

AGENCY FOR INTERNATIONAL DEVELOPMENT PROJECT IDENTIFICATION DOCUMENT PAGESHEET (PID)		1. TRANSACTION CODE A: Add C: Change D: Delete	DOCUMENT CODE																					
2. COUNTRY/ENTITY MADAGASCAR		3. PROJECT NUMBER 687-0122																						
4. BUREAU/OFFICE AFRICA	A. Symbol AFR	B. Code 06	5. PROJECT TITLE OPPORTUNITIES FOR ENTREPRENEURS																					
6. ESTIMATED FY OF AUTHORIZATION/OBLIGATION/COMPLETION A. Initial FY: 9 5 B. Final FY: 9 8 C. PACD: 9 9		7. ESTIMATED COSTS (\$000 OR EQUIVALENT, \$1 =) <table border="1"> <thead> <tr> <th colspan="2">FUNDING SOURCE</th> <th>LIFE OF PROJECT</th> </tr> </thead> <tbody> <tr> <td>A. AID</td> <td></td> <td>12,500</td> </tr> <tr> <td>B. Other</td> <td>1.</td> <td></td> </tr> <tr> <td></td> <td>2.</td> <td></td> </tr> <tr> <td>C. Host Country</td> <td></td> <td></td> </tr> <tr> <td>D. Other Donor(s)</td> <td></td> <td></td> </tr> <tr> <td colspan="2">TOTALS</td> <td>12,500</td> </tr> </tbody> </table>		FUNDING SOURCE		LIFE OF PROJECT	A. AID		12,500	B. Other	1.			2.		C. Host Country			D. Other Donor(s)			TOTALS		12,500
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A. APPROPRIATION		B. 1ST FY 95		C. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan
(1) DFA		2,500		12,500	
(2)					
(3)					
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TOTALS		2,500		12,500	

9. PROJECT PURPOSE (maximum 480 characters)

To establish a competitive, open market environment, supportive of micro- and small-enterprises.

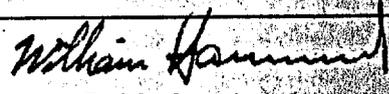
10. RESOURCES REQUIRED FOR PROJECT DEVELOPMENT

Staff:

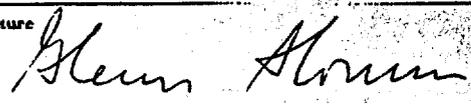
USAID: PDA/EC, PDA/PD, MBD, CONT, REDSO/RIA, REDSO/PDO, REDSO/CMO

Outside T.A.: 9 persons / 2months

Fund: PD&S: \$243,587

14. ORIGINATING OFFICE CLEARANCE	Signature 	15. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION M M D D Y Y [] [] [] [] [] []
	Title A/ Mission Director USAID/Madagascar	

16. PROJECT DOCUMENT ACTION TAKEN S = Suspended A = Approved D = Disapproved CA = Conditionally Approved DD = Decision Deferred	17. COMMENTS
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18. ACTION APPROVED BY	Signature 	19. ACTION REFERENCE	20. ACTION DATE M M D D Y Y [] [] [] [] [] []
	Title Director, AFR/EA		

OPPORTUNITIES FOR ENTREPRENEURS (OPEN)

Project Identification Document

Table of Contents

I. PROGRAM FACTORS	1
A. Background	1
1. Economic Factors	1
2. The Private Sector in Madagascar	2
B. Relation to the Development Strategy of the Government of Madagascar	3
C. Relation to the USAID/Madagascar Strategy	3
D. Relation to Other Donors	4
II. PROJECT DESCRIPTION	6
A. The Problem	6
B. Rationale for Proposed Approach	8
C. Project Goal, Purpose and Expected End of Project Status	8
D. Project Activities	9
1. Proposed Components	9
2. Project Implementation Arrangements	10
III. INDICATIVE FINANCIAL PLAN AND ESTIMATED COSTS	10
IV. FACTORS AFFECTING PROJECT SELECTION AND FURTHER DEVELOPMENT	11
A. Social Soundness Considerations	11
B. Financial and Economic Considerations	12
C. Institutional Considerations	12
D. USAID Support Requirements and Capabilities	13
E. Environmental Considerations	13
F. USAID Policy Issues	14
G. Design Calendar and Strategy	15

ANNEXES

- A. OPEN Project Logframe
- B. Initial Environmental Examination
- C. People Consulted
- D. Bibliography

I. PROGRAM FACTORS

A. Background

Madagascar is one of the few African countries to move from a one-party *dirigiste* state to a democratic, multi-party government. A democratic transition began in late 1991. A new democratically-elected President was installed in 1993 along with a new National Assembly and Prime Minister. New democratic institutions and norms are present, such as a vibrant and free press, civil society groups willing to lobby for their interests, increased accountability, civilian control of the military, and a national assembly separate from the executive.

1. Economic Overview

Widespread poverty threatens the fledgling democracy and realization of its high economic potential. Per capita GDP today is 40% less than in 1972. In 1980, 34% of households were below the poverty line; since then, per capita income has fallen 30%. Fifty-one percent of children under five are chronically undernourished. Forty-five percent of the population is under 15. Infant mortality is also high at 125/1000 live births, due in large part to poverty and a lack of health care facilities. Labor force growth is high. Madagascar, with one-fifth the population of France, has 50% more labor-force entrants each year (180,000), which the economy is unable to absorb. Urban unemployment is in the 30 to 50% range.

This bleak picture is in striking contrast to the country's rich resource base. The adequate rainfall, reasonably good soils, agro-climatic variation, mineral wealth and good education levels (a 68% literacy rate but, down from 78%) found in Madagascar are inconsistent with a UNDP Human Development Indicator level of 131 (out of 173 countries) and the abject poverty evident everywhere.

