PDBBM016

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MADAGASCAR AGRICULTURAL EXPORT LIBERALIZATION PROGRAM (MAELP) (687-T-603, 687-0102)

July 1988

Unclassified

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR FOR AFRICA

FROM: AFR/PD, Carol Peasley

SUBJECT: Madagascar Agricultural Export Liberalization Program (MAELP) (687-0102)

Problem: Your approval is requested for a program grant of $16 million and a project grant of $2.735 million from the Development Fund for Africa appropriation to Madagascar for the Madagascar Agricultural Export Liberalization Program (687-0102).

Background: Since 1982 the Government of Madagascar has taken strong action to correct severe fiscal and balance of payments imbalances that had resulted from a poorly conceived investment program launched in the late 1970's, excessive state intervention in the economy, and adverse trends in the terms of trade. These actions have succeeded in stabilizing the economy, but have not been sufficient to restore real growth, with the result that living standards for the majority of the population have continued to decline. This frustrating lack of growth appears to stem from a series of structural distortions that prevent private sector producers, and producers of tradables in particular, from responding to improved price and market incentives. Beginning in 1985, the GDRM has attempted to remove these distortions through a series of structural adjustment programs with the World Bank focussed on the agricultural, industrial and commercial sectors. These programs are only now beginning to show results and it is clear that much more remains to be done. The GDRM remains committed to moving forward with significant reforms in external trade, the financial system and the parastatal enterprise sector. The MAELP will support initiatives in one key area of this comprehensive reform program that promise to bring immediate benefits to the small rural producer who is the target of the A.I.D. program in Madagascar, namely the liberalization of agricultural export markets.

Discussion: The purpose of the Madagascar Agriculture Export Liberalization Program is to remove policy and procedural impediments to liberalized external agricultural markets in Madagascar. These impediments have included state monopolies on export of the traditional crops that account for 80% of all agricultural exports, excessive administrative approvals and licensing procedures, and an administrative allocation of foreign exchange.

This program purpose is to be achieved through two distinct types of interventions:

1) policy reform-conditioned dollar disbursements under an agricultural sector grant to support the removal of specific policy and procedural constraints operating against the agricultural export sector, and

2) technical assistance training and studies to consolidate the reforms addressed by the program grant and to increase the GDRM and A.I.D's understanding of additional reforms that are needed to further the liberalization process in the agricultural sector.

Program grant funds from the FY 1988 obligation will be disbursed in two equal tranches of $8.0 million. Technical assistance and training under the project grant will be targeted to private entrepreneurs with an interest in entering or expanding export trade, and will aim to provide these entrepreneurs with the business skills needed to respond to emerging opportunities in agricultural export markets. Study tours and seminars will focus on policies that promote an expanded private sector role in the agricultural export market, while studies will identify remaining constraints in three closely-linked areas - rural financial markets, input and product markets and consumer goods supply in rural areas - where reform will be essential to sustain progress in agricultural sector reform into the future. A baseline survey, monitoring system and carefully focussed evaluations will enable A.I.D. to closely track progress in achieving program objectives.

The intended beneficiaries of the MAELP are first and foremost the small rural producer engaged in export crop production (export crops are the main source of livelihood for one-third of Madagascar's population, and the great majority of export crop producers are small farmers), and secondarily, the private entrepreneurs engaged in the collection, processing and export of Madagascar's export crops.

Local currencies generated by the sector grant will be programmed within the GDRM budget to initiate that much-needed budget reform (until now all donor counterpart has been used off-budget), and will address a critical constraint to agricultural export growth - road transport - by financing the construction cost of a major program to rehabilitate farm to market roads.

The total cost of the program is $25.030 million of which $18.735 million will be provided by A.I.D. and $6.245 million by the Government of Madagascar. Private sector beneficiaries of training and technical assistance will contribute $0.050 million to project funding. A.I.D.'s contribution of $18.735 million will consist of a $16 million program grant and a $2.735 million project grant. The A.I.D., GDRM and others contribution will support the following inputs:

Input	USAID ($000)	GDRM	Private
Agricultural Sector Support	$16,000	$6,100	$
Studies	435	25	
Training	1,200	60	30
Technical Assistance	800	50	20
Evaluation and Audit	100	-	
Contingency	200	10	
Total	$18,735	$6,245	$50

