consequently been unable to convince government of the critical character of many of the reforms that have been identified. There are several reasons for this, including the lack of a culture of advocacy and independent political activity, and the historical role of business associations as quasi-governmental rather than independent organizations. The United States, with its long history of independent, voluntary associations and advocacy, may be particularly well-placed to assist in developing this capacity in Madagascar through the BEST Project.

1. The Public Enterprise Sector

The public enterprise (PE) sector has been, and remains, a major constraint to private sector development, draining funds from the national budget to cover their deficits, diverting funds from badly-needed investment in maintaining and improving infrastructure, and inhibiting competition.

The PEs As Drain on the GRM's Budget

By the end of 1985, following successive waves of nationalization and public investment, the GRM had 175 state enterprises in its portfolio. With few exceptions, these enterprises have constituted an enormous drain on public resources, as funds went into large public enterprise investment projects in the 1970s, and as they continue to siphon off funds that could otherwise be used for productive purposes. The PEs failed because of poor management, often put in place for political reasons rather than any ability to perform, and because of an economic and regulatory environment that would have made success all but impossible even for the most talented managers. Government controlled pricing and labor policies, conflicting financial and social objectives imposed by the sectoral ministries, combined with ineffective management all led to their losses and growing deficits. The government could not monitor the performance of its 175 PEs effectively either. The PEs continued to rely on direct subsidies while enjoying the benefits of indirect subsidies such as unpaid taxes and "equity injections" by the government to cover their operating losses.

Consequently, the government's budgetary deficit soared from 1.5% of GDP in 1977 to 13% in 1980. At the same time, the external debt also jumped from 13% of GDP in 1977 to 32% of GDP in 1980. In early 1980s the government's external debt tripled from US\$1.223 billion in 1980 to US\$3.577 billion in 1987. The share of total debt service to exports of goods and services almost doubled from 26.8% in 1980 to 45.5% in 1987. As a result, the gross domestic investments declined by 25% between 1980 and 1987. The minimum investment needed to replace depreciated capital is estimated at 13% of GDP.⁴

During this period, the loss making PEs became heavily indebted to the state-owned banks. By the end of 1987, loans from the state-owned banks to the PEs accounted for more than 50% of total bank credit and 10% of GDP. More importantly, these non-performing loans led to crowding out credit to the already deprived and neglected private sector. The existence of the public enterprises and their deficit financing overrode the interests of the private sector, especially the small and medium sized enterprises (SMEs).

A 1992 study of 103 PEs showed that during the period of 1988-1990 they accounted for 4.2% of GDP, and 30% of the total industrial sector, jointly employing close to 100,000 people. Their share of external debt of US\$500 million in 1990 constituted 16% of total external debt of the country which rose in 1991 to nearly 20% of the total external debt.

The Efforts to Reform and Privatize the PEs

In 1990, the GRM developed a master plan for privatization, covering the sale or liquidation of more than half of the Government's PE portfolio and aiming principally at divestiture of non-performing enterprises. Until the program was suspended, more than 80 companies had been liquidated or privatized, while at the time the program was suspended a further 38 were slated to be sold before the end of 1993.

In August 1992, the GRM published a list of PEs where it held a majority holding, and which it intended to sell to the highest bidder.

In the financial sector, the GRM has fully privatized one bank--Banque Nationale pour l'Industrie (BNI), and has partially privatized another (Banky Fampanandrosoana ny Varotra - BFV). The BNI's privatization was relatively straightforward. Credit Lyonnais, already a shareholder, in 1991 acquired 51% of BNI's shares, and assumed management of the institution, renamed BNI-Credit Lyonnais. In March 1991 the French subsidiary of an Italian bank, l'Instituto Bancario San Paolo di Torino (IBSP), acquired 22% of BFV the third-largest bank, increasing the capital from FMG 3 to 6 billion. Further privatization of the remaining state shares in BFV is virtually certain. The Banque Nationale pour le

⁴ *Madagascar: Financial Policies for Diversified Growth; Choices for a Market Economy*, World Bank Report, March 1992, p.11

Développement de l'Agriculture--normally known by its Malagasy initials, BTM--accounts for 40% of the domestic market, and represents the greatest continuing problem in the banking sector. Government officials claim that BTM was responsible for the economic slump because of its imprudent expansion of credit in 1988-89 and its continuing losses reaching a cumulative total of FMG22 billion (US\$ 10 million) in 1992. Government is now trying to extricate itself from all but a minority position in BTM, with France's Credit Agricole emerging as a potential buyer. Jose Raserijona, the Minister of Finance and Budget, recently stated that the banks need not only the additional capital but also the know-how that foreign banks can bring.⁵ The banking sector has also been opened to full competition from private banks, with two new foreign banks establishing a presence in 1988 and 1989. In 1988, Banque Nationale de Paris Intercontinentale (BNPI) established a new commercial bank, the Banque Malgache de l'Océan Indien (BMOI), and in 1989 the Mauritius Commercial Bank established a representative office which in 1993 became a fully-chartered bank, the Union Commercial Bank (UCB). The presence of private foreign banks in the sector is certain to accelerate the privatization of most of the State's remaining interests in the commercial banking sector.

PEs as a Barrier to Competition

The private sector continues to suffer from the inefficiency and the intervention of the PEs in the utilities, transport and communications sector. The PEs increase the cost of doing business for the private sector and restrict competition. According to the CRC study on the PEs, the water supply and electricity company (JIRAMA) had debts as high as \$US110 million in 1990. As is common in many developing countries, but contrary to the practice in most industrialized countries, JIRAMA charges high-volume industrial and commercial users higher rates than it does household consumers. While this may meet certain social policy goals, it results in imposition of an uncompetitive cost structure on businesses. This suggests that JIRAMA could benefit from the introduction of market-based pricing and disengagement of the state from strategic decision-making, which in turn could reduce the price of electricity for private businesses.

The oil refinery and distribution company (SOLIMA) is also a state monopoly in importing, storing, transporting and distributing petroleum. Due to inefficiencies in its procurement and operating inefficiencies in the state refinery, whose capacity substantially exceeds domestic consumption, the real price of petroleum products is substantially above world market prices, while retail prices are fixed by decree at a level substantially below cost.

The PEs such as railways (RNCFM) and international air transport (Air Madagascar - Air Mad) impose transport constraints on the private sector. The railways operate inefficiently and result in delays. Air Mad as a state monopoly controls access to all domestic and all major international routes. The monopoly of air transport results in limited frequency and

⁵ *Revue de l'Océan Indien*, November 1993, p.23.

high cost of international and domestic air links. In turn, this deters private sector activity as well as tourism, which is potentially a sector that could contribute significantly to the country's development, and generate foreign currency receipts. These issues are discussed in greater detail in the section below dealing with infrastructure constraints. In the context of privatization, however, it is probably unrealistic to think that the railways can be privatized, since there are few, if any, scenarios under which they could compete profitably and effectively with road transport, particularly in view of liberalization of road transport and likely future infrastructure investments in that sector. In addition to liberalization of the current international air transport sector, however, disengagement of the state from business decisions is also a likely development, which may ultimately lead to full or partial privatization of the company.

The international telecommunications (STIMAD), and the post and domestic telecommunications company (PTT) limit provision of all types of communications to the state. There is at the moment inadequate investment and infrastructure in this sector.

The two existing insurance companies (NY Havana and ARO Assurances) also have a monopoly of the domestic insurance market. With no competition, these companies have no incentive to develop new products, markets or strategic alliances.

Although not public enterprises, the existing accounting and audit firms have managed to create a quasi-monopoly by controlling entry into the profession. Only three major firms and three or four smaller ones supply the market. The GRM has not defined entrance standards to the audit profession despite over 5 years of debate on a text.

In the consulting field, BAPIM, according to its charter an NGO, but a company with strong ties to the Ministry of Economy, appears to be seeking to control access to the investment approval process, forcing other lawyers and consulting firms specializing in services to investors to share their business with BAPIM if they do not wish to be shut out of the market.

In short, the operations and pricing policies of these PEs and nominally private businesses in protected sectors increase the cost and difficulty of doing business in Madagascar both for domestic and foreign firms. The GRM needs to introduce competitive elements into these sectors as a priority measure. Any revived privatization program should therefore be accompanied by an opening to competition, since otherwise the process will simply substitute a private monopoly for a public one. The banking sector may be an appropriate model for this, where liberalization and opening to competition have been accompanied by disengagement of the State.

Interruption of the Privatization Program

In July 1993 the GRM suspended the privatization program, citing many irregularities in the sale or liquidation of PEs and the widespread belief that the process had been rigged in favor

of insiders, thus reducing State revenues from the sale and depriving the public of the opportunity to participate. Although the GRM has not renounced the concept of privatization, it has not indicated whether or when it will revive the program. Indeed, the disbursement of the third tranche of \$45 million of the World Bank's structural adjustment credit, which was conditional on progress in privatization, has been blocked.

The new government of Prime Minister Francisque Ravony recently announced that it is in the process of reviewing the general principles and the modalities of its privatization program. The GRM is also contemplating on what kind of a structure it plans to employ for best results. However, these are not the only concerns of the Ravony government. Besides finding the right structure and the modalities of more acceptable privatization program, the new government encounters a strong nationalistic sentiment vis-a-vis privatization. The Malagasy seem very much concerned about losing their "national patrimony" to "foreigners" and to their "ex-colonizers." There is also growing skepticism about the benefits of privatization. Some officials at the Ministry of Finance stated that the board of directors of the PEs on the block were given to first chance to buy shares of the enterprises.

Despite all these concerns, some acceptance of the need to privatize exists, reinforced by considerable pressure from the World Bank and other donors. Government continues to state its intention to pursue privatization, the Minister of Economy going so far as to state recently that privatization, along with liberalization and decentralization, was one of the principal elements of the Government's economic policy. It is uncertain, however, whether the GRM has a clear sense of how to restart the privatization program in such a way that the mistakes of the past can be avoided.

Areas in which BEST Project Assistance may be appropriate:

Given the problems the GRM has faced at the level of developing and implementing a privatization strategy, the BEST Project may be able to assist in the development of such a strategy and, even more important, in fostering a debate on the subject that will ensure that the lack of transparency that led to the suspension of the program is no longer an issue. AID, which organized seminars in Tunisia on both the rationale for privatization and the methods of privatizing, may be uniquely qualified to offer such assistance.

In key infrastructure areas, such as telecommunications and air transport, the need for restructuring of PEs and for the development and implementation of a new and more open regulatory framework is critical, even independent of their ultimate privatization. Deregulation of these sectors and the creation of genuine competition, is one of the most important conditions necessary for the expansion of private business activity. The United States, which has a wealth of experience in deregulation of both telecommunications and air transport, may be uniquely qualified among donor countries to provide assistance in this area.

2. Legal and Regulatory Framework

The problems in the legal and regulatory framework in which the public sector operates have been extensively identified and studied. They essentially fall into two categories: 1) problems in the content of the laws as written; and, 2) problems in the application of the laws.

a. Problems in the Content of the Laws

Most of the laws in effect in Madagascar were inherited from the French colonial system, and are no longer appropriate for the current economic, political and social situation of the country. In addition, most of the laws passed subsequent to independence were socialist in orientation and should be revised in view of the adoption of a market economy.⁶ Specifically,

- Civil and commercial contract law is in many ways outmoded and needs to be adapted to a modern economy, especially in the area of business contracts;
- Company law is based on French laws dating back to 1867 (*société anonyme*) and 1925 (*société à responsabilité limitée*), and on more recent laws passed during the socialist period that are diametrically opposed to the notion of a market economy (*entreprise socialiste*);
- Securities laws (shares, bonds, commercial paper, mutual funds, etc.) do not reflect the changes that have occurred in financial markets in industrialized countries over the past 20 years, many of which could be applicable to Madagascar;
- Laws pertaining to collateral and security of financial institutions (mortgages, pledges, etc.) do not respond to the needs of a modern market economy;
- Laws regulating methods of financing business transactions and investments (letters of credit, checking, factoring, overdrafts) do not meet the needs of businesses in Madagascar and reflect few of the innovations made over the past 20 years elsewhere in the world;
- Laws governing the registration of companies are outmoded, reflecting neither modern methods of collection and storing of data, nor the need for efficiency and rapidity that characterizes modern commercial transactions;

⁶ Many of the problems in applicability of existing laws to current economic conditions are summarized in Hilton Root's study, "Environment for Investment in Madagascar: Institutional Reform for a Market Economy", Center for Institutional Reform and the Informal Sector (IRIS), February 1993.

- Bankruptcy laws are inadequate, oriented towards liquidation of enterprises in difficulty rather than towards providing (as is the case with U.S. bankruptcy laws) mechanisms for restructuring and saving enterprises in difficulty;
- Procedures for adjudication of disputes are oriented almost entirely towards the formal legal system, with few possibilities for mediation and arbitration;
- Property law, especially as it pertains to buildings, needs to be clarified, both in the principles on which it is based (right of foreigners to own property, right of eviction), and in the dissemination of essential information (property registers, obtaining clear title);
- Tort law has been characterized by many analysts as insufficient in the area of recovery of damages;
- Commercial and industrial law contains too many restrictions on private business activity and contains too many provisions for controls and prior authorizations;
- The Labor Code contains numerous provisions for protection of workers rights which in fact constitute obstacles to employment (e.g., detailed hiring procedures, prior authorization required to sack employees, the requirement that workers be retained even in the event of a fundamental change in the legal structure or commercial prospects of a company);
- Tax law, which involves too many restrictions and places the entire tax burden on the formal sector, while more than 80% of all economic activity takes place in the informal sector.

b. Problems Related to Application of the Law

Problems in application of the law are of three sorts: 1) those related to the functioning of the court system; 2) those related to the publication and dissemination of laws; and, 3) those related to the enforcement and application of the laws.

i. Problems due to the poor functioning of the court system

Most analyses of the legal system have concluded that justice functions poorly in Madagascar. There are numerous reasons for this, including: lack of judicial independence, intervention by the State in legal decisions, frequent failure by the State to enforce decisions of the courts, and lack of adequate training for personnel in the legal system.

ii. Problems due to insufficient dissemination and knowledge of the law

This is a critical problem in Madagascar. The laws are little known or unknown, not only by those accused of infractions of the law but also by the government agencies responsible for their application and enforcement.

There are numerous causes for this: 1) the colonial system paid little attention to dissemination of laws; 2) during the post-independence period there was little attention paid to contradictions in the laws and the need to revoke existing laws before passing new ones; and, 3) the lack of material means to publish and distribute texts in an economy growing consistently poorer.

iii. Problems due to poor enforcement and application of the laws

A critical problem, which is common to many developing countries, is that of the officials responsible for application and enforcement of the laws, who often apply the laws in an arbitrary and selective fashion, or not at all. The causes of this are well-known: abuse of power by officials; lack of knowledge or poor understanding of the laws (or incomprehensible texts); lack of material and equipment necessary for proper enforcement; and inadequate training.

c. Problems of Greatest Concern to the Private Sector

All of the problems discussed above concern the private sector. If laws governing business are archaic or based on a philosophy directly opposed to that of a market economy, they discourage private initiative. If the laws are unknown or only partly known, and if they contain numerous contradictions, they fail to offer potential investors the security of investment they seek. Finally, if enforcement of the law is arbitrary, selective, or in opposition to its intended purpose, an environment of rule of law is absent and, consequently, an enabling environment for investment is also absent.

Clearly, not all of the problems outlined above are of equal importance to private sector development. Some pose a difficulty at the time of an initial investment (company law, legal framework), while others are mainly felt when it is time to renew an investment (principally tax laws), while others can have negative effects throughout the life of a project (commercial law, labor law, financial and economic regulation)

It is equally clear that the impediments to private business activity created by the legal framework are not the same for all private operators or investors. The "private sector" is not a single entity but is rather made up of a wide range of different kinds of businesses, ranging from small, informal sector traders to large, multinational manufacturing companies. The importance of the legal framework is therefore a function of the position of an enterprise in the economic cycle. Consequently, a dynamic approach is called for, which takes into account the different impact of legal and regulatory constraints on enterprises at different stages of development. In view of this need, it is possible to identify the problems most urgently requiring BEST Project assistance.

i. Importance of the security of the legal framework

The most important thing to an investor, whatever the size of his investment, is the security of the law. The focus here on "investors" is deliberate; private sector development can occur only through increased investment which, by definition, is something that requires some time before it produces a profit. Investors are willing to assume commercial risk; by nature an investor bets on his own ability to gauge commercial conditions and to produce a product that will sell in the market he has identified. Few investors, however, are willing to assume what is generally termed political risk; that is, the risk that government action or the action of certain agents of government will deprive them of the fruits of their investment. The importance of a secure legal framework and a general acceptance of the concept of rule of law cannot, therefore, be overstated. The financial benefits of the Investment Code and Zone Franche law are important, but what is perhaps more important to investors is the security they provide, in a well-defined legal and policy framework.

ii. Importance of training and human resource development

The manner of application and enforcement of the laws, whether by the courts themselves or by law enforcement personnel, is also of critical importance. Laws are only as good as their enforcement. In the context of Madagascar, what is required is a profound transformation of people's way of thinking. In particular, it is necessary that people in Government who are responsible for applying the laws become convinced of the benefits of private sector development, so that they no longer regard private operators as actual or potential criminals who need to be controlled more tightly. This is something that can be accomplished only through a long-term effort of training, which can also be assisted by the opening of a continued dialogue between Government and the private sector. In addition, a better knowledge of the law is an essential prerequisite, since the more widely the laws are known, the more protection there is against their arbitrary application.

iii. Importance of redrafting certain legislation

The choice of specific laws requiring priority reforms is not easy, since all of the laws mentioned above have some importance for the private sector. Nonetheless, in Madagascar, even though most of its laws are very similar to those in effect throughout francophone Africa, the practical effect of many of those laws is quite different from that which is found in other countries.

Thus, tax law, the labor code, and overall economic and financial regulations, which in other parts of Africa constitute a major barrier to private sector development, in Madagascar do not appear to be such a major obstacle, whether in the content of the laws or in their application. This conclusion is supported by the statements of a wide range of private sector operators. While the laws could certainly benefit from further liberalization, their effect, even if strictly enforced, is not excessively onerous. Enforcement, however, tends to be fairly lax, as a result of limited resources available to the authorities. On-site tax inspections,

for example, a regular occurrence in many countries, are relatively infrequent in Madagascar. Companies report few problems in dealing with the labor authorities. The transfer of funds into and out of Madagascar, a matter of fundamental importance to any foreign investor, while not as free and as simple as it could be, does not appear to be a major obstacle to foreign investment.

The one point on which all business people are unanimous concerns company law, which is universally considered outmoded. In addition, modernization of contract law is generally considered important. Finally, it is everywhere agreed that new financial instruments and methods of financing investments, working capital and sales are required, some of which may require new legislation. Given the inadequacies of the judicial system, introduction of mediation and arbitration is considered desirable. Finally, clarification, if not reform, of the laws pertaining to property ownership by foreigners is important, especially in the tourism sector, where few significant foreign investments are likely to take place without the ability to purchase land.

In summary, the priority areas for legal reform include:

- revision of civil and commercial contract laws, even if only for the purpose of unifying the various texts, many of which contradict one another;
- revision of company law;
- modernization of laws governing securities and financial instruments;
- drafting and passage of enabling legislation for leasing, hire-purchase, and installment credit, for consumer as well as capital goods;
- reform of financial sector legislation; in particular those laws governing security and collateral, which would give banks in practice the right to seize collateral in the event of default, without which provision access to bank credit will remain severely limited;
- further liberalization of the Zone Franche law and the Investment Code in ways that will facilitate provision of services and inputs by domestic companies to ZF enterprises, and which will eventually make ZF and Investment Code benefits available throughout the economy.

Other areas that should be considered for reform include:

- reform of property laws, although, as mentioned above, this is not a major obstacle to development;

- liberalization of commercial and industrial codes is fundamental; however, this is more a regulatory than a legislative matter and depends more on acceptance of a general policy orientation than on any revision of legal texts: it is primarily a question of rescinding certain decrees, proclamations and administrative orders which limit free access to certain kinds of economic activity and which inhibit competition;
- revision of contract laws;
- development of a system of arbitration and mediation; Malagasy law, however, does not prohibit any such system, at least in commercial disputes; the problem is one of giving arbitration decisions the force of law, and is therefore tied more closely to administrative decisions and their application, and to the establishment of an institutional framework, than to any legislative reform.

3. Infrastructure

Infrastructure is generally cited by private sector operators as a constraint more serious than those posed by deficiencies in the legal and regulatory framework. The two elements most frequently mentioned are telecommunications and transport, the latter comprising internal road transport, as well as external sea and air links.

Telecommunications, even by the standards of an underdeveloped country, are woefully inadequate. Exporters, shippers, and entrepreneurs in all industries characterize the telephone system as it currently exists as an enormous handicap. The entire country has fewer than 35,000 lines, of which more than half are in Antananarivo. In Antananarivo itself, there is a backlog of more than 3,000 requests for telephone installation. 'at the same time, the existing system barely functions; it is estimated that barely half of all calls within the capital get through during peak business hours.⁷ There are fewer than 1,000 fax lines for the entire country. The situation for interurban and international telecommunications is even worse than within the capital. Telephone connections between Antananarivo and Toamasina, the principal port, are almost impossible, forcing businesses to rely on private couriers and single sideband radios. The lack of lines makes it difficult for international calls to get through, even though access to the international network is controlled by STIMAD, a mixed enterprise established in 1970, in which the State owns 53% and France Câble et Radio, a French company, 47%.

⁷ These, and other figures for telecommunications, are taken from Charles Steedman, *et al.*, *Do telecommunications and Air/Sea Transport Problems Limit Madagascar's Exports?*, Center for Research on economic Development, University of Michigan, for USAID/Antananarivo, January 1993.