Fifteen years of rhetorical socialism for the masses and unrestrained profiteering for the elite explain in large part Madagascar's poverty-potential paradox. Eventually the bankruptcy of the economic and political system had to be confronted. Transformation to a market economy began in 1986. In the late 1980s, large parts of the Malagasy economy were liberalized. Most price controls on goods were eliminated, as were public monopolies (e.g., rice, road transportation, etc.), the foreign exchange system was liberalized, as was the banking system. These measures helped the economy turn in a positive direction, albeit modest, with Madagascar experiencing a 13% percent growth between 1986 and 1990.

The reason for the less than full response is that non-price factors also play a critical role in any economic recovery. In Madagascar, these non-price factors are two-fold: (1) the poor state of **physical infrastructure**, mainly the transport system and telecommunications, which tends to fragment markets; and (2) the poor state of the **institutional infrastructure**, including the educational system, financial system, legal and regulatory environment and service institutions. The Government and other donors (most notably the World Bank, European Development Fund, Swiss, and *Caisse Française de Développement* (CFD)) are addressing key infrastructure problems, along

with longer-term institutional concerns such as the education and financial systems. The economy succumbed to a series of major economic, political, and natural disaster blows during the period 1991-1994. Export prices declined, balance of payment problems increased, and most importantly, political protests led to a general strike in mid-1991, and marked the beginning of a two-year transition to a new constitution and a new democratically-elected president. The political uncertainty during this period hindered the transition government's development efforts, discouraged private investment, and stalled foreign aid flows. Per capita growth stagnated during the transition period and there was little investment.

For 1994, GDP is estimated to have declined 0.9%, mainly because cyclone damage, especially to road and rail infrastructure had a significant impact on all sectors. Fiscal receipts are well below targets, increasing an already high fiscal deficit (now estimated at 7% of GDP). Inflation for 1994 has increased significantly, estimated at around 30-40%. However there are some positive signs. Exports, for example, are up 22% in SDR terms and are expected climb even higher.

The new Government, installed in late 1993, has recently carried out several significant economic reform measures, such as the floating of the currency in May 1994 (which resulted in a devaluation of more than 50% of the Malagasy franc), the institution of a value-added tax to help increase revenues, and the inauguration of a one-stop window (*guichet unique*) for investment approval. Notwithstanding these major reforms, the Malagasy have been slow to form a solid political consensus on an overall economic reform program. However, after concerted communication efforts by the united international donor community, the Prime Minister announced on October 21, 1994 the GRM's unequivocal decision to follow an orthodox structural adjustment program with the IMF and World Bank and formally denounced all future so-called "parallel" or shady financing schemes on the part of his government. Concrete progress, as measured by the IMF and World Bank, in this area will be monitored closely and will be required before the Mission goes forward with the OPEN project.

2. The Private Sector in Madagascar

Madagascar is faced with the imperative to reverse the downward spiral of the economy, to encourage major private investment and to create jobs in a sustainable and equitable fashion while attacking the longer-term causes of poverty. The Government's program is focused on private sector-led growth and a market economy but is hindered by the lack of an open, market-led environment favorable to private sector investment and growth.

Among the most critical problems related to the overall "market environment" requiring rapid resolution are: (1) the legal and regulatory framework in which private businesses operate, and the institutional framework for administering laws and regulations; (2) constraints to free competition imposed by state control of critical sectors; (3) the economic policy framework in which private enterprises operate and the institutional framework for conceiving and implementing economic policy; (4) public deficits that drain investable funds from the private sector; (5) inadequate physical infrastructure that

has not been improved or even adequately maintained for 20 years or more; and (6) inadequate services and service facilities for the private sector. The problems generally affect micro and small enterprises (MSEs) as much as larger firms.

But who is the private sector in Madagascar? Mission-financed MAPS¹ studies and more recent studies have shown that more than 90 percent of all registered firms in Madagascar are MSEs. Thus, the dynamic private sector response that emerged under market liberalization begun in 1986 and is now beginning to re-emerge after the democratic transition was and is comprised of mainly MSEs. With their employment potential, broad spread effects and comparatively low capital investment needs, micro and small enterprises offer the best and most equitable avenue to rekindle growth.

B. Relation to the Development Strategy of the GRM

Madagascar's present strategy for economic development is based on private sector investment as the driving force in the economy. In his first major address to the nation (*Discours Programme*), the new Prime Minister 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. [...] [T]he 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 new government's policy emphasizes support for MSEs as an equitable means of encouraging jobs and growth.

The Opportunities for Entrepreneurs (OPEN) project, which has as its purpose the establishment of a competitive, open market climate supportive of MSEs, is fully consistent with and supportive of the GRM's objectives as outlined in the Prime Minister's program approved by the National Assembly in September 1993. In this regard, the project recognizes existing shortcomings in the dissemination and application of laws and regulations affecting the private sector, inconsistencies and constraints in the laws and regulations themselves, and the need for improved quality and more widespread availability of business services and support to MSEs.

C. Relation to the USAID/Madagascar Strategy

The Agency's recently issued policy statement on economic growth states the following:

USAID's strategy emphasizes the role of economic growth in achieving sustainable development, including major reductions in poverty and lasting improvements in the living standards of the poor. It identifies three broad areas of concentration: **strengthening markets; investing in people;**

¹ USAID, Madagascar MAPS Private Sector Survey - Final Report, Bureau for Private Enterprise, April 1991.

expanding access and opportunity. It also identifies three "thematic approaches" to help shape our interventions in each of the three areas of concentration: participation; institutional development (including training); sustainability (defined broadly to encompass not only natural resources but also human resources, financial resources, institutional resources). And the prospects for economic growth are influenced by international factors such as frameworks for trade and investment, and technology.²

USAID's private sector development strategy is based on four vital mutually reinforcing elements:

- Promotion of a policy environment conducive to business activity;
- Development of viable, competitive markets;
- Fostering greater reliance on market forces; and,
- Support for small business and micro-enterprise development.