The MAELP is fully consistent with the 1986 CDSS for Madagascar and the Concepts Paper approved in February of 1988. The PAAD - with the PP elements contained therein - demonstrates that the program is economically, technically and socially sound and administratively feasible. The constraints imposed by OAR/Madagascar's limited staff are to be addressed by hiring a full-time program manager with project funds and by contracting out a majority of training and technical assistance activities. The technical design and cost estimates are reasonable and adequately planned, thereby satisfying the requirements of Section 611 (a) of the Foreign Assistance Act of 1961, as amended. In addition, the requirement for a 25% host country contribution is met in that the host country will agree to fund training, technical assistance and studies under the project and will provide $18.0 million in local currency which will be used for construction of the Seventh Highway Project as well as to establish a $600,000 trust fund to cover some of USAID's operating expenses. The timing and funding of project activities are appropriately scheduled, and adequate provision has been made for evaluation and audits. The environmental analysis resulted in a categorical exclusion. There are no human rights concerns with an impact on this project.

Additional grant funds will be obligated in FY 1989 if the 1989 AID evaluation and review of GDRM's policy reform progress, deems continued A.I.D. support for agricultural market liberalization through MAELP appropriate and additional policy reforms are identified. Amendment of this program would serve as the authorization mechanism for the additional funds.

Conditions Precedent and Covenants: The Conditions Precedent to Disbursement established for the release of the first tranche of $8.0 million relate to the elimination of government monopolies for the marketing of the traditional export crops (cloves, coffee, pepper) and the maintenance of free access to these markets for private

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operators, and to the continued allocation of foreign exchange through an open and market-clearing system. Also a third subcondition requires the GDRM to submit a schedule for meeting the conditions precedent to the second disbursement of funds. CP's for the release of second tranche funds call for the successful implementation of policies and procedures to promote liberalized agricultural export market operations as well as the continued allocation of foreign exchange through an open and market-clearing system. An external review will be conducted to assess performance in meeting progress indicators whose recommendation will be the basis of second tranche release.

Covenants are intended to assure that policy reforms are not reversed, that the private sector will be the primary beneficiary of project-supported training, and that a special local currency account will be established and regularly reported.

Justification to Congress: A Congressional Notification was sent to the Congress on June 29, 1988. The 15 day waiting period expired on July 14, 1988.

Recommendation: That you approve the attached PAAD face sheet and Project Authorization for the Madagascar Agricultural Export Liberalization Program.

Attachments:

1. Project Authorization
2. Program Assistance Approval Document

Clearances:

DAA/AFR: WBollinger		Date	7/21/88
DAA/AFR: E.L. Saiers		Date	7/28/88
AFR/PD/EAP:JSchlesinger	draft	Date	
AFR/EA:DLundberg	draft	Date	
AFR/PD:JGraham	JG	Date	20 July 88
AFR/DP/PAR:JWolgin	draft	Date	
AFR/CONT:RKing	draft	Date	
GC/AFR:AAdams	draft	Date	
PPC/PDPR:RMaushammer	draft	Date	7/18/88
State/AF/E: JDavison		Date	
State/AF/EPS: CFreeman	draft	Date	

CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: 687-T-603 687-0102

2. Country: Madagascar

3. Category: Madagascar Agricultural Export Liberalization Program

4. Date: May 1988

5. To: Charles Gladson, Assistant Administrator for Africa

6. OYB Change Number: N.A.

7. From: Samuel Rea, A.I.D. Representative to Madagascar

8. OYB Increase: N.A.
To be taken from:

9. Approval Requested for Commitment of: $ 16,000,000

10. Appropriation Budget Plan Code:

11. Type Funding: ☐ Loan ☒ Grant

12. Local Currency Arrangement: ☐ Informal ☒ Formal ☐ None

13. Estimated Delivery Period: N.A.

14. Transaction Eligibility Date: N.A.

15. Commodities Financed:

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash	$ 16,000,000	Other	

18. Summary Description

The Madagascar Agricultural Export Liberalization Program (MAELP) is intended to support the efforts of the Government of the Democratic Republic of Madagascar (GDRM) to restructure its agricultural sector and will focus, in particular, on removing policy and procedural impediments to liberalized agricultural export markets. Government monopolies on export of the traditional crops of coffee, cloves, vanilla and pepper (which together account for about 80% of export revenues), low fixed producer prices, and cumbersome and discriminatory licensing procedures have been the most serious obstacles to agricultural export growth in Madagascar. The removal of these and other policy and procedural constraints will improve market opportunities and producer prices, and will increase private sector participation in all stages of the marketing of agricultural export crops. Over the longer term, the improved export environment should provide an incentive for increased production of both traditional and non-traditional export crops, which are the principal source of income for almost one-third of Madagascar's population, as well as export revenue for the country.