Investment has been almost nonexistent, partly due to the fact that at least 25% of telephone bills are never paid. Although many countries use international tariffs to subsidize domestic use, in few countries is the gap quite as wide as in Madagascar. Local calls cost only 115 FMG (about 6 U.S. cents) for three minutes, while interurban calls go up to a maximum of \$1 for three minutes. By contrast, a call to France costs \$23 for the first three minutes and \$2.50 per minute thereafter, while to the U.S. it is more than \$50 for the first three minutes and nearly \$6 per minute thereafter.

Two factors are responsible for the present obsolete and inefficient status of the telecommunications sector in Madagascar: First, the lack of government resources left this sector deprived of the investments in recent technological improvements in North America, Europe and Asia. Second, the deregulation and modernization of telecommunications during the past five to ten years have widened the gap between these regions and Madagascar.

In several countries, privatization has been preceded by liberalization of the telecommunications sector, opening the door to private companies to provide new niche services. The economics of telecommunications dictate that the services such as cellular, paging networks, data communications, and value-added services should be increasingly left to the private sector. In Malaysia, for example, the operation of paging service networks was assigned to several private companies. Pakistan's Ministry of Communications granted licenses to introduce and operate a cellular mobile phone system to serve 25,000 subscribers. Operators are expecting 100,000 customers on each network within four to seven years. Tunisia has also liberalized the work of installation of public and private switching exchanges and civil works, while paging services are provided by a local company. The Tunisian PTT has also passed the post-installation inspection and approval of equipment to a private company. The new entity covers all activities, including public exchanges, PBXs, and long distance transmission. The local commercial banks were instrumental in creating this new entity. They were seeking more sophisticated maintenance for their private network and then also invested in the new company.

Whether or not the telecommunications sector is to be privatized immediately, there is an urgent need to pass a new Telecommunications Law to loosen state ownership and service monopolies, and to encourage new private operators to enter the market. In addition, the GRM will need assistance to create a regulatory framework for the incoming players into this sector.

Significant advances have already been made. The Ministry of Posts and Telecommunications (MPT), under pressure from the World Bank and other donors, as well as the International Telecommunications Union, agreed to a set of reforms that included:

- Complete separation of regulatory authority and operational responsibility;
- Separation of postal and telecommunications functions;
- Fusion of domestic and international systems;
- Management and financial autonomy;

- Involvement of an outside partner or partners in the management of the telecommunications system.

An five-year investment plan, involving some \$150 to \$170 million over the period 1993 through 1998 has been approved, involving French support for the installation of a digital switching system, Japanese support for upgrading the internal microwave relay system, and an expansion of the domestic satellite system, for which the source of funding has not yet been identified. Ultimately the State is intended to acquire most of the shares now owned by FCR as a preliminary step to privatization of the system. By 1998 it is expected that the State will offer 34% of the company, via an international open tender, to a company or consortium that will operate and manage the system. An additional 17% is expected to be offered to employees and/or other domestic investors. Ultimately, the State, which will retain 34% of the company initially, will sell off a significant portion of its remaining shares. It is expected that, apart from the basic telephone network, other services, including cellular telephones and data transmission, will be open to free competition.

A number of potential problems are foreseeable in this scenario. The Caisse Française de Développement, which has indicated its willingness to lend more than \$25 million to the investment program for 25 years at 3%, has made this commitment conditional on excluding non-French equipment suppliers and on a continuing role for FCR. If this condition is retained, and French switching equipment is installed, it will make it difficult for U.S. or other, non-French companies to bid successfully for control of the telephone company itself. The GRM, however, appears unwilling to accept such stringent conditions. The Minister of Posts and Telecommunications reaffirmed that "a policy based on opening the market to all private investors from any country who are interested in participating"⁸ USAID and the BEST Project can play a useful role in providing the technical support the GRM will need to honor this pledge, and to provide a legislative and institutional framework for the restructuring of the industry.

Air Transport is yet another area of concern, in which the problem is not so much the quality as the quantity of service, and its price. Air connections to Europe are limited to four weekly flights between Paris and Antananarivo, two operated by Air Madagascar and two by Air France. Regional air links are infrequent, with two weekly flights to South Africa, three to Nairobi, one to Lilongwe and Lusaka, and several to Mauritius, Reunion and the Comores. Passenger tariffs to and from Madagascar, moreover, are among the highest in the world. This has serious implications for Madagascar's ability to attract investment. Madagascar is in direct competition with Vietnam, Burma, Indonesia, Bangladesh, Sri Lanka and India for investment from East Asian countries such as Hong Kong, Korea and Taiwan. A major concern for investors from these countries is the ability to maintain relatively close control over their offshore operations. The absence of reliable air connections, combined

⁸ *Midi Madagascar*, November 10, 1993.

with the inadequacy of telecommunications, has already, according to anecdotal evidence, caused many potential investors to decide against pursuing investments in Madagascar.

The situation with respect to air freight is somewhat better, since it is only at peak seasons (particularly in December when the lychee crop is harvested and transported to Europe) that any shortages in available cargo space are felt. Freight tariffs are generally competitive; knitwear exports from Madagascar are charged FF8.30 per kilogram from Madagascar and FF8.50/kg from Mauritius.⁹ There is little question, however, that further development of exports of perishable items is constrained by the lack of cargo space, which in turn is a function of Air Madagascar's monopoly. Kenya, for example, exports about 25,000 tons of fresh green beans annually to Europe, while Madagascar is able to export only 200 tons.¹⁰ This, and other horticultural exports, would undoubtedly increase if the cargo space were available. This in turn requires liberalization and, possibly, privatization, of air transport in Madagascar.

One of the World Bank's conditions on its sectoral adjustment credit to the industry and export sector is the privatization of air transport. Domestic air transport has in fact been liberalized, and a new, private company, Travaux Aériens de Madagascar (TAM), has been set up to compete in the domestic market. Although the GRM has agreed in principle that Air Madagascar should be privatized, it has adopted a number of delaying tactics, raising concerns about aeronautical safety and the issue of private carriers skimming off the profitable routes, leaving Air Madagascar with the ones requiring extensive subsidies. A decision appears to have been taken that Air Madagascar will, for the time being, remain in the public sector. This should not, however, prevent liberalization of the industry and opening of the international market as well as the domestic one to competition. In the event that Air Madagascar is eventually privatized, Air France, which formerly owned 25% of the company, but now owns only 3%¹¹, will obviously be in a competitive position. It will be an important concern to ensure that any full or partial privatization, or any form of operating contract, be open to full international competition.

Sea Transport, although it could be improved, is generally adequate. The port of Toamasina functions well under the management of the Société d'Exploitation du Port de Toamasina (SEPT), which acts both as a port authority and a freight handling company. The relative efficiency of the operation is largely attributable to its management structure; although wholly state-owned, the company has management autonomy, with a Director General who

⁹ Steedman, *et al.*, *op.cit.*, p. 17.

¹⁰ Anil Barday, personal communication.

¹¹ Groupement CRC Sogema-Mpanazava, *Etude Générale Portant sur le Secteur des Entreprises Publiques, Etude du Secteur Transport*, Délégation Générale du Gouvernement pour la Réforme des Entreprises Publiques (DGGP), Antananarivo, July 1992.

reports to a 14-member board representing the GRM, company personnel, and representatives from the Toamasina region.

Toamasina is not plagued by many of the bottlenecks common to African ports: dilapidated infrastructure and pilferage being among the most important. Port operations have been computerized, and turnaround for ships is competitive with Mauritius and Réunion. The main bottleneck is administrative. The Customs Service controls and other administrative delays often add 50% or more to the loading time. The number of signatures required, the unwillingness of Customs officials to work outside normal business hours, even though the port operates 24 hours a day, and routine demanding of bribes in exchange for clearance signatures, all contribute to inefficiency.

Freight rates are on average 30% higher than from Mauritius, although they have fallen by more than 50% since 1988, when greater market competition was introduced, breaking the monopoly of the Conférence Internationale Madagascar Comores Réunion Maurice. In addition to the Conference, there are now five lines with scheduled service to Madagascar as well as frequent non-scheduled arrivals. The openness of the market and the efficiency of the port are likely to bring Madagascar rates more closely into line with those of neighboring countries, especially Mauritius.

Privatization of SEPT is an issue that has been accepted in principle by GRM and the Director General of SEPT. As a profitable and comparatively well-managed enterprise, privatization is not a high priority, although as a state enterprise it has more employees than are required. One area in which liberalization is more urgently needed is in freight handling. SEPT currently exercises a monopoly on this, and does not permit shippers either to use their own equipment or to allow agents to conduct handling operations. Opening freight handling to competition could lower port charges and make shipping costs more competitive.

Road Transport remains a serious constraint to development, which ensures that most future investment will take place in the relatively few areas served by adequate roads. Currently, only 15% of the country is served by roads, and only 55% of the population have access to the road network.¹² Many of the high potential zones are connected by very poor roads to the rest of the country. USAID's CPSP notes this as a major constraint, remarking that "the transformation of a subsistence, rural economy and inward-looking, fragmented market system will require income growth (on and off-farm), secondary town development, the rehabilitation and extension of infrastructure, input supply...and stepped up investments in labor intensive manufacturing, transportation and services." USAID's Market Infrastructure Expansion (MIX) project is aimed at achieving many of these goals, focusing primarily on helping to link high-potential zones with the rest of the country and with world markets. The Commercial Agriculture Promotion (CAP) Project also will contribute to development of road transport by intensifying trade-oriented agricultural production in high potential zones

¹² CRC Sogema - Mpanazava, *Rapport de Synthèse*, p. 35.

and by providing road building and maintenance equipment to business entities and associations.

Substantial infrastructure investment will be required, as well as a restructuring of the road transport sector. Most of the state-owned enterprises in the sector are at or near a state of liquidation, with road transport effectively open to competition by private operators. A number of public enterprises in the sector have already been liquidated. TAFITA (Société de Transport Routier de Marchandises), for example, although it remains on the list of active state enterprises, ceased operations in 1982, its trucks sold at public auction. Another transport company, FIBATA, has already been liquidated by the DGGP, while yet another, SOFITRANS, has been partially privatized, with 51% of its shares privately owned.

A review of the laws affecting interurban transport, particularly of freight, may be required, with eventual reforms aimed at ensuring the right of the private companies and individuals to operate in the sector. An important advance was the recent liberalization of the importation of used vehicles, making it possible for private operators to enter the sector.

4. Training and Technology

Malagasy workers are highly productive compared to those on the African mainland. Given the low wages prevailing, Madagascar has the potential to compete effectively for investment and in export markets with other countries, such as Vietnam, which currently are attracting enormous interest from investors in Asia, Europe, and North America. The full development of this potential, however, depends on development of skills and access to technology and, above all, on the development of the local, Malagasy private sector.

As discussed above, the Zones Franches cannot by themselves generate enough employment to meet Madagascar's needs, nor can they ensure the transfer of skills and technology. Zones Franches are often criticized as contributing little to the sustainable development of the countries in which they operate, relying as they do on unskilled or semi-skilled labor. The example of Mauritius shows that this need not be the case. The challenge, however, is to leverage the investment in the Zones Franches into a sustainable and measurable increase in domestic economic activity. This in turn requires that linkages between Zone Franche companies and the domestic private sector be expanded. The Zone Franche companies, because they are large and relatively concentrated geographically, are potentially easier marketing targets than the purely domestic industrial sector. In addition, the foreign ownership of many of the ZF companies and their orientation towards the world market means that technology transfer and development of higher-quality production will be more likely to occur. This has not yet occurred to any significant degree, and is unlikely to occur unless two important constraints are overcome. These are:

- **Zone Franche Legislation/Administration:** The current laws constituting the Zones Franches inhibit the development of linkages with the domestic private sector. It is difficult, if not impossible, for a company to subcontract work to local private operators rather than employing them directly. Certain garment manufacturing operations lend themselves to this sort of subcontracting, just as Madagascar's own garment industry got its start with the transfer by Mauritius companies of some of their labor-intensive operations to Madagascar, and similar to the subcontracting by Hong Kong manufacturers to companies in China. Several Madagascar industrialists have expressed their interest in developing such subcontracting, which could also include the provision of equipment, training and financing to local SMEs. However, The GRM's fear of flooding the domestic market with ZF goods on which duty has not been paid has prevented this kind of arrangement from being developed. There is also an existing provision (Article 12 of the ZF Law), which requires ZF companies to deposit a bond to ensure re-export of materials and equipment imported duty-free under the ZF regime. This bond is assessed as a percentage (1 % every 3 months) of the CIF value of the goods imported, including plant and equipment. This provision is particularly onerous for plant and equipment, since it is never re-exported (as an example, a company with \$100,000 worth of machinery would pay \$1,000 every three months as a caution, which would never be repaid until it liquidated its investment). This can restrict the ability of all ZF companies to compete but, even more important, can prevent smaller domestic companies from becoming exporters and taking advantage of the ZF Law or Investment Code.

In addition, the laws on supplying intermediate goods to ZF companies are less than clear. A company which sells inputs to ZF companies should be able to deduct taxes and import duties on the imported content of those goods. Although duty drawback legislation is in place, it is rarely, if ever, applied in such cases. This is probably due to a lack of capacity for processing claims, a poor understanding of the applicability of the legislation to such cases on the part of Customs staff, and a lack of knowledge on the part of the suppliers themselves of their right to the drawback and of the method for claiming it. As long as ZF companies can import duty-free but must pay import duties and TUT on locally-procured inputs, they will have no incentive to source inputs domestically.

Finally, the GRM can offer incentives to ZF companies to use local inputs, by allowing access to the domestic market in proportion to the percentage of local inputs used in production.

- **Training and Information Constraints:** Many of the goods and services available locally could be supplied to ZF companies. An industrial linkages project in the Dominican Republic identified a large number of products and services that local companies could provide to EPZ companies. These included: plastic hangers, plastic bags, precision plastic and metal parts, cartons and boxes, pallets, transport, catering,

laundry, accounting, repair and maintenance, cleaning, and construction and allied trades.

The reform of ZF legislation will make it possible for Malagasy entrepreneurs to develop the ZF market. Few local entrepreneurs, however, have any knowledge of the needs of ZF companies, nor of how to establish and run a business catering to those needs. Part of this is a communication problem; the ZF companies are in a sense isolated from the rest of the Malagasy economy. Just as Malagasy entrepreneurs are unaware of a potential market in ZF companies, so too are ZF companies unaware of potential Malagasy suppliers.

The questionable quality, and problems in consistency and timeliness of delivery of locally-produced inputs may also discourage ZF companies from doing more local procurement. In a protected domestic market, local companies have had few incentives to improve quality, lower costs, and upgrade service to customers. Many of these are problems that can be addressed by an appropriate combination of training, technical assistance and information, that would use the resources of the ZF companies themselves, as well as those of local professional associations, training institutions and private providers of business services, to improve the technical, management, marketing and financial skills of local companies. Starting as suppliers to ZF companies, many such local private enterprises could eventually make the step to exporting in their own right.

There exists a large number of training institutions and professional associations whose resources can be mobilized in the transfer of technology, dissemination of information, and the advocacy of policy reforms. These include:

Professional Associations: The **Groupement des Entreprises de Madagascar (GEM)** is, with 600 associations and companies as members, the largest professional grouping in the country, equivalent to an employers' federation or a "patronnat." It is potentially effective as a means of disseminating information and of advocating necessary policy reforms, and is in the process of establishing a regular forum with both the Ministry of industrial Promotion and the Ministry of Economy to discuss policy issues of concern to its members. However, because of its size, the diversity of interests of its membership, and its position vis-à-vis government, it may be unable to focus effectively on essential policy questions, and may be unwilling to confront government directly. Its main preoccupation seems to be strengthening government control because of what it sees as cheating on taxes and import duties by both informal and formal-sector companies. As such, it may not be the most effective possible voice for liberalization of the economy. Within the membership of GEM are many other sector or subsector-specific professional associations (known as "syndicats" in French). These include: **Syndicat des Importateurs et Exportateurs de Madagascar (SIMPEX)**, **Syndicat des Industries de Madagascar (SIM)**, **Syndicat des Entrepreneurs de Madagascar**, **Syndicat des Transportateurs Maritimes**, **Association Professionnelle des Banques**, **Comité des Sociétés d'Assurances**, and several others. There is also, reportedly, an

association of exporters who are alumni of INSCAE, one of Madagascar's principal training institutions. While the time available did not permit visits to these groups, the BEST Project will have no difficulty finding appropriate groups with which to work as a means of reinforcing the domestic private sector.

FTV.MP.AMA is another association, comprising mainly SMEs. It is critical of the Zone Franche companies and their isolation from the domestic economy, as well as of potential foreign domination of the economy resulting from special privileges extended to foreign investors. It therefore sees the development of linkages between local SMEs and the Zone Franche companies as a priority, if Madagascar is to gain any lasting benefit from the Zone Franche and Investment Code legislation.

For reasons that remain unclear, the **Chamber of Commerce** is virtually moribund. There is talk of reviving it, or possibly of splitting it into sector-specific chambers, but currently there is no real structure with which the BEST Project could potentially work.

Training Institutions: There are three major institutions offering specialized training in commerce and business. **INSCAE (Institut National des Sciences Comptables et de l'Administration d'Entreprises)** is a government institution set up with substantial Canadian assistance, which has worked extensively with USAID. It offers three levels of diploma courses, corresponding roughly to A.S., B.S. and MBA degrees in accounting, management, finance and marketing. In addition, INSCAE offers a wide range of short-term courses, many of them tailored to individual companies' needs, the costs of which are paid by the companies themselves. INSCAE also functions as a consultancy, conducting market studies and providing management advice to individual companies. With the support of USAID, INSCAE has sent exporters for training in the U.S. It also collaborated with USAID on a government-private sector forum on issues concerning the economic liberalization and private sector development. On its own, INSCAE conducts executive management program, courses on commercial law, and courses in finance, marketing and other disciplines. Although the fees are relatively high (a one-month course can cost FMG2.5 million), most of the companies benefiting from INSCAE courses are small and medium enterprises rather than large ones, many of which prefer to send people for study abroad. INSCAE brings in local and foreign experts with a practical orientation to conduct many of its courses. A key need, as identified by INSCAE personnel, is for expertise in international marketing.

Other training institutions include **ISCAM (Institut Supérieur de la Communication des Affaires et du Management)** and **IMATEP (Institut Malgache...)**. ISCAM is a private school with an enrollment of some 250 full-time students, 80% of them women, which offers two-year diploma-level courses in international marketing, sales and marketing, tourism, and administration. Aimed at a slightly lower level than INSCAE, ISCAM aims to develop middle managers and technicians, providing practical training that includes 14 weeks of practical experience in an enterprise during the two-year course. ISCAM is also, increasingly, turning to continuing education, providing off-the-shelf and tailor-made courses to individual companies, most notably BNI-Crédit Lyonnais, where it trained 50 bank tellers in

business English and 100 Air Madagascar people in sales techniques. As a private institution, concentrating on practical training and oriented towards English as the future language of business, ISCAM is potentially a useful collaborator in the BEST Project.

Private Business Services: The business service sector is relatively well-developed. There are six audit and accounting firms, about a dozen companies providing management and marketing consultancy services, several computer consulting firms, and various engineering, architecture and industrial consulting firms. A significant number of the professionals who own and work in these firms are well-educated and have a wide range of professional experience. The accounting profession currently remains closed to foreigners, so that none of the Malagasy firms have any correspondent or affiliate relationship with international accounting firms. As a result, financial statements are less reliable than they otherwise might be, which tends to limit banks' willingness to lend money to private companies. A clear need on the consultancy side is for greater awareness of international market opportunities and the ability to assess potential export markets, either independently or in association with foreign consulting firms. The development of these links and a transfer of market research and management information technology from U.S. to Malagasy consulting firms may be one area in which USAID can make a significant contribution.

Other Structures: Both within and outside of Government there exist several nascent structures that can potentially have a significant role in developing skills and promoting private investment in the Malagasy private sector. These include:

The "Guichet Unique": The concept of the "guichet unique," or one-stop-shop for investment approvals has been widely promoted as a solution to delays, whether deliberate or not, in obtaining investment approvals. The reality in most countries is somewhat different. A guichet unique can render things somewhat simpler for potential investors by becoming the sole point of contact between the investor and the government. There are few, if any cases, however, in which the guichet unique actually possesses the power to grant the necessary approvals. Government authorities do not, as a rule, like to give up even a small portion of their power, which they would have to do if the guichet unique were to have any real authority. In Madagascar, this has not yet become an issue, since although the legislation establishing the guichet unique was passed over two years ago, it has yet to become operational. It is unlikely that if and when it does begin to operate it will have the authority to approve investment applications without recourse to other ministries. The guichet unique can, however, perform an essential function in the dissemination of information. It can provide information to potential investors in response to specific questions or in more general terms on the rights and responsibilities of private companies, and on the specific administrative requirements and steps in obtaining the necessary approvals.

Office de Promotion des Investissements à Madagascar (OPIM): This is another structure, constituted legally but so far not operational. Its role and responsibilities

vis-à-vis those of the guichet unique are not well-defined, and it is likely that considerable overlap in mission and function exists.

Both the Guichet Unique and OPIM could potentially benefit from BEST Project assistance in better defining their respective roles and responsibilities and developing the operating procedures and material and human resources they require to perform effectively. The BEST Project can consider providing advisory services, training and technical assistance to either or both of these units, assisting them better to define their mission and strategy, and to enable them to provide a useful range of services to the private sector.

Bureau d'Appui et de Promotion des Investissements à Madagascar (BAPIM): Officially an NGO, BAPIM has very close ties to the Minister of Economy. Its purpose is to promote foreign investment in Madagascar, to help develop partnerships between foreign investors and Malagasy entrepreneurs, and to help foreign investors conduct market and feasibility studies and to obtain the necessary investment approvals. BAPIM was also engaged by the Ministry of Economy to help revise the investment code, to establish the guichet unique, and to develop partnership law. Although its membership includes a number of consultants, lawyers and accountants, as individuals or as companies, BAPIM's aim appears to be to act as the sole intermediary between foreign investors and the GRM so that these other entities, in order to continue to serve foreign investors, will be pressured to do so within BAPIM, which itself will keep a substantial share of the profit. BAPIM may have sufficient influence to act as the main gatekeeper to the guichet unique and other authorities within the Ministry of the Economy. The implications for the BEST Project are serious, in that effective promotion of the private industrial sector may be possible only in collaboration with BAPIM.