The proposed project fits within USAID's private sector development strategy, as well as the Agency's new guidelines on economic growth, and falls under USAID/Madagascar's first sub-goal of increasing investment and employment in the private sector in Madagascar. USAID/Madagascar's first strategic objective (SO), as outlined in the 1994 Action Plan (revising the 1992 Country Program Strategic Plan logframe), is to "establish a competitive market environment for micro and small firms."³ The targets in support of this SO are:

- (1) to work towards a legal, regulatory and judicial environment supporting fair and swift treatment of entrepreneurs;
- (2) to support financial market reforms leading to increased availability of domestic resources for the private sector (savings and credit); and,
- (3) to expand the range of business services and technologies available to micro- and small-businesses.

USAID/Madagascar's Financial Market Development (FMD) project, approved in September 1993, is implementing measures to address the second target listed above. OPEN would be fully consistent with all of these targets, and would be oriented principally towards achievement of the first and third above-listed targets.

D. Relation to Other Donors

Madagascar is considered a priority country for development assistance, not only by the United States, but by many other donors, largely because of its successful recent

² USAID, "Implementation Guidelines: Economic Growth", January 1994 (draft), p. 1. (italics added).

³ USAID/Madagascar, Action Plan, FY 1995, Part I, page 8.

transition to democratic rule and its economic development potential. In the area of MSE development, as well as more general legal, regulatory and judicial reform, three principal donors have undertaken complementary efforts. In the project paper (PP) design, we will consult closely with these donors to maximize information sharing and complementarity.

1. French Bilateral Assistance

France is the largest donor in Madagascar. The French are interested in several areas of legal reform and the training of judges and magistrates. Other recent or current French assistance in areas complementary to OPEN include:

- Assisting private enterprises in preparing feasibility studies and obtaining financing, through funds which lend to entrepreneurs through local banks.
- Assistance to the Ministry of Justice in improving functioning of the courts.
- An MSE support project which is just underway and limited in geographical focus (Antsirabe). It will provide technical assistance and credit for MSEs⁴.

2. The World Bank

Since the 1980s, the World Bank has provided four general and sectoral structural adjustment loans. The World Bank was instrumental in pressing the GRM to adopt a privatization program. The World Bank continues to push reforms necessary for a competitive market environment, such as decentralization, public investment reform, and market liberalization (telecommunications, air transport, and petroleum).

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. This work will impact positively on the development of a competitive open market environment.

The APEX loan established in 1990 (running through 1997) provides support to MSEs through credit and technical assistance. However, during the two-year political instability hiatus which started in 1991, loan disbursements were stopped.

Finally, in 1995 the World Bank is planning a private sector project which will address three issues: (a) fiscal reform; (b) privatization in a few important sectors (banking, petroleum distribution, transportation, both and sea and air); and (c) harmonization of the different incentives under the three tax regimes, i.e. the free zones, the investment code (*Code des Investissements*), and business law (*Droit Commun*).

⁴ The European Union has an MSE support project based in Antananarivo ("ADEVA"), which provides technical assistance and credit to MSEs.

3. United Nations' Agencies

The United Nations Development Program (UNDP) is involved in activities directly related to OPEN. "*Entreprendre à Madagascar*" (EAM) is the principal UNDP effort, a project which since 1989 has promoted micro- and small-enterprise development, partly in collaboration with other donors such as the French *Caisse Française de Développement* (CFD) and German GTZ. It is aimed specifically at assisting MSEs in areas outside 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. Severe budget reductions, however, are limiting UNDP's ability to continue its support to this program.

The findings of a recent EAM evaluation will soon be available. If the recommendations of this evaluation can be implemented (likely to be related to financial controls, excessive follow-up/monitoring, staff quality and sustainability), USAID might consider, under OPEN, providing additional support to this type of activity.

Further, UNIDO is also in the design stage of an MSE support project. Issues which would be addressed are as of yet not specifically defined, but may include technical assistance and direct support to MSEs. USAID has already been invited to several planning meetings so that our efforts would not overlap.

II. PROJECT DESCRIPTION

A. The Problem

The major economic liberalization reforms begun in 1986 were expected to constitute sufficient incentives for the private sector, including MSEs, to increase production and output for the market. Yet, despite all of these measures, the producers' response, while positive, was more modest than what was expected. This lack of a strong supply response from the private sector was indicative of not only political and macro-economic uncertainties, but also of a series of other constraints at the firm level that inhibit investment and growth.

If MSEs, either formal or informal, are the best engine of Madagascar's future economic growth and employment, they will be unable to fulfill their full growth potential until key institutional and market environment constraints are addressed. Because of the lack of an open market environment, **transaction costs for MSEs are extremely high relative to expected benefits.** MSEs respond to this environment by restricting their business dealings to firms owned by relatives, by integrating support services (such as trucking or customs clearance) into the firm instead of contracting out and by forgoing expansion opportunities. Each of these responses reduces the probability that MSEs have chosen the "least cost" method of input use which, in turn, decreases MSE impact in the economy.

The higher than necessary transaction costs borne by MSEs are symptomatic of an unfavorable business environment. Delving deeper, analysis has shown that Madagascar's MSEs in general lack access to market information, to appropriate technology and to credit/capital. Further, the micro- and small-enterprise community must operate in a legal, regulatory and judicial (LRJ) environment which is not supportive of a transparent market economy and to which they do not have access in any case. Therefore, the problems to be addressed by OPEN are the lack of access and availability of direct services for MSEs and the lack of access to a fair and equitable LRJ system. Resolving all of these should have a net effect of stimulating MSE growth and expansion and by reducing transactions costs, permit MSEs to play a more important role in Madagascar's economic recovery.

The following sections provide more detailed information on the key problems which this project will address.