19. Clearances	Date
C. Peasley AFR/PD	7/18/88
D. Lundberg AFR/EA	7/15/88
J. Westley AFR/DP	7/15/88
A. Adams GC/AFR	7/15/88
E. Owens M/FM	7/19/88
R. King AFR/CONT	7/15/88
W. Bollinger DAA/AFR	7/21/88
ELSaiers DAA/AFR	

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature:

Date: 7-21-88

Title: Assistant Administrator for Africa

CLASSIFICATION:

The MAELP consists of a US$ 16,000,000 agricultural sector grant which will be disbursed in two equal tranches following the satisfaction of policy reform conditions, and an accompanying US$ 2,735,000 project grant for supportive technical assistance, training and studies. In FY 1989, additional funds may be obligated if the review of policy reform progress planned for January 1989 deems continued A.I.D. support for agricultural market liberalization through MAELP appropriate and additional policy reforms are identified. Technical assistance and training are designed to make the proposed policy reforms effective, while the studies will analyze remaining constraints in input, product, and financial and consumer goods markets without whose removal export marketing of agricultural products will quickly reach its limits. Performance in achieving policy reform objectives will be closely monitored on the basis of progress indicators, both through a baseline and follow-up household income and expenditures survey and periodic evaluations. The following conditions and covenants will be included in the program grant agreement:

CONDITIONS PRECEDENT TO DISBURSEMENT

1. Prior to the disbursement of the first tranche of $8.0 million under this Agreement or to the issuance of documentation by A.I.D. pursuant to which such disbursement will be made, the Grantee will except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., evidence that the Grantee has carried out the following:

i. On the basis of prior discussions and agreement with A.I.D., opened export marketing of the traditional export crops (coffee, cloves and pepper) to the private sector and continues to permit private operators to operate on an equal basis with public sector firms;

ii. Instituted the Open General Licensing (OGL) System or an agreed alternative system to allocate foreign exchange in an open and market-clearing manner; and

iii. Submitted a letter to USAID which outlines the GDRM's proposed schedule for meeting the conditions precedent to the second disbursement.

2. Prior to the disbursement of the second tranche of $8.0

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million under this Agreement, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish, in form and substance satisfactory to A.I.D. evidence that (a) it has met all the conditions set forth hereunder for the release of the second tranche of $8.0 million, and (b) the Democratic Republic of Madagascar has successfully implemented policies and procedures to promote liberalized agricultural export market operations, and continued to allocate foreign exchange in an open and market clearing manner through the OGL or an agreed alternative mechanism, as determined by measurement of the following progress indicators:

i. The share of traditional crops marketed by private operators has increased to at least 50% of total value for at least two of those crops.

ii. There is free access to export markets for all non-traditional export crops.

iii. The OGL system or an agreed equivalent mechanism operates as planned with respect to receipt of the full amount of foreign exchange applied for within the six working day time period specified in the implementing regulations for the OGL.

iv. The number of administrative approvals, clearances and fees for export transactions has decreased and the time required to process an export shipment has been reduced to less than three days.

v. The Government will have published an export guide providing a complete and concise summary of all export regulations in effort.

These progress indicators will be the subject of an Implementation Letter (IL) to be issued following the signature of the Grant Agreement. The IL will establish the baseline against which the progress indicators will be measured as well as the performance targets to be met. Upon notification, that the conditions precedent to disbursement for the second tranche have been met, A.I.D. will designate an external review team to assess the progress made and to determine whether performance satisfies the conditions for second tranche release. This assessment will be held as soon as feasible after notification is received, except that it shall be held no earlier than December 31, 1988.

The Program Grant Agreement will contain the following covenants:

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Covenants: The Grantee shall covenant, that unless A.I.D. otherwise agrees in writing:

i. It will not in any way discontinue, reverse or otherwise impede any action it has taken under this Agreement in satisfaction of any condition precedent to initial or subsequent disbursements.

ii. It will establish a Special Account and to have deposited therein local currency of the Democratic Republic of Madagascar in a sum equivalent to the dollars disbursed to the Grantee under this Agreement. The amount of the local currency to be deposited in the Special Account shall equal each dollar disbursement, and will be determined by using the highest exchange rate per US dollar which is not unlawful in Madagascar on the date of disbursement of the corresponding dollar amount. Funds will be deposited in three equal installments in the fourth, fifth and sixth months following disbursement of the dollars.