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ANNEX I

DRAFT

**BUSINESS ENTERPRISE SERVICES AND TECHNOLOGY (BEST)
PROJECT IDENTIFICATION DOCUMENT (PID)**

I. PROJECT BACKGROUND

A. The Development Context

Madagascar, despite its potential, is one of the world's poorest countries, a country with a declining economy, a crumbling infrastructure, a declining educational base, which is saved from total bankruptcy only by the continued injections of credit by international donors. Perhaps the most telling statistic is that per capita GDP today is 40% less than in 1972, when the socialist government of President Didier Ratsiraka came to power. The most ambitious and optimistic projections of future performance call for per capita GDP to rise to its 1972 level within 10 years. Other projections, not necessarily the most pessimistic that have been produced, estimate that this level will not be achieved for another 70 years.

The reality no doubt lies somewhere in the middle. As the pace of technological change in the developed world increases, countries that cannot achieve very rapid economic growth are destined to fall further and further behind. This outcome is not fore-ordained, however, and there is much Madagascar can do, with the judicious help of donors such as USAID, to embark and stay on a more hopeful course. For Madagascar, this means achieving a rate of annual GDP growth of at least 6%, although much faster growth is possible, as countries such as Thailand, Korea, and, now, China, demonstrate. This growth can only come through a very rapid growth in private investment, both foreign and domestic, and a rapid growth in exports. Foreign investment can be leveraged to generate rapid development of the domestic private sector, fulfilling its role as a catalyst to investment, technology transfer, market access, and financial and managerial know-how. For this scenario to be realized, however, numerous problems must be addressed.

Among the most critical problems requiring rapid resolution are: 1) the economic policy framework in which private enterprises operate and the institutional framework for conceiving and implementing economic policy; 2) the legal and regulatory framework in which private businesses operate, and the institutional framework for administering the laws and regulations; 3) anti-business attitudes within government that prevent the effective implementation of market-based reforms; 4) constraints to free competition imposed by state control of critical sectors; 5) public deficits that drain funds from the private sector and prevent adequate investment in physical and educational infrastructure; and, 6) inadequate physical infrastructure that has not been improved or even adequately maintained for 20 years or more.

B. Conformity with Madagascar's Development Strategy

Madagascar's strategy for economic development is based on the new investment and Zone Franche codes, and on the assumption that private sector investment must be the driving force in the economy. The Prime Minister, in his Discours Programme, stated that "liberalization of economic activities is essential," and that one of the key elements of his government's economic program would be to encourage private investment. He further stated

that the State must "disengage itself, partially or totally, from public enterprises in order to stimulate production and get the economy started again." Even for those enterprises in which the State might retain part ownership, the Prime Minister has stated that their management would be privatized and given its independence, and their managers held responsible for the results of companies under their direction. In the same speech, the Prime Minister also said, "I am convinced that a well-managed policy of industrial promotion and the establishment of an investment climate capable of inducing international investors to choose our country should enable us within a few years to create tens of thousands of new jobs, if not more."

The BEST Project, which has as its principal purpose the development of a favorable business and investment climate, is fully consistent with and supportive of the GRM's objectives as outlined in the Prime Minister's speech, and as applied in the new investment code and Zone Franche law passed in 1989. In this regard the Project recognizes existing shortcomings in the dissemination and application of laws and regulations affecting the private sector, of inconsistencies and constraints in the laws and regulations themselves, and of the need for improved quality and more widespread delivery of business services.

C. Relationship to USAID Mission and A.I.D. Strategic Concerns

A.I.D.'s policy with respect to private sector development is based on three essential and mutually reinforcing elements:

- Promotion of a policy environment conducive to private business activity;
- Development of viable, competitive markets; and,
- Fostering greater reliance on market forces.

Each of these elements is reflected in the BEST Project design recommendations.

In addition, A.I.D.'s overall strategy places substantial emphasis on democratization and development of greater government accountability. The BEST Project, by focusing on the dissemination of information on laws and decrees, and by promoting increased transparency in government decision-making, fully supports this strategy.

One of USAID/Madagascar's main priorities, as outlined in the Country Program Strategic Plan (CPSP), is to "establish a competitive, pro-business climate." The principal targets in support of this priority are: 1) to work towards a legal, regulatory and judicial environment supporting market development; 2) to promote financial market reforms leading to increased availability of domestic resources for the private sector; and, 3) expansion of the range of services and technologies available to private business. The BEST Project is fully consistent with these targets, and is oriented principally towards achievement of the first and third of these targets.

II. PROJECT DESCRIPTION

A. Statement of the Problem

There exists a large number of critical constraints to the growth of investment and the development of the private sector. These include:

- Inadequate infrastructure and costly services, particularly in the telecommunications and air transport sectors, due to monopoly power exercised by State-owned Enterprises (SOEs), and the consequent lack of investment, innovation and competition;
- A persistent inability to control budget deficits and the public investment budget, resulting in inadequate investment in essential infrastructure;
- Insufficient access to credit for domestic enterprises, due largely to:
 - i. insufficiencies in laws regarding bank security, making it difficult for banks to recover collateral and thus making them unwilling to lend, especially to small enterprises;
 - ii. underdevelopment of instruments such as leasing and hire-purchase, which would make it easier for small enterprises to acquire capital equipment and for households to acquire consumer durables;
- Insufficient information on export markets and a lack of knowledge on the part of domestic companies on how to market to Zone Franche companies (i.e., a failure of the Zone Franche companies to develop backward linkages with the domestic private sector, and a failure by domestic private sector companies to identify and exploit market opportunities in the Zones Franches);
- A lack of any tradition of advocacy, and a corresponding lack of any ability on the part of private business associations to conduct a dialogue with Government that can lead to positive policy change;
- An inability on the part of private business associations to ensure a flow of information to their members and to play an active role in the transfer of production, marketing and management technology;
- Poor functioning of the justice system, due to:
 - i. inadequate publication and dissemination of laws;
 - ii. failure of those responsible for administering and enforcing the laws to adopt attitudes more favorable to the private sector;

- iii. ineffective methods for adjudicating commercial disputes and a failure of the system to pronounce fair, impartial and generally uniform sentences;
 - iv. inability of the law as it stands to provide a framework for development of modern financial markets;
 - v. the outmoded and inconsistent character of many parts of the law that were passed during the socialist period (e.g., company law, which still includes "socialist enterprises").
- Inadequacy of business services and training, as provided by training institutions and private consulting firms;
 - A need for reform of fiscal policy, which places inordinate tax burdens on the minority of enterprises registered in the formal sector and provides a powerful disincentive for informal operators to enter the formal sector;
 - A general lack of macroeconomic policy coordination.

This is by no means a comprehensive list. It does, however, represent a set of problems that:

- a. can be at least partially resolved within the scope of a five-year \$14 million project;
- b. fit the strategy of A.I.D. and USAID/Madagascar;
- c. are areas in which American experience and skills may have some distinctive advantages; and,
- d. are not currently being dealt with in an adequate fashion by other donors.

It is in this context that the BEST Project will take place, addressing those elements of legal, regulatory and economic policy reform that are most critical to Madagascar's efforts to increase foreign investment and develop linkages between foreign investments and the domestic private sector.

B. Statement of Project Goal and Purpose

The goal of the BEST Project is to increase investment and employment in the private sector in Madagascar. The assumption underlying this goal is that only the private sector is capable of generating the levels of employment and investment needed to reverse 20 years of economic decline and begin to develop Madagascar's natural and human potential.

The project's **purpose** is to establish a competitive, pro-business climate. In advancing this purpose the BEST Project can usefully focus on improvement of the legal and regulatory framework for a market economy and on improving the delivery of training, technical assistance and information services to private entrepreneurs.

C. Expected Achievements/Accomplishments (EOPS)

As a result of project assistance:

- 1) Infrastructure constraints to private sector development imposed by lack of competition and dominance of the public enterprise sector will be substantially reduced;
- 2) The efficiency and fairness of the legal system pertaining to private sector business will be improved;
- 3) Foreign direct investment will increase;
- 4) Provision of products and services by Malagasy companies to Zone Franche companies will increase.
- 5) Madagascar will, in the near term, establish its eligibility for re-entry into U.S. organizations such as OPIC and the Ex-Im Bank, appropriate African trade organizations, and multilateral groupings such as the World Bank's MIGA; over the longer term Madagascar, with BEST Project assistance, will meet the criteria for full membership in GATT.

**MADAGASCAR BUSINESS ENTERPRISE SERVICES AND TECHNOLOGY (BEST) PROJECT
LOGICAL FRAMEWORK FOR PROJECT DESIGN AND EVALUATION**

November 1993

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS/RESPONSIBILITY	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Activity Goal: (The broader objective to which this activity contributes)</p> <p>To increase investment and employment in the private sector in Madagascar.</p>	<p>Measures of Goal Achievement:</p> <ol style="list-style-type: none"> 1. Increase in foreign direct investment. 2. Increase in domestic private sector investment. 3. Increase in private sector employment. 4. Increase in domestic content of exports. 	<p>Government and World Bank statistics</p>	<p>Affecting purpose-to-goal link:</p> <p>Zone Franche and Investment Code legislation remains unchanged or is further liberalized</p>
<p>Activity Purpose:</p> <p>To establish a competitive, pro-business climate.</p>	<p>Conditions that will indicate purpose has been achieved (EOPS):</p> <ol style="list-style-type: none"> 1) Infrastructure constraints to private sector development imposed by lack of competition and dominance of the public enterprise sector will be substantially reduced; 2) The efficiency and fairness of the legal system pertaining to private sector business will be improved; 3) Foreign direct investment will increase; 4) Provision of products and services by Malagasy companies to Zone Franche companies will increase. 5) Establishment in the near term of Madagascar's eligibility for admission into U.S. organizations such as OPIC and Ex-Im Bank and, over the longer term, membership in GATT. 	<p>BEST Project Reports; GRM and World Bank statistics</p>	<p>Affecting output-to-purpose link:</p> <p>GRM restarts privatization program and opens telecommunications, transport and other key sectors to competition.</p> <p>GRM continues democratization and economic liberalization.</p> <p>Continued political stability.</p> <p>Access to European and U.S. markets remains open.</p>

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS/RESPONSIBILITY	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Outputs:</p> <ol style="list-style-type: none"> 1. Analysis and improvement of macro-economic policies 2. Improved access to finance for SMEs 3. Improvement in quality and cost of telecommunications and transport 4. Increase in number of domestic private companies supplying to ZF companies; increase in volume of domestic sales to ZF companies 5. Improvement in adjudication of commercial disputes 6. Establishment of public/private sector dialogue 	<p>Magnitude of Outputs necessary and sufficient to achieve purpose.</p> <ol style="list-style-type: none"> 1. Studies and policy reforms prepared for: a) public debt management; b) fiscal reform; c) reduction of public expenditures; d) establishment of a government-private sector policy forum, with at least one annual roundtable discussion; at least one policy reform attributable to private associations' advocacy. 2. 2 or more companies offering leasing and hire-purchase; reform of laws pertaining to seizure of collateral; reform of bankruptcy law. 3. Drafting of new telecoms law; provision of new telecoms services (cellular and paging) by private companies; full or partial privatization of Air Mad; opening of domestic and international air transport to competition. At least two seminars on "why privatize" and "how to privatize" 4. At least one seminar per year on doing business with ZF companies; direct TA to at least 20 local private companies; development and delivery of at least 6 new courses on marketing, management and production for domestic sales to ZF companies. Development of 2 newsletters in partnership with 2 or more private business associations: 1 dealing with business opportunities with ZF and foreign companies, the other dealing with legal and regulatory issues affecting private businesses. 5. Creation of private business arbitration mechanism whose decisions have force of law; Training/observation tours in U.S. for 10 or more judges/magistrates each year 6. At least 1 public/private roundtable per year <p>Training Training</p>	<p>TA and Training Reports; Quarterly and Annual Activity Reports</p>	<p>Affecting input-to-output link:</p> <p>Continued competitiveness of Madagascar wage rates</p> <p>Continued success of ZF expansion</p> <p>Absorptive capacity of local training institutions and business service providers</p> <p>Willingness of professional associations to advocate policy reforms</p> <p>Willingness of financial institutions to develop broader range of products and services</p> <p>Continued progress towards liberalization and disengagement of the State from productive sectors</p> <p>Availability of funds for infrastructure investment</p>

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS/RESPONSIBILITY	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Inputs: (Activities and Types of Resources)</p> <p>Long-term policy/advocacy advisor/COP</p> <p>ST TA/training in bus. associations/advocacy</p> <p>Long-term and short-term TA/studies in macroeconomic policy;</p> <p>Long-term and short-term TA in business services and training;</p> <p>Short-term TA and training in revision of legal texts and training of legal system personnel;</p> <p>Short-term TA in deregulation & privatization strategy and techniques;</p> <p>Short-term TA in development of financial products/services;</p> <p>Short-term TA in newsletter publishing;</p> <p>Business association grants</p> <p>Co-funding feasibility & market studies</p> <p>Seminars/observation tours;</p> <p>Provision of material (computers, software, vehicles)</p>	<p>(Level of Effort/Expenditure for each activity)</p> <p>LT - 60 p.m., \$1,320,000</p> <p>ST - 30 p.m., \$ 660,000</p> <p>LT - 60 p.m., \$1,320,000 ST - 30 p.m., \$ 660,000</p> <p>LT - 60 p.m., \$1,320,000 ST - 60 p.m., \$1,320,000</p> <p>ST - 60 p.m., \$1,320,000</p> <p>ST - 60 p.m., \$1,320,000</p> <p>ST - 20 p.m., \$ 440,000</p> <p>ST - 12 p.m. \$ 246,000</p> <p>\$1,000,000</p> <p>\$1,000,000</p> <p>\$1,000,000</p> <p>\$1,000,000</p> <p>Total LOE - 452 p.m. Total Cost \$13,926,000</p>	<p>TA and Training Reports; Project Budget Submissions; Quarterly and Annual Work-plans, Activity Reports, and Financial Reports.</p>	<p>Conditions precedent to activity implementation:</p> <p>Agreement by GRM to accept TA in macroeconomic policy, privatization, and judicial/legal reform</p> <p>Agreement by local training institutions, business associations and consultancies to collaborate with BEST Project</p> <p>GRM designates counterpart Ministry, Directorate and individuals for BEST Project experts and allocates personnel and office space to Project</p> <p>GRM clarifies ministerial responsibility for macroeconomic policy</p>

D. Project Outline

The project strategy, forms of project assistance, and the choice of counterpart institutions with which to work, have all been determined based on an assessment of the needs of the private sector in Madagascar as outlined in the sections above, A.I.D. and USAID/Madagascar strategy, and on the need to design a project that, to the extent possible, complements the activities of other donors. Other donor activities are described in greater detail below. Project design has focused on selecting those areas of activity which 1) can have the most immediate and greatest impact on investment and employment creation by the private sector; 2) make use of any comparative advantage A.I.D. and the United States have with respect to other donors; 3) are not currently the focus of activity of other donors; 4) complement current or planned activities by other donors.

In view of the expected end-of-project achievements outlined above, the BEST Project Strategy should focus on three principal areas:

- **Reduction in infrastructure constraints to private sector development, particularly those caused by inefficiencies and inequities in the public enterprise sector;**
- **Improvement in the efficiency and fairness of the legal, regulatory, and economic policy environment for private sector enterprises;**
- **Reform and privatization of public enterprises, particularly in areas essential to development of the private sector; and,**
- **Improvement of the provision of information, technical assistance and training to private enterprises.**

1. Public Enterprise Reform and Privatization/Infrastructure Improvement

The initial setback in the GRM's privatization program can be traced directly to two elements:

- **Lack of transparency**
- **Poorly-conceived strategy**

Any effort to develop the private sector in Madagascar will require attention to the public enterprise sector because of its role as a barrier to entry to private firms and as a barrier to introduction of market forces, particularly in the transport and communications sector. The BEST Project should therefore include a privatization component which will focus on assisting the GRM in articulating a privatization and PE reform strategy, opening the process of privatization to a wider range of potential investors, both Malgache and foreign, and in ensuring the transparency of the process, both to potential acquirers and the public at large.

Specifically, the BEST Project can assist in:

- developing an institutional, regulatory and legal framework for the restructuring of key sectors, especially telecommunications and air transport, ensuring that these sectors are opened to competition, that barriers to entry favoring certain countries or companies are removed, and which can use the U.S. experience in deregulation of both telecommunications and air transport to develop a modern and flexible framework for the modernization of these sectors in Madagascar (this assistance can take place independently from privatization of state companies in those sectors, and is essential whether privatization itself is pursued);
- setting up and defining the roles and responsibilities of GRM structures with responsibility for managing the privatization program;
- defining and putting into place procedures for identifying and valuing PEs to be privatized;
- defining modalities for privatization (e.g., public offering, private placement, open tender) and methods of executing transactions;
- providing assistance in the selection and training of technical staff with responsibility for evaluation of PEs and preparation of privatization dossiers;
- developing a forum and techniques for public dissemination and discussion of information and issues pertaining to privatization and PE reform;
- assisting in the development of financial instruments, such as ESOPs and mutual funds, that can help widen public participation in the privatization process;
- providing equipment and material, as required, in support of the above objectives.

Specific activities could include:

Legal/Regulatory Reform: The most important contribution of the BEST Project in this area may be to liberalize and deregulate the telecommunications and air transport sectors, as well as other sectors in which state involvement poses a significant constraint to private sector development. This assistance can and should involve developing a new and liberal regulatory framework (including redrafting laws governing those sectors, as required); strengthening institutions responsible for monitoring those sectors; and, establishing ground rules for entry of private operators into the sector and for the fair and impartial granting of licenses and permits. The U.S., as the world leader in deregulation of air transport and telecommunications and in the development of legal, regulatory and institutional frameworks for new technologies, such as cable TV, has potentially a great deal to offer in this area.

Strategy Formulation: The BEST Project can assist the GRM in developing a strategy for privatization and restructuring of PEs, paying particular attention to the need to improve

infrastructure and increase competition in key sectors, while ensuring the openness and transparency of the program and increasing the ability of employees of PEs and the general public to participate in privatization.

Training/Skill Development: The World Bank argues that Madagascar can improve its privatization procedures by learning from the experiences of other African countries, as well as those of Eastern Europe and Latin America. Visits by privatization policy-makers and technicians to other countries with successful privatization programs may be undertaken. USAID may provide on-the-job training to technical staff of the entity responsible for privatization, once the program is re-started. In cooperation with local training institutions, courses on valuation and restructuring of PEs may be developed. A transfer of skills to local consulting and accounting firms is also to be encouraged, to enable local firms to undertake some of the work of valuation of enterprises and structuring of transactions. Collaboration with local private banks to develop appropriate financial products and to develop local merchant banking capability can also be a part of the Project. The Project can also contribute to improving the management and market competitiveness of restructured and privatized PEs, possibly through cooperation with IESC.

Public Awareness Campaign: The skillful use of mass media can assist the GRM to carefully prepare the public about the benefits of the privatization and to ensure the success of the program beyond the government circles. A Privatization Conference, or a series of such conferences in Madagascar, similar to those conducted several years ago in Tunisia ("Why Privatize?" and "How to Privatize") and in Côte d'Ivoire, with USAID assistance and participation, can remove some of the cloak of secrecy from the process and reduce the level of public opposition to the program, much of it based on incomplete or false information.

Assistance to Restructuring or Privatization of PEs in Strategic Sectors: Although it is unlikely to be a principal area of activity, the BEST Project may fund sector and industry studies to assist in the privatization of individual PEs. The Project may also, in collaboration with local accountancy firms, conduct valuations of individual PEs and assist the GRM to structure and package specific privatization transactions.

In the event that privatization in certain sectors is something the GRM cannot or will not undertake, the Project can nonetheless assist in developing a more competitive structure in the sector or subsector and in introducing autonomous, business-like management practices. For example, performance contracts and/or management contracts are methods already used by several countries to improve the performance of PEs, often as an intermediate step leading to full privatization. Various kinds of direct assistance to and training of PE managers in these strategic sectors, involving such methods as IESC experts, and short, focused training courses either in the USA or in Madagascar, can be employed.

2. Legal, and Regulatory Framework

Actions to be Undertaken

BEST Project activity in the area of legal reform is likely to focus on:

- Assistance in the publication and dissemination of laws;
- Assistance in training and information;
- Assistance in the modernization of certain laws and the development of new institutions for arbitration of commercial disputes.

i. Assistance in Publication and Dissemination of Laws

Knowledge of the law is an essential prerequisite for any attempt to establish a known, stable and uniformly applied legal system, which in turn is an essential prerequisite for private sector development.

The BEST Project can provide equipment and material needed for the printing, storage and distribution of legal texts, and in the development and publication of clear and simple documents that will inform private sector operators and other citizens of their rights and responsibilities under the law in matters pertaining to business activity. This activity will be undertaken in cooperation with a wide range of Government authorities responsible for different areas of law, including: the courts system, tax administration, property register, Zone Franche administration, and Investment Code administration, to name a few of the more prominent ones.

ii. Assistance in Training and Information

The needs in this area are substantial. It is an area, moreover, where the United States is widely perceived to have a distinctive advantage. The preeminence of the U.S. in the area of free enterprise is strongly felt and is demonstrated in part by the current interest in English as a language of business in Madagascar, despite the country's long-standing ties to the francophone community. As such, many people in Madagascar look to the U.S. in areas that do not necessarily have a direct connection to legislative reform: for example, management, sales and marketing, international market access, and financial technology. This interest, however, can also be translated into an advantage, particularly in helping to change the attitudes of people in government away from a statist, interventionist attitude to one more closely linked to the spirit of enterprise in which the U.S. excels.