1. MSE Lack of Access to Market Information and Technology

MSEs have limited knowledge of market opportunities; they have difficult access to information and technical advice; they confront excessive and bewildering regulations on the importation of small equipment; they are unaware of better and more efficient technologies. Also, MSEs have little if any access to credit; they have limited skills in the process of designing and optimizing a production process; and suffer from an acute shortage of formal vocational training for the small scale, both in technology and business management.⁵ MSEs have typically small premises, often without legal title, relatively unsophisticated tools and equipment, and enjoy limited cooperation and little trust among competing businesses. A survey of constraints faced by Malagasy industry showed that access to equipment was also seen, especially for MSEs, as a major constraint.⁶

2. MSE Legal, Regulatory and Judicial (LRJ) Constraints

Sustainability of OPEN's efforts to provide support to MSEs depends largely on an improved LRJ environment. Madagascar's legal system functions poorly, contributing to an environment inauspicious for equitable economic growth, hampering MSEs from establishing themselves as competitors in the formal sector. The problems with the judicial system are all-encompassing:

- (a) The publication and dissemination of laws is inadequate, making it more difficult for MSEs to ensure that their tax payments and record keeping, for example, conform to the legal requirements. Simple informational pamphlets explaining laws and regulations to MSEs are not yet available in

⁵ The International Labor Organization (ILO) has a limited program which is providing training for small-scale enterprises.

⁶ "New Horizons", World Bank, November 1993.

the Malagasy language;

- (b) There has been a failure by those responsible for administering and enforcing laws to respect the legal rights of the private sector, particularly micro- and small- enterprise firms;
- (c) Methods of adjudicating commercial disputes and the system to pronounce fair, impartial and generally uniform decisions are grossly inadequate;
- (d) Current laws fail to provide a framework for development of financial markets which micro- and small firms can access; and lastly,
- (e) Laws are outmoded and inconsistent.

Continued expansion of MSE economic activity and investment requires improved efficiency and competitiveness, implying a need for both deregulation, and appropriate regulation to define the rules of the game. Legal and regulatory structures are presently inadequate to achieve reasonable growth in investment and employment, for which MSEs are the primary engine.

B. Rationale for Proposed Approach

The widespread and severe poverty in Madagascar dictates that the Mission's economic growth emphasis be targeted where the greatest opportunities lie for rekindling growth and creating jobs on a sustained basis. In Madagascar, MSEs offer the best and most equitable avenue for sustained economic growth in Madagascar for several reasons. Because MSEs represent 90 percent of registered businesses in Madagascar, our efforts will impact on the majority of the urban productive population. Further, MSEs have considerable capacity to generate employment and to raise income levels. Returns to capital are generally higher for MSEs than for larger firms, and marginal returns per unit of invested capital are generally higher for MSEs than for larger firms. MSEs generally represent the disadvantaged and poorest urban groups. Finally, increasing efficiency in the MSE sector provides sources of intermediate products for the production processes of larger firms.

This PID proposes interventions to ameliorate MSE access to services such as information and appropriate technology through use of existing organizations and institutions and to improve the overall LRJ environment for MSEs through institutional change. These interventions are focused on the most important aspects of establishing a more competitive, open market environment for MSEs, which are not being funded by other donors. Finally, the proposed interventions should have a direct impact on the productivity, institutional access, efficiency and growth of MSEs in Madagascar.

C. Project Goal, Purpose and Expected End of Project Status

1. Goal

To increase investment and employment in the private sector in Madagascar.

The assumption underlying this goal is that only the private sector (i.e., MSEs) 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.

2. Purpose

To establish a competitive, open market environment, supportive of micro- and small enterprises or MSEs.

This will increase the participation of MSEs in the economy and greatly contribute to increased investment and employment.

3. End of Project Status (EOPS)

- (a) Foreign and local investment will increase, especially in labor-intensive industries. MSE investment would increase yearly by a 6% average over life-of-project.
- (b) MSE employment will increase by a to-be-determined %.
- (c) One thousand MSEs will expand their businesses, increase incomes and jobs.
- (d) Formerly marginalized MSE entrepreneurs will participate fully in the expanding economic opportunities of the Malagasy economy.
- (e) A deepened public/private sector dialogue, allowing for more economic transparency and greater competition, will lead to more suitable laws, policies and economic legislation that will reflect MSE needs.
- (f) The efficiency and fairness of the GRM legal and regulatory systems pertaining to MSE in specific and the private sector in general will be improved.

D. Project Activities

1. Proposed Components

We envision that the OPEN project will have two major components to be fully developed in the PP design.

a. Support to MSEs: As a wholesaler of ideas and programs, through demand-driven contracting mechanisms, USAID will look for local partners in the business community

to provide direct services to MSEs on an increasingly sustainable basis. Using an integrated approach aimed at immediate impact that combines improving information flows and technology transfer through business associations and other MSE-support institutions facilitates a rationing of services in accord with demand by the MSE sector.

The proposed outputs for MSEs include: (i) increased access to information from a variety of sources, (ii) increased formal sector participation, (iii) increased ability to pay for services and availability of services, (iv) increased access to capital, (v) strengthened linkages between private sector firms and associations and international technology centers, and (vi) dissemination of improved technologies to targeted economic subsectors and regions of Madagascar.

b. Legal, Regulatory and Judicial Framework for MSEs: On the LRJ side, OPEN would focus on changing the so-called enabling environment, i.e., legal, regulatory and judicial reforms that are paramount if MSEs are to thrive. These interventions would strengthen the financial and legal systems to better serve low-income individuals and MSEs. Thus, marginalized Malagasy entrepreneurs would be able to participate fully in expanding economic opportunities. In the process, we would expect improved governance through more transparent, predictable and fairer rules and procedures and through stronger civil society groups that would hold government accountable.

Discussions with MSEs, government officials and legal experts have led to agreement on a set of exploratory LRJ activities in support of MSE's. The five areas of assistance, to be fully developed in the PP, are: (i) modernization of commercial laws; (ii) publication and dissemination of laws; (iii) training and information; (iv) development of alternative dispute resolution programs; and (v) regulatory reform.