(b) Except as provided in subsection (c) below, or except as A.I.D. may otherwise agree in writing funds in the Special Account shall be used to finance the local costs of the Seventh Highway Project and for such other purposes as may be mutually agreed upon by A.I.D. and the Grantee.

(c) Not less than US$ 600,000 from the Special Account over three years shall be made available to the United States Government for the requirements of operating the USAID program in Madagascar.

(d) The Grantee agrees to furnish A.I.D. with such reports and information relating to activities financed with funds from the Special Account and the performance of the Grantee's obligations with respect thereto as A.I.D. may reasonably request. The Grantee will maintain, or cause to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, such books and records relating to the Special Account as are necessary to adequately show, without limitation, the receipt and use of funds from the account by the

Grantee for agreed purposes. Such books and records will be audited regularly and in accordance with generally accepted auditing standards, and maintained for at least three years after the date of the last deposit into the Special Account required under this Agreement.

(e) A.I.D. or any of its authorized representatives shall have the right to inspect, at all reasonable times, the books and records maintained by the Grantee as required under this Agreement and to inspect the activities financed from the Special Account.

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete)
Amendment Number:
DOCUMENT CODE: 3

2. COUNTRY/ENTITY: MADAGASCAR

3. PROJECT NUMBER: 687-0102

4. BUREAU/OFFICE: AFR 06

5. PROJECT TITLE (maximum 40 characters): Madagascar Agric. Export Liberalization

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 06 DD 30 YY 91

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)
A. Initial FY 88 B. Quarter 4 C. Final FY 89

8. COSTS ($000 OR EQUIVALENT $1 = 1270 FMG)

A. FUNDING SOURCE	FIRST FY 88 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total	2,735		2,735	2,735		2,735
(Grant)	(2,735)	( )	(2,735)	(2,735)	( )	(2,735)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country		145	145		145	145
Other Donor(s)						
TOTALS	2,735	145	2,880	2,735	145	2,880

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. 2. Loan	F. LIFE OF PROJECT 1. Grant	F. 2. Loan
(1) DFA	220B	010		0		2,735		2,735	
(2)									
(3)									
(4)									
TOTALS				0		2,735		2,735	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 840 | 650

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	BF	BL					
B. Amount	700,000	200,000					

13. PROJECT PURPOSE (maximum 480 characters)

The purpose of the MAELP is to reduce policy and procedural impediments to liberalized Malagasy external agricultural markets. Project studies will contribute to that purpose by analyzing remaining constraints and recommending solutions, while training and technical assistance will primarily provide Malagasy with the business skills needed to respond to emerging opportunities, as well as building a policy analysis capacity.

14. SCHEDULED EVALUATIONS
Interim MM 10 YY 89 | MM YY | Final MM 08 YY 91

15. SOURCE/ORIGIN OF GOODS AND SERVICES
☐ 000 ☐ 941 ☐ Local ☒ Other (Specify) 935

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ______ page PP Amendment.)

17. APPROVED BY
Signature:
Title: Assistant Administrator for Africa
Date Signed: MM DD YY

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION
MM DD YY

AID 1330-4 (8-79)

INSTRUCTIONS

The approved Project Data Sheet summarizes basic data on the project and must provide reliable data for entry into the Country Program Data Bank (CPDB). As a general rule blocks 1 thru 16 are to be completed by the originating office or bureau. It is the responsibility of the reviewing bureau to assume that whenever the original Project Data Sheet is revised, the Project Data Sheet conforms to the revision.

Block 1 -Enter the appropriate letter code in the box, if a change, indicate the Amendment Number.

Block 2 - Enter the name of the Country, Regional or other Entity.

Block 3-Enter the Project Number assigned by the field mission or an AID/W bureau.

Block 4 - Enter the sponsoring Bureau/Office Symbol and Code. *(See Handbook 3, Appendix 5A, Table 1, Page 1 for guidance.)*

Block 5 - Enter the Project Title *(stay within brackets; limit to 40 characters).*

Block 6 - Enter the Estimated Project Assistance Completion Date. *(See AIDTO Circular A-24 dated 1/26/78, paragraph C, Page 2.)*

Block 7A. - Enter the FY for the first obligation of AID funds for the project.
Block 7B. - Enter the quarter of FY for the first AID funds obligation.
Block 7C. - Enter the FY for the last AID funds obligations.