The task here has two equally important components. The first is to train people in the application and enforcement of the laws in such a way that rule of law, rather than arbitrary and personal exercise of power, becomes the norm. The second is to transfer some of the ideas on which the commercial success of the U.S. is based, so that a mutually supportive,

rather than an adversarial relationship between Government and the private sector can be developed.

iii. Assistance in Drafting and Modernizing Certain Legal Texts

Many other donors are, and have been for some time, engaged in providing assistance in this area.

In 1990-1992, France assisted in the development of a uniform commercial code for the CFA Community, which was then presented at a convention to which Madagascar, although not a member of the CFA, had observer status. Although the exact content of this Code has not been made public, it is probable that it contains significant revisions of contract, financial and security laws in ways that favor development of the private sector. Any action by USAID in this area should therefore be preceded by a more detailed investigation of Madagascar's intention to adopt or not to adopt this code, a decision which apparently has not yet been taken.

In tax and Customs law, France, in cooperation with the World Bank, has also assisted in a revision and simplification of the tax code and has provided technical advisors to assist the GRM in development and implementation of the revised codes. Any BEST Project assistance in this area should be preceded by a more detailed review of World Bank and French assistance and some agreement with those donors on the scope of collaboration.

Substantial French assistance to the Ministry of Justice is already well-advanced in the area of improvement of the functioning of the courts and in the application of judgements pronounced by the courts. This effort appears to be based in large part on similar assistance provided in Cameroon and Côte d'Ivoire.

Canadian aid is supporting new legislation and institutional development in the areas of credit and rural savings.

Social and cultural considerations are important in determining areas in which project assistance can be most effective. It is for this reason, for example, that property law, which is intimately linked to ethnic, tribal, cultural and religious heritage, is unlikely to be a promising area for project assistance. Labor law, although it has not been identified as a significant constraint to private sector activity, is subject to many of the same cultural and social considerations as property, and is thus an area that may best be avoided by the project.

In other areas, some project involvement could be undertaken; however, in a number of these the revision of laws is fairly well-advanced. These include:

- The Guichet Unique, where the problem is institutional and political (the unwillingness of ministries to give up a portion of their power);
- Industrial and intellectual property (patents, copyrights, brands), in which an Office Malgache de la Propriété Industrielle has already been established, with an advisor from the World Intellectual Property Office scheduled to arrive soon;

- In the financial sector, new enabling legislation has either been finalized or is in the process of being prepared, covering regulation of financial institutions; financial instruments such as leasing and mortgage lending; redrafting Central Bank legislation; regulation of savings, credit and security policies for mutual credit institutions. In addition, a new, 300-page Loi des Finances has been drafted and is scheduled for discussion in Parliament in the coming months;
- Other areas, in which revision of texts does not seem to be essential, such as non-contractual responsibility (torts) in which there appears to be no fundamental problem in the underlying laws, but rather in the way the laws are applied in practice.

Other areas, in which some improvement is desirable, do not necessarily lend themselves to USAID intervention. These include:

- Uniform accounting codes, where some easing of stringent reporting requirements would be useful for small enterprises which lack the means to undertake full-scale audits. Since Malagasy accounting practices are based almost entirely on the Plan Comptable Français of 1984, French assistance in this area would be more appropriate than an American intervention;
- Liberalization of exchange controls, moves to greater freedom of foreign exchange transactions, market-determined exchange rates, and a system of auctioning foreign exchange, most of which are currently under discussion with the World Bank and the IMF, and which are questions more of economic policy analysis and administrative decision, rather than legislative reform.

There are, however, many areas in which BEST Project assistance could bring some distinctive advantages of the American legal and financial systems to bear, which would not require a fundamental reorientation away from a French-based legal system towards one based on U.S. and English Common Law, something the Malagasy are unlikely to accept. These areas include:

- **company law and securities law**, in which there is a certain similarity between Anglo-Saxon and Roman law, and which have not been dealt with exhaustively by the uniform commercial code recently adopted by the CFA;
- **access to credit, leasing, hire-purchase and installment credit**, primarily for capital goods but also for consumer durables, accompanied by consumer protection legislation. As mentioned earlier, laws enabling leasing, for example, have already been developed, but require assistance to existing institutions or in the development of new institutions to provide such services;
- **security for financial institutions**, in which Common Law and U.S. practices can fill a genuine need; Mauritius, with a system based on both French and English law, has developed some innovative approaches to this problem ("floating securities," for example);

- **development of arbitration**, in which a precise definition of rules and practices and conditions under which the decisions of the arbitration authority would have the force of law; also in developing an institutional framework for arbitration;
- eventually, and over the longer term, a **revision of Zone Franche laws**, aimed at enabling local SMES to establish stronger links with ZF companies and to benefit more from the ZF activities.

In summary:

- Clearly there is an enormous amount of work to be done on the revision and effective application of commercial law in Madagascar, the country having been left on the sidelines during some of the most important developments in this area during the past 20 years, and the reforms so far undertaken (Zone Franche, Investment Code), having been narrowly focused on some of the more urgently problems;
- Equally clearly, Madagascar has already begun to undertake a longer-term process of reform, both through "ad hoc" structures such as the 1990 symposium of the Académie Malgache which was followed by the establishment of a number of commissions on legal reform, and through more permanent Government structures such as the revision of legal texts by various ministries, participation in the CFA conference on the new Uniform Commercial Code, and the establishment of various entities such as the Guichet Unique and OPIM aimed at creating a more favorable environment for the private sector;
- However, the past two or three years have been a period of profound transition and instability, resulting in a certain slowness of action by the State as debate on basic principles has taken place. The basic framework for continued reform now seems to be in place, and there appears also to be a certain basic agreement on the direction of reforms. Donors, including USAID, are in the process of positioning themselves to support the reform process. BEST Project assistance in the legal and regulatory area, in order to fit into the overall reform process and to define for itself a set of actions distinct from, yet complementary to, those of other donors, should be undertaken soon.

Methods of Advancing Legal and Regulatory Reform

iv. Institutional Framework of the Project

The overall institutional setting for BEST Project assistance is discussed at greater length elsewhere in this report. For legal and judicial reform having a positive impact on the private sector, however, three points need to be emphasized:

- 1) **Identify which GRM entity should be the principal counterpart:** Given the parliamentary form of government that Madagascar has adopted, this question will require more detailed attention, so as to avoid any conflict among the different, and often overlapping portfolios of different GRM ministries. In order to avoid such conflict, a single project unit attached to Government at a high level (even, possibly, as a unit attached to the Prime Minister's Office) may be advisable.
- 2) **Identify more precisely those reforms already undertaken or in process by the GRM, and the areas in which BEST Project assistance will be most welcome.** This report has already identified several of these areas. Given the paucity of information available, and the rapid pace of change, any recommendations made at this time may no longer be applicable a year from now, at the time the BEST Project is ready to be implemented. Close collaboration with the appropriate GRM authority on final project design is therefore essential.
- 3) **Define the area of operation of the BEST Project in the area of legislative and judicial reform.** In this area, the most important point to emphasize is the need, in any activity aiming at revision of laws, for a substantial involvement by Malagasy lawyers and magistrates in the process.

v. **Modalities of Action**

- 1) **Assistance in the clarification and dissemination of legal texts** is based largely, but not exclusively, on material assistance (computers, software, etc.). Equally important is assistance in reorienting the people responsible for applying the laws towards a greater openness to the private sector and a willingness to assist and promote private sector activity. This can be accomplished through a variety of methods, including the preparation and distribution of brochures and summaries of laws; organization of seminars, roundtable discussions and other forms of dialogue; visits by U.S. entrepreneurs and business people to Madagascar (it is worth noting that a delegation of French businessmen, sponsored by the French Government and UNIDO, is visiting Madagascar in November 1993), and establishment of a U.S.-Madagascar Chamber of Commerce to promote U.S.-Madagascar trade and investment links.
- 2) **Assistance in the training of judges, magistrates, lawyers, and business people** is an activity USAID has already undertaken, not only in the legal/regulatory area, but in other, purely private sector contexts as well. According to a number of Malagasy in business and government, U.S. efforts in training and establishment of fora for discussion is viewed as a distinctive competence of USAID. The demand for short-term training and observation visits is certainly very strong and, if well-conceived, can expose Malagasy in the legal and business fields to American practices and concepts that can be translated into improvement in the system of justice in Madagascar. Also, assistance to business and management schools in Madagascar, as well as NGOs, the Institute of Judicial Studies (which trains magistrates and judges) and to the University, can generate positive results. Although foreign study tours and training have an important place, they should be undertaken only if the capacity to deliver similar kinds of training does not exist in Madagascar, and then only if the

GRM or other Malagasy company or association will agree to bear a portion of the cost.

- 3) **Assistance in reform of laws** requires above all a knowledge not only of basic judicial principles but also a detailed knowledge of the area of activity the laws are meant to regulate and practical experience in their application, especially in business law. In the redrafting of laws, in their content and in their promulgation and dissemination, the participation of Malagasy legal professionals is essential. There is also a fundamental need to explain the laws as well as to enact and disseminate them. For any legislative action to have the desired, positive effects, it must of course respond to a need already identified, but it must also be widely understood and accepted.

3. Economic Policy Framework

As the above discussion indicates, although there is a clear need for revision of certain laws and improvement in the operation of the legal system, many of Madagascar's most pressing problems concern economic policy, in which the failure to apply or the misapplication of certain laws is certainly a factor, but which is tied principally to weaknesses in the formulation and implementation of economic policies. Without a clear articulation of economic goals and development of a policy framework consistent with achieving those goals, legal reforms will be of little consequence. For example, although the principle of establishing linkages between Zone Franche companies and domestic SMEs is supported by the GRM, there is no evidence that this has been identified as a priority goal, nor that much thought has been given to the policy measures required to make it happen.

There are also significant weaknesses in the process of policy analysis and development and in the formulation of policies with respect to the operating environment for private sector enterprises. Of particular concern are financial policies related to money supply, interest rates, public deficit financing and the provision of financial services. In many cases, the formulation of clear policies is an essential precursor to revision of legal texts, although there are many instances in which economic policy changes can be effected by administrative decision without the need for legislative reform. A recent World Bank Mission to Madagascar identified several areas of macroeconomic policy in which conditions precedent had not been fulfilled and in which there was an urgent need for policy analysis, reform, and implementation. Despite this need, there is no current indication that the World Bank intends to provide direct technical assistance to the GRM in support of identification and implementation of macroeconomic policy reforms. This is, therefore, an area in which the BEST Project could contribute significantly, and which is a necessary condition for successful economic development. In particular, the World Bank highlighted the need for:

- **Budgetary Reform:** Although the general principles of budgetary reform have been accepted, there remains substantial work to do in the areas of rationalization and simplification of the budgeting process, development of clear and comprehensive manuals for use in the process, production of clear and reliable national accounts, development and implementation of stricter budgetary controls, and in the monitoring

of expenditures, which in the 1993 Budget exceeded by 21% the level recommended by the World Bank. The World Bank also identified the need for reinforcement of the tax court ("la Cour de Discipline Budgétaire") as part of overall budgetary reform and for a stricter enforcement of tax laws.

- **Reform of Public Investments:** In addition to revision of the process by which the Public Investment Budget is developed, there is an urgent need for rationalization of the public investment function itself, with the objective of focusing investment on increasing the productive capacity of the country. Specifically, this will call for a greater investment in physical infrastructure and human resource development, and elimination of many of the estimated 600 public investment projects currently in some stage of development, most of which respond to no real need.
- **Reduction and Elimination of Economic Controls:** For a country whose economy has been tightly controlled by the State for more than 20 years, the idea that Government's role is not to control but to facilitate private economic activity will not come easily to many people in public service. Although substantial progress has been made in liberalizing controls on imports, exports, prices and investments, additional reforms are required. In particular, policies regarding investment approvals ought to be examined with a view towards eventually merging Investment Code and ZF incentives into the civil code (in effect making the entire country a Zone Franche), and entirely eliminating the need for investment approvals.

Support in these areas complements the parallel effort of the Project to develop the capacity of local, private business associations to advocate policy change in ways that will expand private sector economic activity. It is through dialogue with the private sector that Government can become aware of, and seek to respond to, specific concerns of business. For example, the needs of the private sector and the possibility of expanding private sector activity in certain regions should be an important factor in budgeting public investments and deciding, for example, which roads most urgently require rehabilitation.

In the current political and policy environment, where the government remains, in a basic sense, in a period of transition, and in which several key government posts have yet to be filled, it is difficult to identify the ministries or other entities with which the BEST Project might work most effectively. This difficulty is further complicated by the overlapping responsibilities of several ministries and the relative personal power of several ministers, which can both facilitate and hinder various efforts at policy formulation and reform. Nonetheless, there is a clear role for the BEST Project to play in the formulation of macroeconomic activity as it affects the private sector. Among the possible structures are:

Macroeconomic Policy Support to Ministry of Finance/Ministry of Economy: The BEST Project can assist the Ministries of Finance and Economy in the formulation and implementation of macroeconomic policy. The World Bank currently has two long-term advisors, one in each ministry; the advisor in the Ministry of Finance is focusing on budgetary reform, while the advisor in the Ministry of Economy is focusing on public investments. While these are among the most important aspects of macroeconomic policy,

there is a need for policy coordination and for focus on fiscal and monetary policy, as well as on public debt management.

The BEST Project, for example, could conduct studies on various methods of reducing public expenditures, increasing tax and customs receipts, and managing the public debt. Of primary importance is the need to increase the size of the tax base by bringing operators in the informal sector into the formal sector. With the informal economy, by some accounts, three to four times the size of the formal economy, this is essential. The only way to accomplish this is to reduce the incentives for economic operators to remain outside the formal system by reducing the potential rents from evading Customs duties and income or value-added taxes, and by increasing the penalties for violation (as well as improving the efficiency of enforcement). For example, a critical element of such policy support may be to establish optimal tax rates so as to maximize receipts while ensuring that tax rates do not rise so much as to inhibit business activity and prevent informal operators from entering the formal sector.

The Ministry of Finance one month ago named a Conseiller Technique to coordinate macroeconomic policy and to establish a macroeconomic policy unit within the Ministry. Among the priority tasks for this unit will be:

- Improving fiscal administration and redefining fiscal policy;
- Helping to establish a computer database for the collection, storage and analysis of macroeconomic data, including national accounts;
- Training Ministry of Finance staff in macroeconomic analysis;
- Developing modalities for liberalization of foreign exchange;
- Revising or redrafting the privatization law, and establishing privatization policies, procedures and regulations.

The Directeur du Cabinet in the Ministry is eager to receive technical assistance in this area, and would be likely to provide full support to USAID efforts in this area.

The Ministry of Economy is in the process of establishing four policy units dealing with 1) macroeconomic policy; 2) social rehabilitation; 3) coordination of private investments; and, 4) planning. It is unclear to what extent these functions and those of the Ministry of Finance overlap; however, the private investment unit, which is responsible for the Guichet Unique, is eager to receive assistance in the areas of analysis of private sector activity, dissemination of information to private companies, revision and improvement of investment laws, and development of medium- and long-term macroeconomic strategy in coordination with the macroeconomic policy unit. These are areas which merit assistance under the BEST Project, and which could be the focus of both long-term and short-term technical support.

Other countries, including Jamaica, Mali and Botswana, have set up economic policy units with USAID support, which have proven effective not only in setting economic policies but,

equally important, in conducting economic analyses that can be used by a wide range of entities within Government, and which can serve an essential role in the compilation and dissemination of economic information. This has been identified by the Ministry of Finance, as well as by the World Bank and other donors, as an essential development if the GRM is to put its fiscal and monetary policies on a sound basis and provide a stable and rational macroeconomic environment in which the private sector can flourish.

The BEST Project could also monitor policies and other developments in those countries which Madagascar might seek to emulate in developing its industrial base. Mauritius, Malaysia, Thailand, Indonesia, and Chile, for example, are countries that have succeeded in developing their economies in many of the same sectors (textiles, agro-industry, other light manufacturing) that Madagascar is seeking to develop. Mauritius, for example, has already moved beyond the Zone Franche concept by transforming the entire country into an effective Zone Franche, in which tax rates have been simplified and reduced for all individuals and companies, whatever their status, and import duties drastically reduced or eliminated. While Madagascar has not yet reached the point where such steps are feasible, it should be remembered that Mauritius made this leap in a scant ten years from the time it first established the Zone Franche. It is therefore not premature for Madagascar to begin to put into place some of the macroeconomic policies that will permit this rapid evolution and progress to an industrial sector that does not depend solely on the extremely low cost of labor.

BEST Project assistance might focus on development or reinforcing of economic policy units in one or more ministries and on seeking to develop policy coordination among the ministries with some responsibility for formulation and implementation of economic policies.

BEST Project Assistance should also involve the private business associations in establishing policy reform agendas and priorities. With BEST technical advisors assisting both the business associations and the Government entities responsible for enacting and implementing policy reforms, the chances for successful economic liberalization will improve.

4. Development of Business Services and Strengthening of Business Associations

The BEST Project potentially has an important role to play in the development and strengthening of private business service providers, private business associations, and training institutions. The development of backward linkages between Zone Franche companies and domestic SMEs requires certain basic economic policy and legal reforms; however, of equal importance is the development of the required marketing, production and service capabilities on the part of those SMEs, which will enable them to meet the needs of ZF companies. This will require major improvements in communication between ZF enterprises and the domestic private sector. Business associations and training institutions can function as the principal point of contact here, providing a two-way flow of information and serving as the principal vehicle for transfer of production, marketing, financial and management technology to Malagasy SMEs. In addition, business associations can play an essential role in advocating the interests of the private sector and promoting the regulatory and policy reforms needed for

backward linkages to develop. There are four basic objectives here, each of which can best be achieved by working with and through existing Malagasy organizations and companies:

- a. Development of Advocacy: There is little evidence that the interests and needs of private sector operators are seriously considered when government policy is formulated. This is not necessarily because of any lack of concern on the part of government officials, but rather because no effective forum for an exchange of ideas exists, and because local business associations are not accustomed to engaging in such dialogue with Government. There exists, however, a panoply of private business associations of various degrees of prestige, effectiveness and size, many of which are excellent candidates for partnership with USAID and the BEST project in developing an exchange of information and ideas between the private sector and Government. These include large, multi-disciplinary groupings such as GEM, and smaller, more specialized sectoral associations. Although the Chamber of Commerce is moribund at the moment, there is talk of setting up a number of sector-specific chambers, many of which could work effectively in a policy dialogue with government.

This is a concept that has worked successfully in other countries. The Botswana Confederation of Commerce, Industry and Manpower (BOCCIM) has received technical assistance from USAID for many years, and has transformed itself into a respected voice of the private sector. Starting in 1990, BOCCIM has conducted an annual conference in Francistown, in which the private sector and Government meet for several days to discuss areas of concern to the development of Botswana's industrial sector. This is an exercise which has resulted in positive policy reform and which also more fully engages the private sector in the social and political, as well as the economic development of the country. In addition to allowing private entrepreneurs to press for government action that will benefit them, it provides a means for Government to explain the rationale for certain of its decisions and policies that may not always be understood or well-received by the business community. A similar kind of forum, involving one or more Malagasy business groupings and the GRM, could be developed with BEST assistance.

- b. Dissemination of Information: One of Madagascar's critical problems has been the lack of information on Government policies and the rights and responsibilities of private businesses. Businesses often cannot comply with the law because they have no way of knowing what the law is. This situation lends itself to petty corruption and may be one reason why many entrepreneurs choose to remain in the formal sector. If the law is arbitrary and unclear, there is little incentive voluntarily to subject oneself to it. Private business associations can contribute to the flow of information by informing their members of existing laws, regulations and requirements, and of any changes that occur. One important task will be to translate often obscure language from the legislation into terms that business people, especially those in SMEs, can readily understand. Business people, especially in SMEs, often lack information about market opportunities that may exist, either internationally or in the domestic market. The BEST Project could provide assistance in developing newsletters and bulletins to inform businesses of legal and regulatory developments and market opportunities. Several of the business associations in the U.S., as well as those in Hong Kong, have

publications that might serve as models for such bulletins. With appropriate advertising, these publications can become self-supporting. In addition to technical assistance, the BEST Project may provide desktop-publishing equipment in support of these activities.

In view of the need, discussed above, to develop links between domestic Malagasy firms, especially in the SME sector, and Zone Franche companies, it will be essential to develop and improve communications between ZF companies and the purely domestic private sector. The ultimate aim will be to enlist ZF companies in efforts to improve the quality, timeliness, quantity and price of domestically-produced inputs. While ZF companies cannot be expected to do all of this themselves, communication as to their requirements will be an important first step, which could be facilitated by the involvement of one or more business associations with BEST Project support. In addition to one or more conferences on the subject, which could serve as an initial contact, a longer-term effort would be appropriate, which might also explore ways in which ZF companies could help local producers to obtain technology and financing for enterprises that will eventually produce some of the inputs they require.

The BEST Project should also seek to work with the Guichet Unique and other agencies, such as OPIM, not only on redesigning and improving their procedures, which may prove difficult in view of the many institutional and, above all, political constraints involved, but to develop their capacity to provide information to foreign and domestic investors alike and to increase the transparency of the investment process.

- c. **Training:** Training of Malagasy entrepreneurs is essential if they are to develop the ability to produce and market products for the local, ZF and export markets, and if they are to develop the ability to start up and manage companies on a financially sound basis. A number of training institutions, among them INSCAE, ISCAM, and IMATEP, provide a wide variety of courses to Malagasy entrepreneurs, managers and technicians. It is universally reported that the most critical need of these institutions and, by extension, their students, is for more expertise in international marketing. BEST can contribute in the design of courses responding to this need, and, where appropriate, in the fielding of experts, preferably those with practical business experience, to teach them. BEST could, where appropriate, provide some financial assistance to small entrepreneurs to enable them to take advantage of these courses, although such funding should supplement, rather than replace, the enterprises' own contribution. BEST may also support internships in companies which would give Malagasy entrepreneurs practical exposure to international marketing, quality control, and production technology as well as the chance to develop joint ventures or other forms of collaboration with foreign companies. Depending on the availability and appropriateness of companies willing to accept Malagasy interns, companies in the U.S. as well as those in Mauritius, Reunion, Europe, the Far East, and on the African continent could be selected for such partnerships.
- e. **Development of Private Business Services:** The BEST Project may, in certain cases, provide direct assistance to Malagasy enterprises, in cooperation with IESC or other organizations. Of even greater importance, however, is the development of private business services in Madagascar and facilitating their use by Malagasy enterprises.