This would result in an improved climate in which micro- and small- entrepreneurs operate, reduced regulatory delays (obtaining licenses, import-export permits, processing of tax rebates, etc.), and would encourage the GRM to rely on simple, low-cost procedures to adjudicate an increasing number of business disputes, and thus reduce transaction cost for micro- and small- entrepreneurs.

2. Project Implementation Arrangements

Request for proposals would likely be issued for the implementation of the two components of the OPEN project. During PP design, USAID/Madagascar will first look for Gray Amendment firms that could carry out the required services. Should this prove to not be a viable avenue, the Mission would broaden its search.

III. INDICATIVE FINANCIAL PLAN AND ESTIMATED COSTS

The five-year OPEN project will utilize Development Fund for Africa (DFA) resources for an estimated \$12.5 million to support the activities outlined above. It is expected that actual obligations will take place over a four year period.

Host country contributions (HCC) will include both public and private sector

contributions. Private sector contributions will include in-kind costs of staff time, facilities, transport, etc., that private sector firms and BAs will contribute to overall project objectives. Public sector contributions will most likely include similar in-kind costs of staff, facilities, transport and other costs. Since most assistance will be provided directly to private sector entities, mainly MSEs, most HCC will come from the private sector. At this point it is difficult to estimate the total host country contribution. The PP design team will carefully ascertain what can realistically be counted as HCC. If the HCC does not equal 25 percent of total project cost, the Mission will request a waiver from the AA/AFR.

Table 1 below provides an illustrative budget for the project.

Table 1
Illustrative OPEN Project Budget

Component/Activity	Budget (\$ million)
A. Support to MSEs	\$ 7.0
1. TA/Training (\$3.5)	
2. Access to Technology (\$2.5)	
3. Strengthened MSE Support Institutions (\$1.0)	
B. LRJ Support for MSEs	\$ 5.0
C. Evaluation and Audit	\$ 0.5
Project LOP Total	\$12.5

IV. FACTORS AFFECTING PROJECT SELECTION AND FURTHER DEVELOPMENT

A. Social Soundness Considerations

Madagascar has not generally 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 ethnic 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.

Also, there are ethnic rivalries present, in which the OPEN 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. OPEN activities should scrupulously avoid any hint of

favoritism in fact or appearance, whether in favor of or against this and other communities. 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.

There will be two types of direct beneficiaries: (1) those benefitting from support to MSE associations of which they are members, and (2) those MSEs receiving TA or other types of assistance directly from intermediary institutions. Small producers/investors will stand to benefit as they become full-fledged participants in the liberalized economy. Other beneficiaries would include newly hired workers hired as MSEs expand their businesses.

Support to MSEs under OPEN will also directly impact upon informal sector producers/employees. It is estimated that their numbers are at least fifty to a hundred-fold that of formal sector private enterprises. **Women-owned micro-enterprises will be a specially targeted beneficiary group in this project.** Informal surveys suggest that non-registered women-owned businesses make up a substantial percentage of all businesses.

These target beneficiary groups have been, and will continue to be consulted in the design process. Additionally, we are reaching these beneficiary groups through the most cost-efficient means that we can. As a "wholesaler donor" it is neither cost-efficient nor sustainable to attempt "retailing" efforts with individual private sector firms. Our involvement with business associations or groups, rather than individual firms, is predicated on the economic and social impact of business associations acting as advocacy groups vis-à-vis the Malagasy legislature and executive branch and also more efficient multiplier effect way of delivering services. Strengthening their capacity to advocate for economic reform will institutionalize equitable OPEN project interventions. Preliminary discussions with MSE groups indicate their support for these types of interventions. A USAID team recently visited Mahajanga, one of the Mission's two high potential zones, and confirmed the need and lack of know-how by Malagasy business groups on ways to improve current client services and their marketing, increase the variety of new services, access and disseminate information, strengthen members' stakeholder roles and expectations, and present an economic agenda to the government.⁷ Because of the importance of the socio-cultural context in Madagascar, a full social soundness analysis will be carried out during PP design.

B. Financial and Economic Considerations

The theoretical underpinning of OPEN draws extensively for the ideas developed by the "new institutional economics" school of thought. This school has enlarged our notions of what determines economic efficiency, going beyond the choice of technology and the use of labor and capital. As its name suggests, the school looks at the roles of institutions,

⁷ Indirect beneficiaries will include all firms which will operate within the revised legal framework which recognizes private property rights and obligations.

and in particular the influence of institutional arrangements on transaction costs and resource allocation. Malagasy legal institutions offer a cogent example of the interplay of institutional structure, transaction cost and resource allocation. The micro- and small-enterprise business community has no confidence in the court system. The process is unreasonably slow, the impartiality of judges is not assured, and outcomes (court decisions) are not predictable. In short, **transaction costs for MSEs are extremely high relative to expected benefits.**

This reduction in transaction costs will produce three beneficial effects. First existing resources will be used more efficiently (boosting incomes in the short-term): second, a low transaction cost economy will be relatively more attractive to domestic and foreign investors (boosting incomes in the medium-term). Third, it will facilitate entry of new micro- and small- firms into the formal sector and thus increase competition.

The first component will be evaluated in the project paper in terms of their cost effectiveness, for example, cost per beneficiary. The design team will be able to compare the "unit cost" of OPEN interventions to comparable costs of other donor interventions.

The principal financial issue for the design team is the ability of the GRM to provide adequate budgetary allocations to ministries and institutions collaborating with the project so that the project-provided resources (including intangible resources such as training) will be used as intended and so that changes introduced by the project can be maintained. This analysis will be especially pertinent for the Ministry of Justice, the court system and the public technology centers.

C. Institutional Considerations

In the current political and policy environment, where the relationships between GRM institutions remain in a period of flux, it will be a challenge to identify the ministries or other entities with which OPEN will work most effectively. In the past this has been further complicated by overlapping responsibilities of several ministries and the relative personal power of several ministers, which can both facilitate and hinder various efforts at LRJ formulation and reform. The recent (August) cabinet re-shuffle seems to show promise as a new set of more technically oriented ministers have come on board in agencies related to MSE development.