The BEST Project could explore the possibility of developing subcontracting relationships with a number of Malagasy consulting firms, working with them to provide services to local businesses and, ultimately, to develop a culture of fee-for-service business assistance that is not restricted to large, international companies. Initially, BEST might co-fund the cost of market or feasibility studies, to be conducted by local consulting firms alone or in collaboration with U.S.-based consultancies, and partially paid for by the local company contracting for the service. BEST can also assist local firms to establish links with U.S. consulting firms to enable local firms to gain access to international expertise and to provide local clients with a wider range of services (for example, the ability to conduct U.S. or European market studies on behalf of Malagasy exporters). The possibility of working with organizations such as APDF to provide both expertise and co-funding of studies can be explored.

III. FACTORS AFFECTING PROJECT APPROACH AND FURTHER DEVELOPMENT

A. Economic Considerations

Madagascar is universally described by the Malagasy themselves as having reached a crossroads in its economic, political and social development. It is almost universally agreed that, in an economic and political sense, the past 20 years have been a complete failure from which the country slowly began to emerge in the early 1990s.

The 20 years of socialism have, to mention only the most striking achievements:

- Caused a 40% drop in per capita GDP from its level of 1970;
- Created an economy in which no less than 80% of economic activity takes place in the informal sector, thus outside the fiscal reach of the State;
- Given the country an external debt 120% of GDP and accumulated arrears of more than \$1 billion;
- Created a bloated and inefficient state sector that employs too many people and provides mediocre products and services at excessively high prices;
- Shrunk the tax base and engendered persistent budget deficits of close to 10% of GDP;
- Caused savings and investment levels to drop to levels inadequate even to sustain the present standard of living;
- Left the country with a decrepit infrastructure.

In spite of this gloomy scenario, Madagascar has made some impressive progress in attracting investment and developing a dynamic export sector. The principal challenge the country faces in the immediate future is one that is common to many countries undergoing similar transitions from socialism and excessive state control of the economy: namely, **how to undertake the necessary economic reforms, with their inevitable negative short-term consequences for people's standard of living (e.g., elimination of subsidies, reduction of government and public enterprise payrolls) without creating popular resistance that threatens to derail the reform process entirely.** Two attempted coups d'état in Russia in the past 2-1/2 years are but the most vivid current example of the risks that countries such as Madagascar face as they seek to make the difficult transition from socialism to a market economy.

It is for this reason that the BEST Project has been designed to undertake action on a number of fronts that can, if successfully implemented, result in rapid, measurable, and, above all, visible, improvements in an economic landscape that offers too little hope to too many people.

B. Social/Political Considerations

Although the Malagasy people showed their ability to effect fundamental political change through passive resistance to the Ratsiraka government, there is no real tradition of advocacy in Madagascar. Also important is the lack of an enterprise culture among the Malagasy people, which translates into a need to change the attitudes of people in Government from a socialist, anti-business view to an attitude of acceptance and promotion of the private sector.

As the BEST Project seeks to develop the ability of local business associations to press for policy change, it will have to work on developing, at the same time, the concept of "loyal criticism" in which criticism of certain policies is not intended and should not be interpreted as personal criticism of those charged with setting or implementing those policies.

Madagascar has never been a country in which business, political or even social activity has been governed according to an impartial set of rules, evenly and uniformly applied. As is common in developing countries, family and tribal connections count for a great deal, and often affect the interaction between Government and the business sector. These entrenched relationships are sure to have an impact on the development of independent advocacy and the institution of a "level playing field" for business.

An important political consideration is the nascent character of parliamentary democracy and remaining tension and uncertainty as to the ultimate division of power among the Prime Minister and his Cabinet on the one hand, and the Presidency on the other hand. In a parliamentary system each cabinet minister may have his own power base, which will affect the influence of his ministry and his ability, in interministerial turf battles, to prevail. These elements must be carefully considered in project design, as counterpart ministries for project activities are designated.

Finally, there are ethnic rivalries present, in which the BEST Project should avoid involvement. In particular, the preeminence of the Indo-Pakistani ethnic group in commerce

and industry is the source of substantial resentment, often disguised but rarely too far below the surface. The BEST Project activities should scrupulously avoid any hint of favoritism in fact or appearance, whether in favor of or against this community. To the extent possible, companies and associations with which the project works should be selected so as not to exclude any ethnic, religious, gender or tribal group.

C. USAID Relevant Experience with Similar Projects

USAID has undertaken numerous projects with similar objectives.

USAID/Jordan's Private Services Sector Project, starting in 1987, and USAID/Indonesia's Strengthening Business Services Project, started in 1993, have both focused on assisting the development and growth of private sector service enterprises.

USAID/Mali's Policy Reform for Economic Development Project, started in 1992, has several components similar to those envisaged for BEST. These include assisting the Ministry of Finance in articulating and implementing macro-economic policy reforms; assisting in the revision of laws regulating private sector activity and improving the functioning of the commercial courts; and, developing the ability of private business associations to promote policy reforms. Madagascar and Mali have many commonalities, which include a recent transition to democratic government, economic liberalization aimed at removing restrictions to private enterprise, and a civil and commercial code based on French law. In contrast to Mali, however, Madagascar has a strong and rapidly-growing export-oriented manufacturing sector.

USAID has worked in several countries to strengthen business associations, developing their ability to advocate policy change and to deliver information, technology and training to their members. The Botswana Workforce Skills and Training (BWAST) I and II Projects, starting in 1981, have provided almost continuous support to the Botswana Employers' Federation, subsequently expanded and renamed the Botswana Confederation of Commerce, Industry and Manpower. USAID support was instrumental in setting up the annual Francistown conferences on private sector development, in which representatives of Government and the private sector meet to discuss policy issues of concern to private businesses. In Ghana, USAID Ghana, under the Implementing Policy Change (IPC) Project, supported a policy dialogue between the private sector and Government, and assisted in the establishment of a voluntary private business association, the Association of Ghanaian Exporters. USAID through the IPC Project also supported a similar Government-private sector discussion in Uganda, focusing on policy change for export and investment promotion.

USAID/Mozambique has undertaken numerous activities under the IPC and Privatization and Development (PAD) Projects, aimed at improving infrastructure and public services through privatization and reform of state enterprises. Under IPC, USAID has supported, in conjunction with a World Bank project, the restructuring of the Mozambican railway and ports system by reducing the workforce, divesting non-productive assets, and preparing the groundwork for operation of the principal southern rail line under a private lease-management contract. Under the Privatization and Development Project, USAID prepared a

strategy for privatizing the trucking industry, contributing to improved service and lower tariffs.

USAID/Dominican Republic in 1987 started the LINKS Project to establish and strengthen linkages between domestic companies and Industrial Free Trade Zone Enterprises.

USAID/Madagascar, finally, has substantial experience assisting Malagasy private companies to become more competitive in export markets. The MAELSP Project, in particular, has helped Malagasy agro-industrial and horticultural companies to develop export marketing and distribution channels in Europe. USAID/Madagascar's Financial Markets Development (FMD) Project, started in 1993, complements the proposed BEST Project activities by contributing to financial sector liberalization and the development of financial markets and financial instruments that will contribute to private sector development.

D. Relationship to Other Donor Assistance

Madagascar is considered a priority country for development assistance, not only by the U.S., but by many other donors, largely because of its successful recent transition to democratic rule and its evident development potential.

France, as the former colonial power, is the largest donor presence. As outlined in Section II.D.1, the French are involved in several areas of legal reform, including the redrafting of several major laws, including the Code de Commerce, and the training of judges and magistrates. Other recent or current French assistance in areas related to the Best Project include:

- (In conjunction with the World Bank), technical support to fiscal and economic administrations, Customs administration, and Investment Code and Zone Franche administration. In March 1993 organized a seminar on taxation, focusing on simplification and clarification of tax policy;
- Reform of the mining code to facilitate foreign participation in the mining industry;
- Assistance in creating and financing FIARO, a venture capital firm;
- Reform of property law to permit foreign ownership, particularly in the tourism sector, and revision of the tourism code, providing the services of a legal expert to the Direction Générale du Tourisme;
- Improvement of market infrastructure and market functioning in secondary towns.
- Through the Caisse Française de Développement (CFD), assisting private enterprises in preparing feasibility studies and obtaining financing; CFD operates several funds which are lent to local banks in French francs and on-lent to local private enterprises in FMG; Proparco, the financing arm of CFD, also provides some direct loans to private enterprises, while the Aide aux Initiatives Productrices de Base (AIPB)

provides direct concessional loans to small projects that are unable to obtain bank financing.

There are unlikely to be many possibilities for direct collaboration between BEST and any of the French initiatives. The French see themselves as the most knowledgeable, as well as the largest, of the donors, and is unlikely to accept any joint activity, particularly with USAID involvement in project design. Continued French activities in the legal and economic policy areas should be carefully monitored in the BEST Project design to avoid any direct conflict or excessive overlap.

The World Bank has been involved in Madagascar since the 1980s, and has provided 4 general and sectoral structural adjustment loans. The World Bank was instrumental in pressing the GRM to adopt a privatization program, going so far as to give the government a list of 11 enterprises that had to be privatized as a condition for disbursement of the third tranche, worth \$45 million, of the CASEP loan for balance of payments support. The World Bank has provided assistance in preparing the new 1994 Finance Law, establishing policy guidelines for the budget and public investment. The Bank continues to push reforms in the area of privatization, decentralization, public investment reform, and market liberalization, especially in the area of infrastructure (telecommunications, air transport, and petroleum). Because of Madagascar's failure to fulfill the conditions precedent for a number of facilities, there remains about \$400 million of undisbursed Bank credits, with only \$43 million having been disbursed during the 1992-1993 fiscal year. Major sectoral projects of the World Bank include: forestry, energy, roads, water and telecommunications, many of which have been delayed because of non-compliance with conditions precedent and the failure of the GRM to assign responsibility for the management of World Bank credits.

The World Bank is providing direct technical assistance through two long-term advisors in budgetary reform and public investment management, which are two of the most pressing problems the country now faces. Given the enormity of the tasks to be accomplished in policy analysis and reform, the proposed BEST activities in this area should complement, rather than duplicate or conflict with, World Bank efforts. The World Bank strategy is highly compatible with that of A.I.D. and USAID/Madagascar, and therefore should be taken into account in final project design. In particular, the Bank is in the process of preparing an assessment of the private sector in Madagascar, which should contain specific recommendations for policy reforms and technical assistance. Every effort should be made by the BEST Project design team to obtain this report, and to consider its conclusions in recommending specific project activities.

UNDP is the other major donor with activities directly related to the BEST Project. *Entreprendre à Madagascar (EAM)* is the principal current UNDP effort, a project which since 1989 has promoted economic liberalization and small and micro-enterprise development, partly in collaboration with other donors such as CFD and German GTZ. It is aimed specifically at assisting small enterprises in areas outside the main population centers to obtain technical assistance, information, and bank financing. The typical recipient of project assistance is an enterprise situated on the cusp between the formal and informal sectors, and it is expected that the project will serve to move a significant number of enterprises into the formal sector. The project has a representative in each province,

responsible for identifying recipients of project assistance and helping them to develop business plans and to obtain market information, credit, and technical assistance. The project representative, in collaboration with the lending bank, also provides ongoing management assistance. The principal means of financing is through UNDP guarantees of 50% of the amount lent by banks, which also on-lend CFD and German GTZ credits to those enterprises. The average loan is about \$11,000. The EAM Project was instrumental in developing the production of foie gras, now an important export product for Madagascar, by helping several large French companies to channel credit and technical assistance to peasants, with UNDP co-providing the credit in exchange for a commitment from the French companies to buy the product. As important as the UNDP effort is in developing SMEs, it is also important in developing the skills of its project representatives, all but one of whom (out of 6) are Malagasy. The development of an indigenous capacity to provide essential business services, especially in remoter areas, may be one of the more lasting achievements of the EAM project. The BEST Project design team should explore ways that the project can support EAM initiatives, either through direct technical support or co-financing of studies, technical assistance, and small business credits.

E. Proposed Implementing Organizations

It is difficult at this stage to propose a central implementing agency for the BEST Project. The most likely possibilities would appear to be the Ministry of Economy and the Ministry of Industrial Promotion and Tourism, although in any case an important role is foreseen for the Ministry of Finance. Each has a central role to play in the formulation and implementation of policies affecting the private sector. The Ministry of Economy, which has responsibility for the Guichet Unique, is a likely candidate; however, the Minister of Economy, whose party has only one seat in the National Assembly, may prove less influential and less able to set and implement a policy agenda than the Minister of Industry, who leads a 15-member block in the Assembly. Macro-economic policy reforms are likely to be centered in the Ministry of Finance and Budget, judicial reforms in the Ministry of Justice, and activities centered on business associations will work with one or more such associations, as well as engaging in frequent dialogue with GRM entities. Given the complexity and interconnecting nature of these multiple activities, one option worth considering may be to situate the project in the Primature, the Prime Minister's Office. Alternatively, whichever of the proposed project components emerges as the dominant theme in final project design should dictate the choice of implementing agency.

F. Issues to be Considered in PP Design

1. Emphasis on foreign vs. local investment

There is little question that, in the short run, foreign direct investment will have the most immediate and greatest impact on private sector job creation and GDP growth. Over the long term, however, economic growth cannot be sustained unless there is a broad-based growth in domestic, private investment. In terms of measurable project outputs, this creates something of a dilemma for project design, since more dramatic successes may be registered if the project focuses on encouraging foreign investment. Most of the incentives required to attract

foreign investment are already in place, however, and further improvements, especially in the area of infrastructure and public services, will benefit both foreign and domestic investors. Project design should address this issue, especially in terms of the inputs required to develop better linkages between foreign and domestic investment.

2. The need for parallel progress on public finances and financial markets development

As this report has indicated repeatedly, access to finance is a critical constraint to domestic private investment. Some of the proposed project activities, such as revision of legislation governing bank security and bankruptcy, direct technical assistance to businesses to help them develop more "bankable" projects, and improvement in public finances and a reduction of public sector deficits, will all have a positive impact on credit for domestic SMEs. There is a further need, however, to monitor progress on financial sector liberalization and financial markets development, and to ensure coordination at both the policy and the implementation level with USAID's Financial Markets Development (FMD) Project.

3. Educational and training requirements

It has not been possible, in this report, to undertake a comprehensive assessment of Madagascar's educational and training requirements. We have identified certain areas in which existing local institutions, in conjunction with direct project training assistance, complemented by appropriate overseas training, can meet some of the needs of the private sector in areas such as finance, marketing and management. We have not, however, been able to determine the degree to which Madagascar's basic educational infrastructure is able adequately to prepare people for the focused training proposed in the BEST Project context. These training recommendations must therefore be examined more closely in view of the possibility that parallel assistance to basic education, or specific remedial education for the beneficiaries of BEST training must be provided, whether by the BEST Project itself, or other assistance projects.

4. Absorptive capacity of Malagasy institutions

We have paid little attention in this report to the numbers of people that can realistically receive training and technical assistance under this project through the intermediary of Malagasy training institutions, business associations, and private providers of business services. It remains to be determined whether BEST should seek to achieve dramatic increases in the numbers of beneficiaries, or should instead focus on improving the quality and appropriateness of training and technical assistance provided to an existing base of recipients. Most likely, there will be an increase in both numbers and quality, but the exact weight given to each of these dimensions must depend on a more detailed examination of the absorptive capacity of counterpart institutions.

5. Resources required to manage TA and training

As a \$14 million project delivering more than 300 person-months of short-term technical assistance, some \$3 million in direct training support, seminars, and association grants, \$1

million in commodity procurement and at least 120 person-months of long-term technical assistance, significant resources will be required to manage effective delivery of services and to comply with A.I.D. management and reporting requirements. For this reason, a long-term Policy Advisor/Chief of Party has been proposed, who will have technical responsibilities, but whose principal task will be to manage the delivery of other project services: preparing scopes of work for short-term TA and training, organizing seminars, coordinating project relationships with the GRM and USAID, and ensuring compliance with A.I.D. regulations. It is anticipated that this project would be awarded to a single institutional contractor or consortium with the proven ability to manage complex, long-term projects overseas. USAID/Madagascar may want to consider the possibility of engaging a personal services contractor to handle some of the administrative and technical aspects of project management.

ANNEX II
SCOPE OF WORK

**PRIVATIZATION AND DEVELOPMENT PROJECT
AFR/ONI PAN-AFRICA BUY-IN
PRIVATIZATION ASSESSMENT/BEST PROJECT DESIGN
SCOPE OF WORK**

I. Background

Privatization of state-owned enterprises is a major policy element in AID's market-oriented economic policy development strategy. African missions have long been encouraged to identify opportunities for assisting host country governments to develop and implement privatization strategies. To assist missions in this process, a number of privatization reconnaissance studies are being carried out to identify privatization opportunities which USAIDs might exploit. In this regard, USAID/Madagascar believes it opportune to avail itself of AFR/ONI's sponsored privatization assessment.

In the context of USAID/Madagascar, a project currently under design, the Business Expansion Services and Technology (BEST) will address the slow rate of growth of private sector investment and job expansion in Madagascar, despite recent changes towards more favorable economic policies and a liberalized political climate.

After two decades of government controlled marketing, growing deficits and foreign exchange shortages, and failed socialist policies, Madagascar adopted a serious structural adjustment program. It liberalized its markets, devalued its currency, freed up foreign exchange, reformed tax and tariff structures, and began gradual political liberalization. Within three years the reforms have sparked an economic recovery.

The majority of private entrepreneurs in Madagascar believe the business climate has improved significantly. Malagasy entrepreneurs appear to be taking advantage of new opportunities and are moving into new areas of business. Small firms, especially, have experienced high growth in the areas of agribusiness, fisheries/aquaculture, mining of non-traditional minerals, and garments.

Overall, however, the private sector response is still tentative. Firms assert that GRM tax policies and regulations, the legal system, poor transport and communications systems, and finance are constraints to further private sector expansion. Restrictions in public policies towards business, including abrupt policy changes, inconsistent application of regulations, lack of investment services, red tape, and unfair competition from the public sector, prevent private sector investment needs from being met. The business climate needs to be transformed into one that encourages and facilitates private investment and job creation. The development of public fora for the dialogue which must precede policy development is needed, as well as the growth of business services.

The BEST project will work towards a legal and regulatory environment that encourages private investments by both Malagasy and foreigners. The emphasis will be placed on reasonable, equitable, and transparent treatment of all business enterprises by public authorities and on the development of business associations responsive to the needs of their members.

The BEST project will have two principal components:

A. Public Sector Component

Legal and economic advisors will assist the GRM to update property, contract and tort laws. The project will encourage the GRM to rely on simple, low-cost procedures to adjudicate business disputes, to reduce transaction costs for enterprises, and to allocate adequate resources to the judicial branch of government so that decisions are rendered quickly and impartially. The project will also address simplification of investment approvals and the establishment of investment promotion services.

The project will establish or strengthen links between policy analysis and the drafting of regulations affecting the private sector by providing technical assistance, training, and commodities to selected economic ministries.

B. Private Sector Component

The project will foster close collaboration between business and government. A critical mechanism for this is the formation of a deliberation council of businessmen, government officials, journalists, labor representatives, and academics to develop a consensus on the policies that govern an industry or sector. The deliberation council will improve the coordination among firms and the flow of information and transparency among business and government.

In light of AFR/ONI's interest in fostering privatization activities in the region, the object of this scope of work is to assess the potential contributions of the BEST project to advancement of the privatization process in Madagascar. This is especially critical in view of the GRM's recent suspension of its privatization program and the recent statement by the Prime Minister, Francisque Ravony, that "not being an end in itself, the disengagement of the State [from the productive sectors] will not take place in a systematic fashion." Therefore, rather than designing a project to provide direct technical support to a stalled privatization program, a more useful contribution of the BEST project may be in the development of political, economic, legal and regulatory conditions that can help ensure the success of future privatization initiatives. In view of the current uncertainty surrounding the future of privatization in Madagascar, the main goal of this scope of work will be to determine and recommend ways in which the BEST project can contribute to: 1) development of an enabling environment in which a successful privatization program can take place; 2) achieving many of the objectives of privatization (e.g., increased competition, reduction of the drain imposed by SOEs on public finances, improvement of basic infrastructure and public services) even in the absence of a systematic privatization program; and, 3) ensuring the success of those privatizations that do take place.

The focus of this scope of work will be to recommend specific areas for BEST project intervention, based on: 1) priority of needs in the Malagasy economic and commercial environment; 2) ability of the BEST project to achieve measurable progress in different

areas, given the resources available; and, 3) comparative advantage of USAID and American technical expertise with respect to other donors.

II. Work Plan

The principal purpose of this scope of work is therefore to provide appropriate assistance to USAID/Madagascar in the initial design of the BEST Project, focusing on identifying project activities that fit the strategic objectives of the project, USAID/Madagascar, and A.I.D. The consultants will recommend activities falling within the overall scope of the BEST project that can contribute to increased private sector activity, particularly in those sectors in which the State has held or continues to hold a dominant position.

Given the current state of uncertainty over the future of privatization in Madagascar, it would be unwise for USAID to make privatization a centerpiece of its BEST project. However, regardless of the current status of the GRM's privatization program, the composition and character of the public enterprise sector and its relationship to the formulation and implementation of public policy can have important consequences for any efforts to develop the private sector and encourage both domestic and foreign direct investment. To the extent that loss-making public enterprises represent a significant drain on public finances, which the commercial banking sector is then obliged to finance, this sector can restrict the amount of credit available to the private sector. The degree of concentration in sectors in which public enterprises play a significant role may also inhibit private investment in those sectors. Inefficiencies and high costs in public enterprises may prevent the development of infrastructure and public services that private sector expansion will require. Finally, the extent to which inefficient public enterprises resist moves to liberalize markets has important implications for the eventual implementation of reforms. Some of these issues may have to be addressed by the BEST project as a precondition for other reforms. Opening the public enterprise sector to competitive market forces, whether through outright privatization or through public enterprise restructuring, may therefore become an unavoidable component of the project.

1. Public Sector Component

A. Assess the Effects of the Public Sector on Private Sector Development

The consultants will therefore examine the public enterprise sector in light of these concerns and recommend areas in which the BEST project, in order to achieve its wider goals, may be obliged to become involved in privatization in Madagascar. The consultants will examine the public enterprise sector in light of its implications for achieving the BEST project goals and objectives. They will pay particular attention to:

1. The effects of the public enterprise sector on public finances, and the implications for government investment in infrastructure and public services;
2. The effects of the public enterprise sector on the availability of credit to the private sector;

3. The extent of state control of the Madagascar economy and constraints to future private sector development posed by continued state ownership of enterprises in key sectors. The effects of the public enterprise sector on competition in key sectors and throughout the economy;
4. The extent to which public sector enterprises constitute a barrier to economic, legal, and regulatory reform;
5. Reasons for suspension of the GRM's privatization program, and likely future developments in the field of privatization;
6. Methods, success and difficulties experienced in identifying and attracting investors and/or operators, in the context of privatization and overall foreign investment;
7. Previous and expected future role of foreign investors in private sector development and the privatization process in terms of providing capital, technology and access to markets;
8. The degree to which privatization or restructuring of certain public enterprises may be required if the infrastructure and services (e.g., telecommunications) on which the private sector depends may require significant improvement to foster private sector growth.

B. Assess Legal and Judicial Constraints to Private Sector Development and Recommend Priority Areas for BEST Project Intervention

The consultants will review recent studies and design efforts in the area of legal, regulatory and judicial reform conducted by AID missions in Madagascar and other countries. They will identify those constraints that are 1) priority areas for reform in order for private sector development and privatization programs to succeed; and, 2) areas in which BEST project intervention can be most effective, given the resources available for the project. They will identify the reforms required, the methods of implementing reforms, and the institutional structures required for their implementation.

The consultants will analyse constraints and provide recommendations concerning potential BEST project involvement in the following areas:

- An overview of the status and trends in the legal and regulatory environment, as they affect private sector development and privatization;
- Major legal constraints to domestic and foreign investment in Madagascar;
- Reform of property law and the system of land allocation and tenure;
- Company law and industrial and commercial licensing;
- Bankruptcy law;

- **Contract law.**

2. Private Sector Component

The private sector component of the BEST Project will focus on the ability of the private sector to advocate necessary policy changes in dialogue with government, and on the ability of domestic private sector firms to provide services such as accountancy, business consulting, data processing, and training. This component will also focus on developing the capacity of training institutions, whether public or private, to provide the kind of training and education required for a dynamic private sector to develop.

The consultants will therefore assess the capacity of professional associations such as the Groupement des Entreprises Malgaches (GEM), of private accounting and consulting firms, and of schools, universities and other training institutions. They will identify specific measures that can be undertaken to upgrade the capacity of these organizations to promote essential policy change and to provide essential business services.

A further purpose of the private sector component of BEST will be to identify means of establishing links between Malagasy entrepreneurs and foreign companies in the areas of marketing, investment, and transfer of technology. The consultants will evaluate existing structures that are meant to provide such services and recommend BEST activities to strengthen them or to establish new structures that can more closely meet the needs of the Malagasy private sector. These may include government, parastatal, or private sector investment and trade promotion services.

III. Reports and Deliverables

The consultants will brief USAID/Madagascar on its findings prior to leaving the country, and will also provide a draft report prior to departure. This draft, and the final report that will be provided upon receipt of the Mission's comments, will provide the basis for a PID to be produced by USAID/Madagascar.

The report will consist of three principal components:

- 1. Relationship of the Project to AID and GRM Strategy**
- 2. Project Description**
 - a. Description of the Problem**
 - b. Statement of Project Goal and Purpose**
 - c. Expected Achievements and Accomplishments**
 - d. Project Outline and Implementation Methodology**
 - i. public enterprise reform**

- ii. legal/judicial reform
 - iii. development of business services
3. Factors Affecting Success of the Project
- i. social considerations
 - ii. financial and economic considerations
 - iii. relationship of the project to other donors' activities
 - iv. proposed GRM implementing agency
4. Preliminary List of Issues to be Addressed in PP Design
- i. priority given to foreign vs. local investment
 - ii. the need for parallel progress on public finances and financial markets development
 - iii. educational and training requirements
 - iv. absorptive capacity of Malagasy institutions
 - v. resources required to manage TA and training

ANNEX III

REVIEW OF PUBLIC ENTERPRISES AND PRIVATIZATION

Growth of the PE Sector

The public enterprise (PE) sector has played a growing and pervasive role in the development of Madagascar since its independence in 1960. Over the past three decades the evolution of the PEs went through three phases: a number of enterprises created by the French remained in the state sector following independence; the wave of nationalizations of the mid-1970s, following the rise to power of the socialists under President Ratsiraka; and the new PEs built through the large-scale investment program launched in 1978 to accelerate the growth rate of the economy. The first group made up the ensemble of the public utilities which the new Malagasy Government had inherited from the French at the time of independence and took over their operation and management. At the time, it was inconceivable for the newly-independent republic that the operation of its strategic sectors--electricity, post and telecommunications, railways, air and maritime transport, exploitation, transport, and wholesale distribution of petroleum products as well as exploitation of minerals--should remain in the hands of its former colonial power.

The second group of PEs was added to the government's portfolio when a socialist government led by President Didier Ratsiraka came to power in 1972 and decided to expand the state control on the economy. As part of a wide "malagasization" movement, the government nationalized all major agricultural, industrial, financial and commercial enterprises, many of them still under French control. The socialist reformation of the economy also dictated that the Madagascar withdraw from the Franc Zone and impose strict administrative controls both on the external trade and the financial system. Exporters and importers were obliged to get special licenses while adhering to the complex export and import tax system. Furthermore, the government introduced credit controls on the new state-owned domestic banking system in an attempt to control the expansion of the money supply and inflation.

Malagasy-style socialism did not lead to the level of economic growth that its proponents hoped or expected. By late 1970s the economy was growing at a slow pace and real per capita GDP declined. This led to the emergence of the third group of PEs and substantial new investments in existing ones. Both the new PEs and the new investments were intended to accelerate the economic growth and create jobs in the modern economy for the new urban population. The creation of these new PEs also coincided with the government's efforts to increase its political constituency throughout the country and to eliminate regional and ethnic imbalances. As a result, numerous new PEs were created in regions in which there was no economic justification for major projects and little likelihood that they would succeed.

This last wave of PE investment was no more successful than its predecessors. Most enterprises created during the late 1970s and early 1980s were in the non-productive sector. Most of them were export and import monopolies, created to stabilize agricultural prices and to provide subsidized consumer prices. These PEs soon became the largest non-performing undertakings and constituted the so-called "white elephants."

All the above additions to the PE portfolio left the government of Madagascar (GRM) with 175 enterprises at the end of 1985. Some 60 of these PEs were in agricultural sector (including 13 state farms), 45 in industry, 18 in transport and public utilities, and 17 in commerce and other services. Even though very diverse in their operations and spheres of

activity, most of these 175 PEs had one common problem: They were running at a loss and could only survive first through direct and indirect subsidies from the government, and later through transfers from the state-owned banks.

The PEs As Drain on the GRM's Budget

The PEs failed because of poor management, often put in place for political reasons rather than any ability to perform, and because of an economic and regulatory environment that would have made success all but impossible even for the most talented managers. Government controlled pricing and labor policies, conflicting financial and social objectives imposed by the sectoral ministrie, combined with ineffective management all led to their losses and growing deficits. The government could not monitor the performance of its 175 PEs effectively either. The PEs continued to rely on direct subsidies while enjoying the benefits of indirect subsidies such as unpaid taxes and "equity injections" by the government to cover their operating losses.

Consequently, the government's budgetary deficit soared from 1.5% of GDP in 1977 to 13% in 1980. At the same time, the external debt also jumped from 13% of GDP in 1977 to 32% of GDP in 1980. In early 1980s the government's external debt tripled from US\$1,223 million in 1980 to US\$3,577 million in 1987. The share of total debt service to exports of goods and services almost doubled from 26.8% in 1980 to 45.5% in 1987. As a result, the gross domestic investments declined by 25% between 1980 and 1987. The minimum investment needed to replace depreciated capital is estimated at 13% of GDP.¹³

During this period, the loss making PEs became heavily indebted to the state-owned banks. By the end of 1987, loans from the state-owned banks to the PEs accounted for more than 50% of total bank credit and 10% of GDP. More importantly, these non-performing loans led to crowding out credit to the already deprived and neglected private sector. The existence of the public enterprises and their deficit financing overrode the interests of the private sector, especially the small and medium sized enterprises (SMEs).

The Efforts to Reform and Privatize the PEs

Starting in 1988 with the assistance of the World Bank and the IMF, the government agreed to formulate a three-year program to rehabilitate its public enterprise sector. The program was meant to cut the size of the PE sector to about half its initial size through liquidation, divestiture, restructuring and privatization. At the same time, a moratorium was imposed on the creation of new PEs and limitations were imposed on the level of bank credit and budgetary transfers.

In 1988, an ad hoc committee was created to manage the PE restructuring program. This was given more formal status in 1989 as a commission attached to the Prime Minister's Office. Initially constituted as the "Delegation Générale du Gouvernement pour la Reforme du

¹³ *Madagascar: Financial Policies for Diversified Growth; Choices for a Market Economy*, World Bank Report, March 1992, p.11

Secteur des Entreprises Publiques," it was charged with reform of the whole public enterprise sector, such reforms including privatization, restructuring, rehabilitation, and liquidation. As privatization and liquidation became the dominant activities, with little attention paid to restructuring and rehabilitating PEs, the DGGP was renamed the "Direction Générale du Gouvernement pour la Privatization."

In 1990, the DGGP put together a team to review the status of the PEs and to develop a master plan for privatization. This was an ambitious plan, covering the sale or liquidation of more than half of the Government's PE portfolio and aiming principally at divestiture of non-performing enterprises. Until the program was suspended, more than 80 companies had been liquidated or privatized, while at the time the program was suspended a further 38 were slated to be sold before the end of 1993.

The PE reform began first by identifying the non-performing enterprises for liquidation, and others for various forms of restructuring. In the case of the railways, for example, the GRM decided to reduce the number of workers by offering them indemnities equal to 5 years of salary. Although precise details are unavailable, it is estimated that as of March 1993, 35 firms had been liquidated, 4 were in the process of liquidation, 31 had already been fully privatized, 4 partially privatized, and 9 were under evaluation.

DGGP was overseen by a Comité de Surveillance which included the Prime Minister, the Ministers of Finance, Economy and the Budget and the ministers responsible for the sectors in question. In February 1992, the DGGP contracted to CRC SOGEMA-MPANAZAVA a study to review the performance of the PEs in each sector, and to select enterprises to be privatized. The final reports were completed by July 1992. The report reviewed the performance of the 103 PEs, and concluded that over the period of 1988-1990 they accounted for 4.2% of GDP, and 30% of the total industrial sector. Estimates show that the PEs jointly employed close to 100,000. Their share of external debt of US\$500 million in 1990 constituted 16% of total external debt of the country which rose in 1991 to nearly 20% of the total external debt. However, as a result of strict credit allocation procedures, the share of the domestic credit for the PEs studied had declined to 8% in 1991, as investment in PEs virtually ceased. The CRC report identified 28 enterprises to be privatized and 19 to be liquidated.

In August 1992, on the basis of the CRC report, the GRM published in a communique the list of PEs where it held a majority holding, and which it intended to sell to the highest bidder.

In the financial sector, the GRM has fully privatized one bank--Banque Nationale pour l'Industrie (BNI), and has partially privatized another (Banky Fampanandrosoana ny Varotra - BFV). The BNI's privatization was relatively straightforward. Credit Lyonnais, already a shareholder, in 1991 acquired 51% of BNI's shares, and assumed management of the institution, renamed BNI-Credit Lyonnais. In March 1991 the French subsidiary of an Italian bank, l'Instituto Bancario San Paolo di Torino (IBSP), acquired 22% of BFV the third-largest bank, increasing the capital from FMG 3 to 6 billion. Further privatization of the remaining state shares in BFV is virtually certain. The Banque Nationale pour le Developpement de l'Agriculture--normally known by its Malagasy initials, BTM--accounts for 40% of the domestic market, and represents the greatest continuing problem in the

banking sector. Government officials claim that BTM was responsible for the economic slump because of its imprudent expansion of credit in 1988-89 and its continuing losses reaching a cumulative total of FMG22 billion (US\$ 10 million) in 1992. Government is now trying to extricate itself from all but a minority position in BTM, with France's Credit Agricole emerging as a potential buyer. Jose Raserijona, the Minister of Finance and Budget, recently stated that the banks need not only the additional capital but also the know-how that foreign banks can bring.¹⁴ The banking sector has also been opened to full competition from private banks, with two new foreign banks establishing a presence in 1988 and 1989. In 1988, Banque Nationale de Paris Intercontinentale (BNPI) established a new commercial bank, the Banque Malgache de l'Océan Indien (BMOI), and in 1989 the Mauritius Commercial Bank established a representative office which in 1993 became a fully-chartered bank, the Union Commercial Bank (UCB). The presence of private foreign banks in the sector is certain to accelerate the privatization of most of the State's remaining interests in the commercial banking sector.

Besides the banks, two cotton producing PEs (COTONA and SOMETA) have been privatized. These two companies were acquired by their previous owners, an Indo-Pakistani businessman and a German company. There is also a talk of privatizing STIMAD, the telephone company (discussed below in the section dealing with infrastructure constraints).

Although the privatization program managed substantially to reduce the number of companies under state ownership, a great many of these were enterprises in name only, many of which had not operated in ten years or more, and whose assets, if they could still be identified, were of no value. This was especially true of many companies created in rural areas for which the economic justification, if any, had been slight from the outset. The CRC study, for example, identifies about 20 enterprises which never began operations or which had ceased all activity for as much as 15 years, but which nonetheless remained in the state portfolio. Many of these were relatively easy to liquidate, since even the remaining employees had long since given up any expectation of a return to work. For companies still operating, the process was slower and was impeded by a number of constraints, including:

Social Benefits: The general directors and the managers of many of the PEs had been named without reference to their aptitude for the job, and had used their position mainly to employ family members and their relatives and friends, often at inflated salaries. While any privatization program is likely to encounter resistance from employees fearing loss of their jobs, this was a particular problem in Madagascar, where many of the employees had obtained their jobs solely through patronage and would almost certainly be sacked if the company employing them were privatized.

Political Conflict: One of the main barriers to action in Madagascar is the desire for consensus and a tendency to avoid taking decisions in any situation where consensus is absent. The government nominally assigned to Mr. Rajaona the power to manage the privatization program, but reserved final decision-making authority to itself. More importantly, the general managers and the members of the Board of Directors of the enterprises often blocked the privatization process. The Board of Directors were often the members of the Assemble National. These "gate keepers" were afraid to lose all the special advantages

¹⁴ *Revue de l'Océan Indien*, November 1993, p.23.

they received from the PEs. AIRMAD was known to provide free tickets to the members of its Board of Directors. Those benefits received did not amount to great sums, but were important enough for the beneficiaries to block the privatization process.

Interruption of the Privatization Program

The Government in 1989 named as Director of DGGP, Mr. Reynaud Rajaonah, a person with good connections in both the old and new governments, having served in various high positions in the Ratsiraka government, including a two-year stint as Director of Public Industrial Enterprises in the Ministry of Industry. Mr. Rajaonah's wife is also well-placed, currently serving as Director of Studies in the Ministry of Justice. After four years as Director of DGGP, Mr. Rajaonah was forced to resign in June 1993, just prior to the GRM's decision to suspend the privatization program. The DGGP still exists, but without a director. Its employees remain on the government payroll but have had nothing to do since July.

Although the GRM has not renounced the concept of privatization, it has not indicated whether or when it will revive the program. Indeed, the disbursement of the third tranche of \$45 million of the World Bank's structural adjustment credit, which was conditional on progress in privatization, has been blocked. A number of concerns were cited by Government as reasons for suspension of the program:

- (a) **Valuation of Assets and Shares:** Many government officials and the press complained that the enterprises were sold below their "real" value. The GRM did not disclose its position with respect to the enterprises' debts, arrears of water bills and electricity they owe to another state-owned enterprise, JIRAMA. There was no public disclosure of the process of valuing the companies and setting the price of shares. Few, if any, companies were privatized through open public tender, leading to the widespread belief that insiders were being given the chance to buy valuable state property at a fraction of its true value. The privatization of some 11 PEs raised 14 billion FMG (US\$7 million). Since many privatization included phased payments, the World Bank estimates that the present value of the total receipts could be as high as 35-40 billion FMG (US\$17-20 million). This amount contrasts with the recommendations of the CRC reports and their expected value of PE assets.
- (b) **Ambiguous status of ownership:** In the case of privatization of SOMAPALM (a palm oil plantation and factory), the difficulty of determining the ownership of its assets posed a problem to the new buyer. The winning bidder, Savonnerie Tropicale, was told after its successful bid, that the land in fact belonged to another party and therefore would not be transferred with the other assets. Savonnerie Tropicale then decided not to pursue its bid and SOMAPALM went to another bidder who agreed to buy the factory and the plantation without the land. Aspects of the judicial process were also unclear. The tribunal declared itself incompetent to judge the matter, and litigation still continues. Furthermore, the legal restrictions on ownership of land by foreigners has complicated and will continue to complicate the transfer of ownership in PEs whose assets include land.

- (c) **Lack of Transparency:** The privatization transactions were all non-transparent. There were no public tenders, no competition, and information about sales before and after was not made public. The lack of a clear competitive bidding process and the lack of clear guidelines soon became a major concern. There have been accusations that the managers of many PEs, knowing that their companies would soon be offered for sale, either hid assets or deliberately bankrupted the companies so that they could then buy them at bargain prices. The opacity of the process was critical in the failure of the program to attract significant foreign interest, and threatened political support for the transition government. Only in May 1992 did the World Bank intervene and request that public tender offers get published in the local press. The DGGP never published reports on the mechanics, activities and results of the program, and made no attempt to win wider public support for its activities.
- (d) **Lack of Techniques for Broad Based Local Participation:** The GRM failed to promote broad based Malagasy ownership. Even though it is reported that 90% of the sales have been made to nationals, the majority went to non-Malgasy ethnic groups, mainly Malagasy nationals of French, Indo-Pakistani and Chinese origin. These groups are the owners of large industrial and trading companies and constitute a major force in the domestic private sector. The DGGP apparently did not seek to develop mechanisms to hold a portion of shares in privatized enterprises in reserve for their employees or the public at large which, even though the value of such efforts might be more symbolic than real, could have been an important factor in creating a wider base of support for privatization.
- (e) **Unclear bidding requirements:** Efforts to reverse the process and to give more opportunity to Malagasy created problems. Malagasy citizens were allowed to present offers which included phased payments, discounted at 13%, while foreigners were required to pay the full price in advance. Because the concept of present value was poorly understood, with no effort by the authorities to explain it, there was an understandable, though misguided, reaction in the popular press when a bid was won by a foreign company at a lower face than that offered by a Malagasy bidder, even though in present value terms the foreign bid was indeed higher.

The new government of Francisque Ravony recently announced that it is in the process of reviewing the general principles and the modalities of its privatization program. The GRM is also contemplating on what kind of a structure it plans to employ for best results. However, these are not the only concerns of the Ravony government. Besides finding the right structure and the modalities of more acceptable privatization program, the new government encounters a strong nationalistic sentiment vis-a-vis privatization. The Malagasy seem very much concerned about losing their "national patrimony" to "foreigners" and to their "ex-colonizers." There is also growing skepticism about the benefits of privatization. Some officials at the Ministry of Finance stated that the board of directors of the PEs on the block were given to first chance to buy shares of the enterprises.

Despite all these concerns, some acceptance of the need to privatize exists, reinforced by considerable pressure from the World Bank and other donors. Government continues to state its intention to pursue privatization, the Minister of Economy going so far as to state recently that privatization, along with liberalization and decentralization, was one of the principal

elements of the Government's economic policy. It is uncertain, however, whether the GRM has a clear sense of how to restart the privatization program in such a way that the mistakes of the past can be avoided.

PEs as a Barrier to Competition

The private sector still suffers from the inefficiency and the intervention of the PEs in the utilities, transport and communications sector. The PEs increase the cost of doing business for the private sector and restrict competition. According to the CRC study on the PEs, the water supply and electricity company (JIRAMA) had debts as high as \$US110 million in 1990. This suggests that JIRAMA could benefit from cost cutting measures and reduce the price of electricity for the private sector.

The oil refinery and distribution company (SOLIMA) is also a state monopoly in importing, storing, transporting and distributing petroleum. Due to inefficiencies in its procurement and operating inefficiencies in the state refinery, whose capacity substantially exceeds domestic consumption, the real price of petroleum products is substantially above world market prices, while retail prices are fixed by decree at a level substantially below cost.

The PEs such as railways (RNCFM) and international air transport (AIRMAD) impose transport constraints on the private sector. The railways operate inefficiently and result in delays. AIRMAD monopolizes all domestic and all major international routes. The monopoly of air transport results in limited frequency of international and reliable domestic air links. In turn, this deters private sector activity as well as tourism, which is potentially a sector that could contribute significantly to the country's development, as well as generating foreign currency receipts. These issues are discussed in greater detail in the section below dealing with infrastructure constraints. In the context of privatization, however, it is probably unrealistic to think that the railways can be privatized, since there are few, if any, scenarios under which they could compete profitably and effectively with road transport, particularly in view of liberalization of road transport and likely future infrastructure investments in that sector. In addition to liberalization of the current international air transport sector, however, at least partial privatization of Air Madagascar and the introduction of more autonomous, market-based management is a likely future development.