The logical alternatives in terms of a "lead" ministry (*ministère de tutelle*) are the Ministry of Industrial Promotion, the Ministry of Economy and Plan, and the Ministry of Finance. The Ministry of Commerce will also be involved. Each has a central role to play in the formulation and implementation of policies affecting the private sector. Judicial reforms will be centered in the Ministry of Justice. Activities centered on MSEs and legal reforms will entail frequent dialogue with the Ministry of Industrial Promotion whereas regulatory reforms will involve the Ministry of Finance. The PP design will examine the institutional capacity and commitment of these Ministries.

Whichever of the proposed project components emerges as the dominant theme in final project design should help dictate the choice of the lead implementing agency. Recent discussions with the Ministry of Industrial Promotion have underscored that Ministry's interest in the OPEN project objectives. This will be confirmed during the PP design, at which point USAID/Madagascar will arrange a series of working meetings with all relevant ministries to better gauge commitment, potential intellectual contribution, and dynamism.

For direct support to MSEs, the Mission will look for existing institutions as partners to provide direct services. One group of institutions that OPEN will use to provide direct support will be business associations. Supporting such associations can help advance the agenda of socio-political pluralism by invigorating "civil society", of which their members are an integral part. As noted by Moore and Hamalai⁸, since business associations represent organized private capital, strengthening BAs should usefully empower, in relation to both the government and other interests, the social group that is central to success of economic liberalism. In addition, enhancement of the capacity of business associations to provide services to MSEs -- information, contract adjudication, certification of product quality, etc. -- should contribute to the success of the private sector economy.

D. USAID Support Requirements and Capabilities

As mentioned above, USAID will either award two distinct technical assistance contracts for project implementation with Gray Amendment firms, HBCUs and/or an 8(a) set-aside. The Mission's Private Enterprise Officer (PEO) in the Office of Market and Business Development will be the full-time Project Officer for the OPEN project and will administer all technical assistance contracts. Depending on a management analysis stemming from the outcome of the Project Paper, the PEO may be assisted by a project-funded assistant.

E. Environmental Considerations

A categorical exclusion for the OPEN project is included in the Initial Environmental Examination, Annex B. It has been determined that the activities for this project meet the criteria for categorical exclusion in accordance with Regulation 16, Section 216.2(c), and are therefore excluded because they fall within the class of actions described in Section 216.2(c)(2)(i) and (iii).

F. USAID Policy Issues

1. Micro- and Small Enterprise Development

⁸ Moore, Mick, and Ladi Hamalai, "Economic Liberalization, Political Pluralism and Business Associations in Developing Countries", World Development, Vol. 21, No. 12, Pergamon Press, Oxford University, December 1993, pp. 1895-1912.

Early in PID process, USAID/Madagascar met to discuss the USAID/W-generated Morfit paper ("Putting People First"). The Mission analyzed the issues addressed in the paper and applied them to the Madagascar context. The paper was used as a litmus test to ask ourselves again, as we did in preparation of the CPSP (1992), a set of questions: Who are the poor in Madagascar? Why are they poor? How can we reach them?

In response to this internal review, the OPEN PID was **adjusted accordingly to focus on support to MSEs, thereby reaching poor, yet potentially vibrant economic actors.** Micro- and small- enterprise development is consequential not only because it contributes to overall economic growth, but perhaps more significantly, because support of this "economic underclass" will contribute in a notable way to spreading the impact of the fruits of economic growth.

The Mission feels that through OPEN, it would address the substance of the policy issue which underlies the Morfit paper, and fit squarely with USAID/W's renewed emphasis on development at the grassroots. In other words it would provide **access, e.g., expansion and democratization of the economy.** Since small- and micro-firms comprise more than 90 percent of the private sector in Madagascar, the project's efforts to assist them to grow, will, per force, contribute to the "economic democratization" process, and reach Madagascar's poorest.

2. Participation/People Level Impact

Expanding participation and reaching out to beneficiaries is a concern of the Mission. During the PP design process, **the design committee will actively seek out participation of target beneficiary groups, especially women-owned MSEs.** Similarly, specific implementation mechanisms will assure that beneficiaries participate actively in project implementation. Indicators will be developed to track the people-level impact, especially on micro- and small enterprise owners and workers disaggregated by gender.

3. USAID Programs and U.S. Jobs

On October 6, 1992, the United States Congress enacted the Foreign Operations Export Financing, and Related Programs Appropriation Act for Fiscal Year 1993 (H.R. 5368), a provision of which prohibited the use of USAID appropriations for certain activities that may impact on jobs in the United States. This provision, Section 599, prohibited the use of appropriated funds for: (1) financial incentives to U.S. enterprises to relocate abroad; (2) assistance to foreign export processing zones; and (3) assistance that would contribute to the violation of internationally recognized workers' rights.⁹ Section 599(b) prohibits assistance for the purpose of establishing or developing in a foreign country any export processing zone, unless the President determines and certifies that such assistance is not likely to cause a loss of jobs within the United States. For Fiscal Year 1994, the

⁹ Section 599 was subsequently re-titled Section 547 of P.L. 103-87 which continued the prohibition for FY 1994; also published as Policy Determination 20, "USAID Programs and U.S. Jobs", dated January 3, 1994.

provision referring to this prohibition is Section 547(b).

USAID/Madagascar will not get involved in those areas prohibited by Section 547(b) under the OPEN project. Further, the Mission will undertake PP design with the full participation of the RLA to ensure full conformity to Section 547(b).