The international telecommunications (STIMAD), and the post, and domestic telecommunication (PTT) limits provision of all types of communications to the state. There is at the moment inadequate investment and infrastructure in this sector.

The two existing insurance companies (NY Havana and ARO Assurances) also have a monopoly of the domestic insurance market. With no competition, these companies have no incentive to develop new products, markets or strategic alliances.

Although not public enterprises, the existing accounting and audit firms have managed to create a quasi-monopoly by controlling entry into the profession. Only three major firms and three or four smaller ones supply the market. The GRM has not defined entrance standards to the audit profession despite over 5 years of debate on a text.

In the consulting field, BAPIM, according to its charter an NGO, but a company with strong family ties to the Minister of Economy, appears to be seeking to control access to the investment approval process, forcing other lawyers and consulting firms specializing in services to investors to share their business with BAPIM if they do not wish to be shut out of the market.

In short, the operations and pricing policies of these PEs and nominally private businesses in protected sectors increase the cost and difficulty of doing business in Madagascar both for domestic and foreign firms. The GRM needs to introduce competitive elements into these sectors as a priority measure. Any revived privatization program must therefore be accompanied by an opening to competition, since otherwise the process will simply substitute a private monopoly for a public one. The banking sector may be an appropriate model for this, where liberalization and opening to competition have been accompanied by disengagement of the State.

ANNEX IV

REVIEW OF LEGAL SYSTEM AND PROPOSED LEGAL REFORMS

**CONTRIBUTION A L'ETUDE DE LA DEFINITION ET DU CONTENU
DU PROJET B.E.S.T. (BUSINESS EXPANSION SERVICES AND TECHNOLOGY)
DE L'U.S.A.I.D., MADAGASCAR,
PARTIE: CADRE JURIDIQUE ET REGLEMENTAIRE**

TERMES DE REFERENCES: CONTEXTE ET OBJECTIFS DE LA MISSION

I - CONTEXTE

II - OBJECTIFS

B. Assess Legal and Judicial Constraints to Private Sector Development and Recommend Priority Areas for BEST project Intervention

The consultants will review recent studies and design efforts in the area of legal, regulatory and judicial reform conducted by AID missions in Madagascar and other countries. They will identify those constraints that are 1) priority areas for reform in order for private sector development and privatization program to succeed; and, 2) areas in which BEST project intervention can be most effective, given the resources available for the project. They will identify the reforms required, the methods of implementing reforms, and the institutional structures required for their implementation.

METHODOLOGIE

- Nos analyses, conclusions et propositions de recommandations d'action ont été basées sur:

- le résultat de nos entretiens et rencontres avec des opérateurs économiques du secteur privé, des représentants d'organisations professionnelles et des instances administratives de l'Etat, des représentants d'institutions internationales d'assistance et d'aide au développement (la liste détaillée figure en Annexe...);

- la lecture et l'examen des différents rapports récemment établis sur l'environnement économique, de façon générale, et le cadre juridique et réglementaire plus

particulièrement, affectant le secteur privé à Madagascar (la liste détaillée de ces rapports figure en Annexe...);

- notre propre expérience, tant des contraintes juridiques et réglementaires à l'essor du secteur privé dans les pays d'Afrique ayant un cadre légal d'origine française, comme celui de Madagascar, que des modalités et résultats de réformes entreprises avec l'appui d'organisations internationales d'assistance au développement, notamment l'USAID, dans le cadre de programmes d'appui au secteur privé, y compris du type du projet BEST.

INTRODUCTION

1 - Il n'existe pas de cadre juridique et réglementaire parfait. En effet, le Droit n'est que le reflet d'un certain ordre économique et social a un moment donne. Et, s'il peut, parfois, se permettre de precéder cet ordre économique et social, de l'orienter, il ne peut, en aucun cas, en être trop éloigné. Sous peine de perdre sa force, son pouvoir, et de ne plus être observe, le Droit doit constamment, par nature, être adapte a la situation économique et sociale et évolue avec elle, changer.

2 - Mais ce changement doit être prudent, attentif, car l'édifice juridique est une oeuvre de longue haleine. De nombreux concepts et principes fondamentaux toujours appliqués par de nombreuses législations ne remontent jamais qu'au droit romain... Dans le domaine juridique, les bouleversements et changements radicaux vont souvent a l'encontre des buts recherchés.

3 - Ces considérations, d'apparence générales, ne sont pas sans importance. Dans nos analyses, nous n'avons pas, en effet, recherché des reformes qui concourraient sur un plan théorique et idéal a un cadre juridique parfait et harmonieux, qu'elles qu'en soient les conséquences réelles, mais bien plutôt, et seulement, quelles seraient les dispositions qui, en l'état actuel de la situation économique et sociale a Madagascar, contribueraient a l'établissement et au développement du secteur prive, et, plus particulièrement, celles sur lesquelles l'USAID pourrait apporter son concours et son soutien de manière efficace.

4 - Dans cette perspective, tout naturellement, nous avons articulé notre intervention comme suit:

- Quels sont les problèmes ?
- Que devrait faire l'USAID ?
- Comment ?

I - EXAMEN DES PROBLEMES EXISTANTS DANS LE CADRE JURIDIQUE ET REGLEMENTAIRE ACTUEL DE MADAGASCAR

5 - Nous avons décomposé cette section comme suit:

- Quels sont les problèmes affectant le cadre juridique réglementaire dans son ensemble ? et
- Quels sont ceux qui concernent le plus directement le développement du secteur privé ?
- Quels sont les plus importants ?

A - PROBLEMES AFFECTANT LE CADRE JURIDIQUE ET REGLEMENTAIRE DANS SON ENSEMBLE: PRESENTATION GENERALE

6 - Les problèmes sont nombreux. Ils ont, pour la plupart, été identifiés, examinés, analysés et des débuts de solutions leur ont été proposées, ce tant par les juristes malgaches que par des experts étrangers.

Plusieurs rapports leur ont été consacrés, et notamment:

- l'" ETUDE SUR LE CADRE JURIDIQUE ET LES MODALITES PRATIQUES D'APPLICATION DU DROIT DES AFFAIRES, DE LA PROPRIETE ET DU TRAVAIL A MADAGASCAR ", établie en Avril 1990 lors d'un colloque de l'Académie malgache, sous le patronage de la Banque Mondiale;

- l'Etude " ENVIRONMENT FOR INVESTMENT IN MADAGASCAR: INSTITUTIONAL REFORM FOR A MARKET ECONOMY ", établie en Février 1993 par Mr. Hilton Root, Hoover Institute, pour le compte de l'USAID;

- l'Etude " TOWARDS AN INDEPENDENT AND ACCOUNTABLE JUDICIARY, REPORT ON JUDICIAL REFORM IN MADAGASCAR ", établie en Septembre 1993 par Mr. Louis Massicotte, pour le compte de l'USAID;

- l'Etude " EVALUATION DU CADRE JURIDIQUE POUR LE DEVELOPPEMENT DU SECTEUR FINANCIER A MADAGASCAR" établie en Septembre 1993 par MM. Alexandre Cordahi, IDLI et Hilton Root, Hoover Institute, pour le compte de l'USAID;

- l'Etude " MEMORANDUM SUR LE SYSTEME JUDICIAIRE A MADAGASCAR ", établie en Juillet 1993 par Me. Yves Ratrimoarivony, GRAD/ILOFAO.

Tous documents très complets et pertinents.

7 - Pour notre part, et compte tenu du but de notre mission, nous retiendrons la classification suivante:

- Problèmes tenant aux textes eux-mêmes, à leur contenu;
- Problèmes liés à l'application des textes.

1) PROBLEMES TENANT AUX TEXTES EUX-MEMES, A LEUR CONTENU

8 - De façon globale et résumée, les textes hérités du législateur français ont, dans leur ensemble, vieillis, ne sont plus adaptés aux situations économiques et sociales modernes et doivent être revus. Les textes établis par le législateur national pendant la période d'économie socialiste doivent eux aussi, bien évidemment, être revus et profondément modifiés.

9 - Ceci étant, et de façon plus détaillée, l'on peut citer les principaux points suivants:

- le droit des obligations civiles et commerciales qui, sur certains points, a vieilli et n'est plus adapté à une économie moderne, notamment en ce qui concerne les contrats conclus par les entreprises;

- le droit des sociétés qui, pour partie, remonte aux lois françaises fondamentales de 1867 (société anonyme) et 1925 (société à responsabilité limitée) et, pour le reste, est empreint de dispositions d'esprit diamétralement opposé à l'économie de marché ("entreprise socialiste");

- le droit des valeurs mobilières (actions, obligations, titres de société) qui n'est plus en rapport avec l'évolution importante des vingt dernières années;

- le droit des sûretés (hypothèques, gages et nantissements, privilèges, garanties) qui n'est plus adapté aux besoins d'une économie moderne;
- il en est de même en ce qui concerne les textes relatifs aux moyens de paiement (lettre de change, chèque,...) et au financement des entreprises (ouvertures de crédit, factoring);
- les textes regissant le Registre du Commerce qui ont vieillis et ne sont plus en rapport avec les moyens modernes de traitement et conservation des données, ni avec les nécessités de rapidité et efficacité, caractéristiques des transactions commerciales modernes;
- les textes relatifs aux procédures collectives, règlement judiciaire et liquidation de biens, toujours empreints du caractère de la "faillite-sanction", au lieu d'être orientés vers la sauvegarde de l'entreprise et les possibilités de redressement;
- les procédures de règlement des conflits, qui restent essentiellement marquées par la prééminence des contrats civils et du judiciaire, les modalités de conciliation et d'arbitrage étant peu développées;
- le droit de la propriété, particulièrement des immeubles, qui nécessite clarification et actualisation tant dans ses principes fondamentaux (reconnaissance ou pas d'un tel droit aux étrangers, droit d'éviction) que dans ses modalités de publicité (remise à jour du cadastre, des procédures d'immatriculation);
- le droit de la responsabilité, qui pour certains analystes, a été caractérisé comme ne contenant pas suffisamment de règles permettant d'apprécier et de remédier aux dommages;
- les textes regissant l'exercice du commerce et de l'industrie qui, semble-t-il, sont toujours marqués par de nombreuses restrictions à l'initiative privée, monopoles, contrôles et nécessités d'autorisations préalables;
- le Code du Travail, inadapté aux exigences d'une économie moderne et mondiale, en ce qu'il prévoit de nombreux contrôles et procédures d'autorisation qui sont autant de freins à l'emploi (contraintes dans le recrutement, autorisations préalables de licenciement, obligation de reprise du personnel en cas de modification de la structure juridique des entreprises);
- la fiscalité dont les concepts restent fondamentalement complexes et axés sur le secteur structuré et qui, de ce fait, fait porter sur ce seul secteur l'essentiel de la pression fiscale ;
- les textes regissant les dispositions incitatives à l'investissement (Code des Investissements, Zone Franche) et leurs organes d'application ("Guichet Unique"), ont fait également l'objet de propositions de modifications et aménagements;

- les textes regissant certaines institutions également (la justice) qui, pour certains analystes, s'ils ne peuvent dans l'immédiat faire l'objet de réformes profondes, doivent cependant être aménagés, pour assurer une plus grande indépendance au pouvoir judiciaire;

- le Code des Procédures Civiles et Commerciales, enfin, dont certaines dispositions ont également fait l'objet de propositions d'aménagements et améliorations .

10 - Tous les points exposés ci-dessus ayant été d'avantage explicités dans les différentes études précitées.

2) PROBLEMES LIES A L'APPLICATION DES TEXTES

11 - Nous examinerons trois aspects sous cette rubrique:

- Problèmes tenants au fonctionnement de la Justice.
- Problèmes tenants à la diffusion des textes et à leur connaissance.
- Problèmes tenants au fonctionnement des Administrations.

i) PROBLEMES TENANT AU FONCTIONNEMENT DE LA JUSTICE

12 - Énoncée de façon directe et simple, la conclusion des observateurs est que la Justice marche mal. La situation a été présentée de façon exhaustive dans les études précitées, particulièrement celle de M. Massicotte et celle de MM. Cordahi et Root.

13 - Les causes apparaissent, à notre avis, multiples: moyens matériels, indépendance des magistrats et corps auxiliaires, interventions ou défaut d'intervention des corps étatiques dans le prononcé et l'exécution des décisions de justice, formation des personnels.

ii) PROBLEMES TENANT A LA DIFFUSION DES TEXTES ET A LEUR CONNAISSANCE

14 - Incontestablement, le problème du manque de diffusion et de connaissance des lois, que l'on rencontre dans d'autres pays en développement, est particulièrement important a Madagascar. Les textes sont peu ou mal connus, non seulement des justiciables mais également, semble-t-il, de la part des Administrations qui sont censées les appliquer.

15 - Les causes sont, a notre avis, ici également multiples: historiques tout d'abord, tant a raison de la lourdeur de l'héritage colonial et du système de promulgation sélectif qu'a raison du manque de rigueur manifeste dans une certaine période législative ayant suivi l'indépendance (la hiérarchie des textes n'ayant pas été observée et l'abrogation des textes modifiés n'ayant pas été systématique); causes purement matérielles, ensuite: les difficultés d'établissement, de suivi et de publication de façon régulière des lois et règlements dans une économie s'appauvrissant.

iii) PROBLEMES TENANT AU FONCTIONNEMENT DES ADMINISTRATIONS

16 - Un obstacle extrêmement important a la bonne application des lois, ou plus exactement a l'application régulière des lois, dans les pays en développement est celui des agents mêmes charges de leur exécution. Ils n'appliquent pas nécessairement les lois comme ils le devraient ou dans le sens qui leur est indique par leurs Autorités. Il n'en va pas différemment a Madagascar.

17 - Les raisons d'une telle situation, qui varient d'ailleurs de pays a pays et n'épargnent pas toujours les pays développés, sont connues; pouvoir de l'individu détenant une parcelle de pouvoir et qui tente d'en abuser, manque de connaissance ou mauvaise compréhension des textes (ou texte incompréhensible!), moyens matériels d'exécution, problème de formation des personnels.

B - EXAMEN DES PROBLEMES CONCERNANT LE PLUS DIRECTEMENT LE DEVELOPPEMENT DU SECTEUR PRIVE.

18 - Tous les problèmes relevés précédemment concernent le développement du secteur privé.

- Si les lois afférentes aux affaires sont archaïques ou extrêmement tatillonnes ou de philosophie totalement contraire à la libre entreprise, elles décourageront l'initiative privée.

- Si les mêmes lois sont mal connues, incertaines ou empreintes de contradictions, elles décourageront de la même façon l'investisseur privé pour défaut de cadre juridique sécurisant.

- Enfin, si dans leur application, les lois ne se traduisent pas par les conséquences qu'elles sont censées produire, il y a négation même de leur raison d'être et de l'état de droit et, donc, un climat à l'antinomie totale de l'investissement.

19 - Bien évidemment, c'est à des degrés divers que les différents points exposés ci-dessus participent du développement du secteur privé. Certains ont une incidence au moment de l'investissement initial (cadre juridique, forme de l'entreprise), d'autres au moment du renouvellement de l'investissement (fiscalité notamment), d'autres, enfin, tout au long de la vie de l'entreprise (droit commercial, droit du travail, réglementation économique et financière).

20 - Bien évidemment également, et ce point est important, l'incidence du cadre juridique et les freins qu'il peut éventuellement présenter n'est pas identique pour tous les investisseurs. Le "secteur privé" n'est pas une donnée unique, uniforme; il va du secteur informel représenté par le tablier qui participe à la distribution à la grande entreprise, nationale ou étrangère, de production. L'importance du cadre juridique et réglementaire est donc, bien naturellement, fonction du positionnement de l'entreprise dans le cycle économique. Ce qui, dans une certaine mesure, implique une approche dynamique dans l'appréhension de la graduelle importance des problèmes.

C - QUELS SONT LES PROBLEMES LES PLUS IMPORTANTS?

1) IMPORTANCE DE LA SURETE DU CADRE JURIDIQUE

21 - A notre sens, ce qui est le plus important pour tout investisseur, quelle que soit la limite de sa taille, c'est la sûreté des lois. Dans notre analyse, le terme "investisseur" est important. Nous considérons que le développement du secteur privé ne peut véritablement s'effectuer que s'il y a investissement et l'investissement, par définition, n'est pas une action qui produit un résultat immédiat, mais un résultat à terme, dans le futur, lequel est par nature incertain. D'où, l'importance d'une certaine sûreté, sécurité dans le cadre juridique et réglementaire pour l'investisseur. Le succès des zones franches, codes des investissements et conventions de stabilisation en est l'illustration. Les exonérations fiscales, douanières ou autres facilités d'implantation ne sont certes pas négligeables, mais la clef de l'attrait de telles institutions tient dans une très large mesure à la sécurisation qu'elles apportent, au cadre déterminé, connu qu'elles apportent aux entreprises.

22 - Un aspect fondamental, sur le plan juridique, du développement du secteur privé est donc celui de la connaissance, de la diffusion et de la stabilité des lois.

2) IMPORTANCE DE L'ELEMENT HUMAIN, DE LA FORMATION

23 - Parmi les entraves au développement du secteur privé, le problème de l'application des lois et règlements, tant par les tribunaux que par les agents des différentes administrations de l'Etat a également été relevé comme important.

Ce point est, à notre sens, indéniable. La meilleure des lois ne vaut que par la façon dont elle est appliquée. Le problème, ici, nous paraît être à plus longue haleine. C'est un problème humain, qui implique une profonde transformation des mentalités, notamment la prise de conscience, par toutes les catégories sociales, des bienfaits que peut apporter le développement du secteur privé; et ce problème ne peut être résolu que par une action continue, progressive, la formation des hommes.

Le début d'une telle action passe d'ailleurs nécessairement par une meilleure connaissance des lois et des textes, comme nous en soulignons l'importance précédemment, car plus la loi est connue et diffusée, plus elle protège contre l'arbitraire.

3)IMPORTANCE D'UNE REVISION DE CERTAINS TEXTES

24 - Le troisième aspect des entraves au développement du secteur privé présenté par le cadre juridique et réglementaire est celui du choix des réformes ou aménagements de textes les plus cruciaux.

25 - En la matière, le choix n'est pas aisé car tous les points précédemment visés (supra §.) touchent au fonctionnement et donc au développement du secteur privé. Ainsi que nous l'indiquions précédemment également, cette importance varie tant suivant le stade de développement de l'entreprise que sa taille. Par ailleurs, à Madagascar, dont le cadre juridique est pourtant très proche de celui d'autres pays d'Afrique francophone, il apparaît que l'incidence pratique, effective de certaines domaines du Droit sur la vie des affaires n'est pas identique à celle que l'on retrouve dans ces autres pays.

26 - Ainsi, la fiscalité, le droit du travail, la réglementation économique et financière qui constituent dans d'autres pays d'Afrique les points d'achoppement fondamentaux du développement du secteur privé apparaissent, en pratique, à Madagascar ne pas constituer - pour l'instant - d'obstacle majeur au développement et ce, tant au niveau des textes que de leur application. Cette conclusion, sous-jacente dans les études que nous avons consultées, nous a été clairement exposée par de nombreux opérateurs économiques. Les contrôles fiscaux, notamment sur pièces, sont relativement peu fréquents et les entreprises ne paraissent pas rencontrer de difficultés anormales dans leurs relations avec les services de l'emploi. La réglementation des relations financières avec l'étranger, matière fondamentale pour un investisseur non national, ne paraît pas, quoique contraignante, constituer un obstacle majeur à de tels investisseurs.

27 - Le point sur lequel les opérateurs économiques montrent un consensus est celui de la législation sur les sociétés généralement perçue comme vieillotte et dépassée et, de façon générale, le droit des obligations civiles et commerciales pour lequel une modernisation est généralement souhaitée. La nécessité de nouveaux instruments de crédit, tel le crédit-bail est également perçue. Le développement de l'arbitrage apparaît souhaité, compte tenu des déficiences du système judiciaire. La clarification de la législation relative au droit de propriété des étrangers apparaît à certains investisseurs étrangers, notamment dans le secteur du tourisme, importante.

28 - A notre sens:

- la révision du droit des obligations civiles et commerciales est certainement souhaitable, ne serait-ce que pour faire oeuvre d'unification et modernisation des textes;

- la révision du droit des sociétés et celui des valeurs mobilières serait très positive pour clarification et modernisation des textes, notamment vis-à-vis des investisseurs étrangers et également dans la perspective du désengagement de l'Etat de certains secteurs de l'Economie;

- l'établissement d'une législation favorisant le démarrage du crédit-bail, de la location-vente, des ventes à crédit, accompagnée de textes visant à la protection des consommateurs et orientée tant sur les biens d'équipement que de consommation serait sans doute très utile au développement du secteur privé national pour lequel l'accès au crédit est difficile;

- enfin, une action dans le sens d'une plus grande libéralisation des textes au niveau de la Zone Franche et du Code des Investissements dans le sens d'une plus grande intégration des entreprises locales aux retombées de la Zone Franche et Code des Investissements serait certainement bénéfique sur le plan économique pour le secteur privé national.

29 - En ce qui concerne les différentes orientations mentionnées dans les termes de référence de notre mission:

- la révision de la législation régissant la propriété foncière est certes d'une grande importance dans une philosophie de libre entreprise et de développement du secteur privé; toutefois, selon certains commentaires, tous les investisseurs, notamment étrangers, qui sont en grande part concernés par cette législation, ne perçoivent pas la situation comme freinant irrémédiablement une décision d'investissement; d'autres considérations sont également fondamentales en préalable à une action de l'AID en ce domaine (cf. infra § 38);

- le droit des sociétés a fait l'objet d'un commentaire au paragraphe précédent;

- la libéralisation de la réglementation du commerce et de l'industrie est certes fondamentale dans une économie souhaitant développer l'investissement privé; la matière est cependant plus réglementaire que législative et, comme telle, relève d'avantage d'une volonté politique d'ouverture que d'une oeuvre juridique: il s'agit fondamentalement de décider l'abrogation des différents décrets, ordonnances, arrêtés, circulaires qui limitent l'accès à certaines activités ou professions et freinent la libre concurrence;

- le cadre juridique du secteur financier est, certes, extrêmement important; en fait, il est très étroitement lié au cadre juridique du secteur privé en général, ne serait-ce que dans le domaine des sûretés, des moyens de paiement, et de l'accès au crédit; et, à cet égard, il est significatif que l'étude de MM. Cordahi et Root, bien que centrée dans son principe sur

le cadre juridique du secteur financier, ait couvert, en fait, l'ensemble des domaines du droit des affaires; une révision de la législation dans le sens d'un élargissement de l'accès au crédit et de la mise en place de sûretés plus modernes, plus souples, inspirées de la pratique bancaire serait, a notre sens, très positive.