G. Design Calendar and Strategy

The PP will be designed by the Mission with some outside assistance. OPEN will be an FY 1995 new start. The following schedule summarizes the Mission's plans:

Action	1994 - 1995
PID review and approval	November
Project Paper design	November - February
PP Review and Approval	March
Initial obligation	May

For the PP, the Mission has requested the assistance of a REDSO PDO, Regional Private Sector Advisor, the RLA, as well as the Regional Commodity Procurement Officer. REDSO/ESA was involved fully in the PID, and their participation in the final design is deemed essential. The timing/duration of these TDYs will be worked out at the REDSO/ESA scheduling workshop in early November. Input from the Mission's Contracts Officer and Controller will also be crucial through out the PP design process.

MADAGASCAR OPPORTUNITIES FOR ENTREPRENEURS (OPEN) PROJECT
LOGFRAME

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</p>	<p>Measure 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 formal private sector employment 	<p>GRM statistics (BDE)</p>	<p>Purpose-to-goal link:</p> <p>The GRM maintains a coherent macroeconomic framework.</p> <p>Foreign and domestic investors responsive to GRM initiatives</p>

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS/RESPONSIBILITY	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Activity Purpose:</p> <p>To establish a competitive, open market environment supportive of micro-and small enterprises or MSEs</p>	<p>Conditions that will indicate purpose has been achieved (EOPS):</p> <ol style="list-style-type: none"> 1. Foreign and local investment will increase, especially in labor-intensive industries. MSE investment would increase yearly by a 6% average over life-of-project. 2. MSE employment will increase by a to-be-determined %. 3. One thousand MSEs will expand their businesses, increase incomes and jobs. 4. Formerly marginalized MSE entrepreneurs will participate fully in the expanding economic opportunities of the Malagasy economy. 5. A deepened public/private sector dialogue, allowing for more economic transparency and greater competition, will lead to more suitable laws, policies and economic legislation that will reflect MSE needs. 6. The efficiency and fairness of the GRM legal and regulatory systems pertaining to MSE in specific and the private sector in general will be improved. 	<p>OPEN Project Reports</p> <p>GRM statistics</p>	<p>Output-to-purpose link:</p> <p>GRM continues democratization and economic liberalization</p> <p>Donors provide significant complementary resources</p>

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS/RESPONSIBILITY	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Outputs:</p> <p><u>Component #1: Support to MSEs</u></p> <ol style="list-style-type: none"> 1. Increased access to information from a variety of sources 2. Increased ability to pay for services and availability of services 3. Increased access to capital through strengthening MSEs ability to present bankable projects 4. Strengthened linkages between private sector firms and associations and international technology centers 5. Dissemination of improved technologies to targeted economic subsectors and regions of Madagascar 	<p>Magnitude of outputs necessary/sufficient to achieve purpose:</p> <ul style="list-style-type: none"> ● # of publications, newsletters, seminars ● increased utilization of CIDST and other Malagasy documentation centers ● increased # of dues-paying members (MSE associations, guilds, business associations) ● professional standards established (" ") ● increased entrants into market ● # of loans for MSEs approved by demand driven financial markets ● increased utilization of documentation center by private sector firms ● increased attendance at technology fairs ● increased utilization by private firms and BAs ● # of prototypes brought into Madagascar ● # of technologies modified by technology centers 	<p>Project reports</p>	

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS/RESPONSIBILITY	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>Outputs (continued):</p> <p>Component #2: Legal, Regulatory and Judicial Framework for MSEs</p> <ol style="list-style-type: none"> 1. Modernization of commercial laws 2. Publication and dissemination of laws 3. Training and information 4. Development of alternative dispute resolution programs 5. Regulatory reform 	<p>Magnitude of outputs necessary/sufficient to achieve purpose:</p> <ol style="list-style-type: none"> 1.3.1. ● Expansion in the number of micro-enterprises <ul style="list-style-type: none"> ● Movement of micro-enterprises to formal sector 2.1. ● # of new or revised commercial laws and deregulation of selected industries 2.2. ● dissemination of commercial laws and texts <ul style="list-style-type: none"> ● improve National Law Library ● improved data base development 2.3. ● # of lawyers, judges, law students, and law professors from National Legal Institute(s) participating in seminars and workshops <ul style="list-style-type: none"> ● curriculum development @ the Law School ● "Twinning" program established (visiting professors swap/university linkages established) 2.4. ● # of cases adjudicated and, throughout the process, speed under the new systems 	<p>GRM and IMF reports</p>	

**INITIAL ENVIRONMENT EXAMINATION
OR
CATEGORICAL EXCLUSION**

PROJECT COUNTRY: Republic of Madagascar
PROJECT TITLE: Opportunities for Entrepreneurs (OPEN) PID (687-0122)
FUNDING: FY(S): 94 - 99 **US\$:** 14 MILLION
IEE PREPARED BY: Josoa Razafindretsa, PDA/PD
USAID/Madagascar

ENVIRONMENTAL ACTION RECOMMENDED:

Positive Determination : _____
Negative Determination: _____ XX _____
Categorical Exclusion : _____ XX _____
Deferral : _____ XX _____

SUMMARY OF FINDINGS: The training and technical assistance is recommended for a categorical exclusion under CFR 216.2(c)(2)(i). The provision of information to Business Association membership and the publication and dissemination of laws are recommended for a categorical exclusion under CFR 216.2(c)(2)(v). The provision of business advisory services and the development of a new institution for the arbitration of commercial disputes are recommended for a negative determination. Interventions in the area of credit provision are recommended for a negative determination with the provision that individual credit agreements contain a caveat against the use of obtained credit for the importation, procurement or use of pesticides. The modernization of laws is recommended for a negative determination with the provision that an EMEMP will be prepared during the PP stage. Commodities proposed for importation under this project are recommended for a negative determination. The OPEN project will not have any significant negative impact on the threatened and endangered species of Madagascar or their critical habitat.