- le droit des contrats rentre dans le cadre plus général de la révision du droit civil et du droit commercial, très étroitement liés dans les pays de droit romain;

- le développement de l'arbitrage ou d'un système d'expertise semble souhaité par certains opérateurs économiques; il est d'ailleurs à noter, qu'ainsi que nous l'ont confirmé d'éminents juristes nationaux, le droit malgache ne prohibe pas l'arbitrage, du moins en matière commerciale, et qu'en principe rien ne s'opposerait à son développement, y compris dans un cadre institutionnel; le problème, à notre sens, est surtout celui de la force obligatoire des sentences arbitrales (de leur "exequatur", c'est à dire leur approbation, sous forme de décision exécutoire au moyen de la force publique, par les tribunaux) ainsi que celui de la définition des principes de l'arbitrage et de l'éventuelle mise en place d'un cadre institutionnel.

II - QUELS SONT LES PROBLEMES SUR LESQUELS L'USAID EST LA PLUS A MEME D'APPORTER SON SOUTIEN OU QUE DEVRAIT FAIRE L'USAID?

A - CRITERES DE DECISION

30 - Différentes considérations ont guidé notre analyse. Il nous paraît fondamental de les énoncer, sans que nécessairement l'ordre retenu dans cette présentation indique un choix sur la prééminence des critères. Il s'agit:

- de la taille du budget du Projet BEST (de l'ordre de ...millions de US \$, étalés sur quatre/cinq années);

- des domaines dans lesquels l'assistance des Etats-Unis d'Amérique est particulièrement qualifiée et a une compétence marquée;

- de l'utilité réelle, à court ou plus long terme, de l'action envisagée pour l'essor du secteur privé et, de façon plus générale, le développement de l'économie de Madagascar;

- de l'action des autres organismes d'assistance et bailleurs de fonds;
- de la plus ou moins grande faisabilité de l'action envisagée compte tenu du contexte politique, social et économique prévalant a Madagascar;
- de la nécessité de conserver une certaine souplesse a l'action envisagée;
- de la visibilité d'une telle action et de sa conformité, tant dans sa définition que modalités d'exécution, aux principes guidant l'assistance des Etats-Unis d'Amérique.

31 - Bien évidemment, ont joué un rôle primordial dans cette analyse:

- le " MADAGASCAR COUNTRY PROGRAM STRATEGIC PLAN FY 1993-98", établi par les Services de l'USAID/ Madagascar;
- l'étude des programmes d'action économique et sociale du Gouvernement de la République de Madagascar, tels que reportés par la presse écrite ou nos rencontres avec des représentants des organismes de l'Etat.

B - PROPOSITIONS D' ACTIONS

32 - L'action du Projet BEST devrait s'exercer sur les trois aspects des domaines dans lesquels nous avons relevé les problèmes les plus importants, savoir:

- action d'assistance a la diffusion et a la publication des textes;
- action d'assistance a la formation et a l'information des hommes;
- action d'assistance dans l'élaboration et la modernisation de certains textes de lois et l'éventuelle mise en place de nouvelles institutions (arbitrage).

1) - ACTION D'ASSISTANCE A LA DIFFUSION ET A LA PUBLICATION DES TEXTES

33 - Une telle action est a la base de toute intervention visant a l'établissement d'un cadre juridique connu, déterminé, applique, préalable nécessaire au développement du secteur prive.

34 - Il y en la matière, bien sur, un aspect assistance matérielle en la fourniture des équipements ou des prestations nécessaires a l'impression, la conservation et la diffusion des textes, mais, également, un aspect non moins négligeable d'assistance technique, intellectuelle, notamment dans la préparation de documents d'information simples et clairs sur la législation de Madagascar ainsi que sur les méthodes modernes de traitement et conservation de données. Le champ d'action en ce domaine est extrêmement vaste, depuis les différents services chargés de l'élaboration des lois jusqu'à ceux chargés de leur application: tribunaux, administration fiscale, cadastre, services de la Zone Franche...

2) - ACTION D'ASSISTANCE A LA FORMATION ET L'INFORMATION DES HOMMES

35 - Les besoins en ce domaine sont immenses. Et, a cet égard, c'est particulièrement vers les Etats Unis d'Amérique que se tournent les regards. La preeminence des Etats Unis dans le domaine de la libre entreprise est fortement ressentie et il y a certainement là un capital non négligeable d'aspirations a satisfaire, dans le domaine légal sans doute, mais surtout dans des domaines non directement liés a un aspect législatif, tels techniques modernes de gestion, de vente, d'accès au marche international et mecanismes du credit international.

36 - L'action doit être double: formation bien sur, mais également information, c'est a dire assurer la diffusion la plus large possible des idées. En d'autre termes, la promotion du cadre législatif dont on souhaite le développement, et, plus généralement, la promotion du secteur prive.

3) - ACTION D'ASSISTANCE DANS L'ELABORATION ET LA MODERNISATION DE CERTAINS TEXTES DE LOIS

37 - La prise en considération de l'action des autres organismes d'assistance dans ce domaine n'est pas négligeable:

- La France a entrepris, il y a environ deux années, l'établissement d'un code de commerce uniforme pour les pays de la Zone Franc. Ce Code a été finalisé et récemment

fait l'objet d'une présentation officielle a laquelle Madagascar a été conviée et a participé par l'envoi d'observateurs. Nous n'avons pu avoir connaissance de la teneur exacte de ce Code mais il est vraisemblable qu'il couvre le droit des obligations civiles et commerciales (contrats) et probablement les instruments de paiement et le droit des sûretés. Sans qu'il soit préjugé de la décision des Autorités de Madagascar sur une éventuelle adoption de ce Code, toute action des services de la Coopération Américaine en ce domaine nous paraîtrait devoir être précédée par une attache préalable des Autorités Malgaches appropriées.

- Dans le domaine de la fiscalité/douanes, il semble que la France ait également en projet une assistance a la révision et simplification du Code fiscal, en liaison, semble-t-il, avec la Banque Mondiale, ainsi qu'une assistance technique sous forme de détachement de personnel. Ce point serait a approfondir avant une action en ce domaine.

- De même en ce qui concerne l'assistance au Ministère de la Justice, les services de la Coopération française paraissent avoir en projet d'engager une action d'assistance relativement conséquente, du même type que celle entreprise en République de Cote d'Ivoire et au Cameroun, notamment sur le fonctionnement des tribunaux et l'exécution des jugements.

- Les services de la Coopération Canadienne apparaissent avoir apporté leur concours a la préparation d'une législation dans le domaine du crédit et de l'épargne rurale ainsi que la mise en place des institutions financières s'y rapportant.

38 - Des considérations d'ordre social sont importantes au regard de certaines actions de réforme législative. Le droit de la propriété foncière nous paraît mal se prêter a une telle action. De même, le droit du travail.

39 - Dans certains domaines, une action n'est pas a exclure, mais les textes paraissent déjà bien avancés, même si leur mise en application ne semble pas parfaite. Nous pensons notamment:

- Au Guichet Unique, dont le modèle est pour l'instant très inspiré de celui du Sénégal et qui devrait logiquement évoluer vers une structure du type Centre de formalités des Entreprises, comme en France.

- Egalement, dans le domaine de la propriété industrielle (brevets, marques, contrats de licences...), un Office Malgache de la Propriété Industrielle a déjà été mis en

place et un expert de l'Organisation Mondiale de la Propriété Industrielle doit y être prochainement détaché.

- Dans le secteur financier, des projets de textes ont déjà été préparés dans plusieurs domaines: réglementation des établissements financiers et activités s'y rattachant (crédit-bail, épargne-logement, crédit immobilier); préparation d'un nouveau statut de la Banque Centrale; prise de décision récente d'une Ordonnance portant réglementation des activités d'épargne, de crédit et de cautionnement des Institutions Financières Mutualistes.

40 - Dans d'autres domaines, des reformes de texte ne nous semblent pas impératives. Il en est ainsi dans le domaine de la responsabilité non contractuelle. Les textes fondamentaux ne nous paraissent pas justifier de modifications. Le problème est celui, plus général, du fonctionnement de la justice, et notamment du pouvoir d'appréciation des dommages des juges, tout comme dans d'autres pays d'ailleurs.

41 - Certaines matières, enfin, ne paraissent pas se prêter à une action de l'USAID, même si des aménagements nous apparaissent souhaitables. Il en est ainsi notamment:

- dans le domaine de la réglementation comptable, ou des assouplissements des obligations apparaissent souhaitables pour les petites entreprises, ce dans la mesure où la réglementation malgache est très fortement inspirée du Plan comptable français de 1984 et qu'en conséquence, les services de la Coopération française sont a priori mieux positionnés;

- dans le domaine de la réglementation des relations financières avec l'étranger ou des aménagements apparaissent également souhaitables dans le sens d'une libéralisation et d'un meilleur fonctionnement du système, mais, ici, il ne s'agit pas d'œuvre juridique, mais d'avantage de la formalisation d'analyses économiques.

42 - En conséquence, à notre sens, une action d'assistance à la révision et la modernisation des textes de la part de l' USAID nous paraît pouvoir être envisagée plus particulièrement - mais sans nécessairement à ce stade de réflexion de façon limitative -:

- en matière de droit des sociétés et des textes relatifs aux valeurs mobilières, domaine dans lequel il existe une certaine convergence des législations anglo-saxonnes et de droit romain, ce dans la mesure, bien sûr, où ces points n'ont pas fait

l'objet de traitement dans le cadre du code de commerce uniforme des pays de la Zone Franc, dont nous avons précédemment parlé;

- en matière d'accès au crédit, crédit-bail, location vente et vente a crédit, notamment pour les biens d'équipement mais également dans le domaine du logement social, accompagnée de dispositions visant a la protection des consommateurs, encore qu'en la matière, comme nous l'avons précédemment signalé, des projets de textes existent déjà pour le crédit-bail et le logement social et qu'une action a ce niveau devrait, donc, d'avantage être orientée vers une assistance a la mise en place des institutions et établissements appropriés;

- dans le domaines des sûretés, notamment bancaires, l'apport du droit de Common Law serait surement positif; il semble que l'Ile Maurice ait intégré a cet égard des concepts intéressants ("floating securities");

- dans le domaine du développement de l'arbitrage, une action pourrait être entreprise ; elle consisterait a apporter une expertise dans la définition précise des règles de l'arbitrage et des conditions dans lesquelles la sentence pourra obtenir l'exequatur mais également, éventuellement, dans la mise en place d'une institution d'arbitrage;

- enfin, mais sans doute a plus long terme, une action pourrait être entreprise dans le sens d'un aménagement des textes de la Zone Franche pour mieux faire profiter les entreprises locales de son développement.

43 - De façon plus synthétique, notre sentiment est le suivant:

- clairement, une oeuvre extrêmement vaste, d'ensemble, importante de révision et d'actualisation de la législation du droit des affaires de Madagascar est a effectuer, le pays étant resté a l'écart des évolutions modernes pendant plusieurs années et les réformes récemment entreprises (Code des investissements, Zone Franche) n'ayant été que ponctuelles, et sur les points les plus urgents;

- clairement également, un début de réflexion a déjà été engagé sur ce sujet, tant au niveau de structures "ad hoc" (Colloque de l'Académie Malgache de 1990 par exemple, suivi de la constitution de commissions) qu'au sein de l'appareil d'Etat (préparation de projets de texte par les Ministères, participation a la rencontre de présentation du Code de Commerce uniforme de la Zone Franc, mise en place de cellules pour favoriser le développement du secteur privé...);

- mais la période qui s'est écoulée depuis deux/trois années a été une période de transition, préparatoire, au niveau de l'action de l'Etat et il y a eu un certain arrêt; le cadre semble maintenant être plus en place; les autres organismes d'assistance et bailleurs de fonds semblent également être prêts et positionnés pour intensifier leur action; une préparation de l'action du Projet BEST dans le cadre législatif doit, pour s'intégrer harmonieusement dans le contexte existant, être entreprise sans trop tarder.

III - COMMENT ?

44 - La réponse à cette question nécessite une approche à deux niveaux:

- quel doit être le cadre institutionnel, fonctionnel de l'action du Projet BEST dans la perspective d'une assistance à des réformes législative/judiciaire ?

- quelles doivent être les modalités d'une telle action ?

A - CADRE INSTITUTIONNEL, FONCTIONNEL DU PROJET BEST

45 - Nous ne nous étendons pas sur ce point, développé, par ailleurs, de façon plus étendue dans l'analyse de l'action générale du Projet BEST, mais, sur le plan de l'assistance à des réformes législative/judiciaire visant au développement du secteur privé, trois aspects nous semblent fondamentaux:

1) - identifier quel doit être le correspondant, au niveau gouvernemental, de l'action du Projet.

Et, eu égard à la nature parlementaire du régime de gouvernement actuellement en vigueur à Madagascar, notre sentiment est qu'il serait souhaitable qu'une approche soit faite à ce sujet au plus haut niveau, pour éviter les conflits de compétence qui pourraient résulter d'une action de préparation de réformes législatives qui mettrait en cause plusieurs Ministères.

Dans une perspective d'efficacité, de concrétisation, également, une cellule de correspondance unique, au plus haut niveau, nous apparaît souhaitable.

2) - identifier plus précisément quels ont été les travaux de réforme législative/judiciaire déjà entrepris par le Gouvernement de la République de Madagascar, directement ou avec l'appui d'autres organismes d'assistance, et les points sur lesquels l'action du Projet BEST serait bienvenue.

Et, pour ce faire, il nous paraît primordial que la recherche soit entreprise avec l'aide d'une autorité gouvernementale ayant un pouvoir délégué à haut niveau, car manifestement de nombreuses actions sont entreprises ou en projet, et elles sont peu ou mal connues.

3) - définir le cadre de fonctionnement du Projet BEST sur le plan de l'assistance aux réformes législative/judiciaire

Et, à ce stade d'avancement de la définition du Projet, le seul point qui nous paraît être essentiel dans une perspective de révision des textes, est celui d'une association - selon des modalités qui peuvent être variables - de juristes nationaux aux travaux envisagés.

B - MODALITES D'ACTION

46 - Elles doivent, bien évidemment, être variées et ont déjà été brièvement évoquées dans la présentation des grands axes d'orientation du Projet sur le plan d'un concours dans le domaine juridique/judiciaire:

1) - l'action d'assistance à la diffusion/ clarification des textes repose nécessairement sur une assise d'aide matérielle, notamment en équipements, mais pas uniquement; toute aussi importante est, sur ce plan, une action d'assistance intellectuelle, notamment dans une perspective de promotion du secteur privé; et les moyens sont nombreux: assistance dans la définition et la mise en place de plaquettes, brochures et même recueils de présentation de la législation des affaires de Madagascar, organisation de rencontres, séminaires, visites d'hommes d'affaires Nord Américains, création d'une chambre de commerce Etats Unis-Madagascar (une chambre de commerce internationale Suisse-Madagascar a été récemment constituée)...

L'action doit cependant être réfléchie et l'utilité de l'assistance clairement établie, notamment dans le domaine de la conservation et de la diffusion des données.

2) - l'action d'assistance a la formation de juristes, magistrats et opérateurs économiques

Une telle action a déjà été entreprise par l'USAID et pas simplement dans le domaine juridique. Les échos que nous en avons eus ont été très positifs. La demande est certainement très forte, notamment sous la forme de voyages d'études.. Des séminaires organisés localement avec l'appui d'experts étrangers peuvent sans doute contribuer également, a coût moindre, a présenter de façon comparable d'autres techniques ou systèmes juridiques. Le détachement de tels experts auprès de Ministères ou autres organismes est aussi un moyen. L'assistance a des écoles de formation commerciale, a des organismes non lucratifs d'assistance au secteur privé, a l'Institut d'Etudes Judiciaires (qui forme les magistrats) et a l'Université fait également partie des possibilités d'action.

3) - l'action d'assistance a des reformes législatives est celle qui nécessite certainement le plus de préparation et d'expertise: l'établissement d'une loi implique tant la connaissance des principes juridiques fondamentaux dans laquelle elle s'intégrera que la connaissance du milieu qu'elle est censée régir, ainsi que l'expérience pratique de ses conséquences, particulièrement en ce qui concerne le droit des affaires.

Tant en ce qui concerne les modalités d'élaboration des lois a Madagascar et leur promulgation que leur contenu, il est primordial qu'il y ait association de juristes nationaux.

Un dernier point enfin, dans le domaine juridique comme dans d'autres, il est fondamental d'expliquer et de promouvoir les textes. Pour qu'une action législative réussisse et soit positive, il faut, bien sur, qu'elle réponde a un besoin et que la loi soit bien faite, mais également qu'elle soit bien comprise et acceptée.

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ANNEX V
LIST OF PERSONS CONTACTED

LIST OF CONTACTS

Government of Madagascar:

Mr. Renaud Rajaonah Rahagafotsy, Ex-Directeur Générale de la Délégation Générale du Gouvernement pour la Privatisation (DGGP)

Mr. Richard Fienena, Directeur du Cabinet, Ministère des Finances et du Budget

Mr. Henri Ranaivosolo, Conseiller Technique, Ministère des Finances et du Budget

Mr. Solomon Clovis, Ex-Directeur de l'Encadrement et de la Tutelle, Ministère des Finances et du Budget

Mr. Miarinasy Ratomson, Ex-Chef du Service de la Promotion des Investissements des Entreprises (Zones Franches, Entreprises Franches, PME/PMI)

Mr. Daniel Rakatonirina, Directeur des Affaires Juridiques, Banque Central

Ms. Victoire Rajaonah-Andriatahiana, Magistrat, Directeur des Etudes, Ministère de la Justice

Mr. Andriantsoa Rajaobelison, Coordinateur Cellule pour la Coordination des Investissements Privés, Ministry of Economy

Mr. Jacques Rakotomalala, Bâtonnier

Donors:

IMF

Mr. Naguib M. Abu-Zobaa, Resident Representative, IMF

The World Bank

Mr. Dieudonné Randriamanampisoa, Director of Operations, Madagascar Resident Mission

Mr. Pierre Demangel, Country Economist for Madagascar
Paul Ballard, Economist

Ms. Elaine Hubert, Economist
Mr. David Donaldson, International Finance Corporation
Mr. Peter White, International Finance Corporation

Mr. Ivan P. Bergeron, Consultant, Ministry of Economy, Madagascar
Mr. Richard Rotodeux, Technical Advisor, Ministry of Economy, Madagascar

UNDP

Mr. Jerome Sauvage, Assistant du Représentant Résident et Chef de Section Renforcement du Rôle du Secteur Privé

International Labor Office

Ms. Farah J. Razafiariso, Administrateur de Programme

European Community Delegation

Mr. Parfaite Monnerville P.Y., Conseiller
Mr. Jean Philippe Duvert, Economist

French Cooperation

Mr. Robert Chahinan, Directeur, Caisse Francaise de Developpement
Mr. Michael Hermite, Conseiller Economique et Commercial, Ambassade de France
Mr. Benoît Descamps, Ministère de la Coopération

USAID:

Mr. George Carner, Director
Mr. Frank Martin, Economist
Mr. John Thomas, Program Officer
Mr. Eugene Grossberg MAELSP Project Coordinator
Mr. Joseph Carroll, Private Sector Officer

Private Sector:

Mr. Jocelyn Thomasse, Manager, Union Commercial Bank (UCB)
Mr. Herve Fougeron, Directeur Général Adjoint, Charge de l'Exploitation, BNI-Credit Lyonnais
M. Yves Rattrimorivony, Président, Bureau d'Appui et de la Promotion des Investissements à Madagascar (BAPIM)
Mr. Anil Barday, President Directeur Général, Omnium Industriel de Madagascar

Mr. Fredy Rajaofera Andriambelo, Directeur Général, Société Nouvelle de l'Imprimerie Centrale, et Conseiller Technique au Ministère de l'Economie
Mr. Charles Andriatsitohaina, President, Groupement des Entreprises de Madagascar (GEM)
Mr. Desire E. Ralijaona, President, Fikambanan'ny Tanora Tantsaha (Association des Operators Economiques de la Province de Mahajanga), FIVMPAMA
Mr. Christian M. Ranaivo, Financiere d'Investissement Aro, FIARO
Ms. Jocelyne Verohanitra Razafitsialonina, Manager, Creation VERO
Ms. Madeleine Ramaholimihaso, Directeur General, Cabinet d'Audit Ramaholimihaso
Mr. Igor Jamnisek, Flexmad
Mr. Serge Lampic, Flexmad
Mr. Klaus Garbers, Manager, SABROE
Mr. Philippe Couture, President, Services Mad
Mr. Lilianah Andrianomanana, Manager, Lilianah S.A

Training Institutions:

Institut National des Sciences Comptables et de l'Administration d'Enreprises (INSCAE)

Mr. Toussaint Rasolofondraibe, Chef du Service des Prestations et Interventions en Entreprises
Mr. Serge Heriniaina, Professeur de Marketing

Institut Supérieur de la Communication des Affaires du Management (INSCAM)

Mr. Jaona Ranaivoson, Secretaire General
Mr. Parfait Ralambosoa, Conseiller Technique

Other:

Ms. Karen Engel, Fulbright Scholar, Ph.D. Candidate, Fletcher School of Law and Diplomacy, Tufts University