CONCURRENCE:

Bureau Environmental Officer: *[Signature]* **APPROVED:** *[Checkmark]*
DISAPPROVED: _____
John J. Gaudet **DATE:** 5/5/94

CLEARANCE: GC/Africa: *[Signature]* Date: 6/22/94

ATTACHMENT No.1

INITIAL ENVIRONMENTAL EXAMINATION OR CATEGORICAL EXCLUSION

A. PROJECT ACTIVITIES DESCRIPTION

The OPEN project proposes to create a more favorable investment climate by helping small- and micro-enterprises to develop directly and through strengthening business associations.

The main areas of involvement of the Opportunities for Entrepreneurs (OPEN) Project are (1) to support the private sector, small, and microenterprises through Business Associations (BAs) to strengthen their institutional capacity to meet membership needs; to respond to market demand; to develop the BAs credible capacity for the provision of services to members; to develop, and disseminate professional standards, and procedures; to enforce standards, self-regulation, and advocacy; and, (2) to assist the Government of the Republic of Madagascar (GRM) to improve the legal, regulatory, and judicial framework under which the private sector operates.

The OPEN Project proposes the following main activities. The OPEN Project will work on macroeconomic analysis by providing a long-term technical advisor and short-term technical advisors to work with the Ministry of Economy, Plan, and Social Recovery, and within an interministerial committee to refine the existing tools, and develop new analytical technic for the preparation of annual macroeconomic framework. Training will be conducted for the purpose of improving the legal, regulatory and judicial framework for businesses in Madagascar and training institutions will be strengthened.

The OPEN Project will provide information to Business Association membership through direct transfer and perhaps the facilitation of information transfer. Assistance will be provided for the publication and dissemination of laws. The project will provide business advisory services in order to assist business association to: improve management, improve technical capability to provide services to members, and improve their advocacy ability.

The OPEN Project will strengthening the National Document Center's (CIDST) capacity and improve the linkages between Malagasy technology centers and international appropriate technology centers. This will be accomplished by providing computer hard ware and soft ware commodities, TA and training.

The OPEN Project will help the "informal sector" to gain access to credit. What form of assistance will be provided will be determined during the PP preparation.

The project will work toward the modernization of certain commercial laws, the relaxation of government regulation of businesses, and the development of new institutions for arbitration

of commercial disputes.

B. EVALUATION OF POTENTIAL ENVIRONMENTAL EFFECTS

The technical assistance and training will not have an adverse impact on the environment. In fact, a beneficial effect can be achieved through the increased awareness of local business people about current world wide environmental concerns. The SOW for TA consultants should include the responsibility to impart modern day environmental awareness concerns. The training should likewise mention environmental considerations of modern business organizations.

The provision of information to Business associations can not be foreseen to have an adverse impact on the environment. Businesses can be provided information concerning appropriate environmentally benign means for obtaining raw materials and waste stream reduction methodology.

The development of new institutions for the arbitration of commercial disputes will not have an adverse impact on the environment.

Providing credit to businesses, providing credit guarantees, or simply liberalizing the credit marketplace should not have an adverse impact on the environment. Credit may not be provided for the procurement, importation or use of pesticides. Likewise, credit may not be used for the procurement or use of logging equipment.

The modernization of laws, primarily commercial laws, can not be foreseen to pose a threat to the natural and physical environment. Nevertheless, it is considered prudent to monitor the revision of laws and the results to prevent any unintended effects on the environment. An environmental monitoring evaluation and mitigation plan (EMEMP) shall be written at the time of PP preparation.

Commodities proposed for importation are limited to computer hard and software and a minimum number of car or four wheel drive motor vehicles. Despite the potential for increases in noise, dust, emissions, off road travel, and pedestrian accidents, such commodities are limited in number and are not considered to pose a significant threat to the environment of Madagascar.

The OPEN project will not have any significant negative impact on the threatened and endangered species of Madagascar or their critical habitat.

Although the OPEN project does not contemplate the procurement, importation or use of pesticides, the following caution should be noted. Written authorization and approval as provided by the procedures specified under CFR 216.3(b) is required before a U.S.A.I.D. project can proceed with pesticide procurement, importation or use.

C. RECOMMENDED ENVIRONMENTAL THRESHOLD DECISION

The training and technical assistance is recommended for a categorical exclusion under CFR 216.2(c)(2)(i). The provision of information to Business Association membership and the publication and dissemination of laws are recommended for a categorical exclusion under CFR 216.2(c)(2)(v).

The provision of business advisory services and the development of a new institution for the arbitration of commercial disputes are recommended for a negative determination. Interventions in the area of credit provision are recommended for a negative determination with the provision that individual credit agreements contain a caveat against the use of obtained credit for the importation, procurement or use of pesticides.

The modernization of laws is recommended for a negative determination with the provision that an EMEMP will be prepared during the PP stage. Commodities proposed for importation under this project are recommended for a negative determination.

The OPEN project will not have any significant negative impact on the threatened and endangered species of Madagascar or their critical habitat.

ANNEX C

LIST OF PERSONS CONSULTED

Government of Madagascar:

Mr. Renaud Rajaonah Rahagafotsy, Ex-Directeur Générale de la Délégation Générale du Gouvernement pour la Privatization (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 Randriamanarnpisoa, 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

25

Mr. Richard Rotodeux, Technical Advisor, Ministry of Economy, Madagascar

UNDP

Mr. Jérôme 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. Parfait Monnerville P.Y., Conseiller

Mr. Jean Philippe Duvert, Economist

French Cooperation

Mr. Robert Chahinan, Directeur, Caisse Française de Développement

Mr. Michael Hermite, Conseiller Economique et Commercial, Ambassade de France

Mr. Benoît Descamps, Ministère de la Coopération

Private Sector:

Mr. Jocelyn Thomasse, Manager, Union Commercial Bank (UCB)

Mr. Hervé Fougeron, Directeur Général Adjoint, Chargé de l'Exploitation, BNI-Crédit Lyonnais

Mr. Yves Ratrimorivony, 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 Rajofera 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. Désiré E. Ralijaona, Président, 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, Secetaire General

Mr. Parfait Ralambosoa, Conseiller Technique

Other:

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

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