Block 8 - Enter the amounts from the 'Summary Cost Estimates' and 'Financial Table' of the Project Data Sheet.

NOTE: The L/C column must show the estimated U.S. dollars to be used for the financing of local costs by AID on the lines corresponding to AID.

Block 9 - Enter the amounts and details from the Project Data Sheet section reflecting the estimated rate of use of AID funds.

Block 9A. - Use the Alpha Code. *(See Handbook 3, Appendix 5A, Table 2, Page 2 for guidance.)*

Blocks 9B., C1. & C2. - See Handbook 3, Appendix 5B for guidance. The total of columns 1 and 2 of F must equal the AID appropriated funds total of 8G.

Blocks 10 and 11 - See Handbook 3, Appendix 5B for guidance.

Block 12 - Enter the codes and amounts attributable to each concern for Life of Project. *(See Handbook 3, Appendix 5B, Attachment C for coding.)*

Block 13 - Enter the Project Purpose as it appears in the approved PID Facesheet, or as modified during the project development and reflected in the Project Data Sheet.

Block 14 - Enter the evaluation(s) scheduled in this section.

Block 15 - Enter the information related to the procurement taken from the appropriate section of the Project Data Sheet.

Block 16 - This block is to be used with requests for the amendment of a project.

Block 17 - This block is to be signed and dated by the Authorizing Official of the originating office. The Project Data Sheet will not be reviewed if this Data Sheet is not signed and dated. Do not initial.

Block 18 - This date is to be provided by the office or bureau responsible for the processing of the document covered by this Data Sheet.

INSTRUCTIONS

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Project Authorization

Name of Country: Madagascar

Name of Project: Madagascar Agricultural Export Liberalization Program

Number of Project: 687-0102

1. Pursuant to the Foreign Assistance Act of 1961, as amended, and the provisions in the appropriations heading "Sub-Saharan Africa, Development Assistance", contained in the Foreign Operations, Export Financing, and Related Programs Appropriation Act of 1988, I hereby authorize the Madagascar Agricultural Export Liberalization Program for the Democratic Republic of Madagascar, ("Cooperating Country") involving planned obligations of not to exceed Two Million Seven Hundred and Thirty-five Thousand U.S. Dollars ($2,735,000) in grant funds ("Grant"), over a three year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs of the project component. The planned life of the project component is three years from the date of initial obligation.

2. This project component will complement a program agricultural sector grant whose purpose is to remove policy and procedural impediments to liberalized agricultural export markets in Madagascar. The project component will support achievement of that purpose by funding (i) training and technical assistance designed to provide Malagasy entrepreneurs with the skills needed to respond to emerging export opportunities and strengthen in-country business training; and (ii) studies to identify remaining policy constraints to liberalized export markets and distortions in closely-linked rural financial, product, input and consumer goods supply markets and to recommend solutions for their removal.

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority shall be subject to the following essential terms and convenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate:

(a) Source and Origin of Commodities, Nationality of Services: The nationality for services, including ocean transportation services, and the source and origin of commodities financed under the project shall be as set forth in the Africa Bureau Instructions on Implementing Special Procurement Policy rules Governing the Development Fund for Africa (DFA), dated April 4, 1988, as may be from time to time amended.

(b). Covenant: The Cooperating Country shall covenant that unless AID otherwise agrees in writing, it will abide by the criteria and procedures outlined in Annex 1 of the Grant Agreement for the selection of participants under the training programs funded under the project component and for the provision of technical assistance.

Charles L. Gladson
Assistant Administrator for Africa

7-21-88
Date

Clearances:
DAA/AFR:WBollinger ______ Date 7/21/88
DAA/AFR:ELSaiers ______ Date 7/20/88
AFR/PD/EAP:JSchlesinger ______ Date 7/16/88
AFR/EA:DLundberg ______ Date 7/15/88
AFR/PD:CPeasley ______ Date 7/16/88
AFR/DP/PAR:JWolgin ______ Date 7/15/88
M/FM:EOwens ______ Date 7/19/88

GC/AFR: AAdams/hml 7/15/88

TABLE OF CONTENTS

ABBREVIATIONS

AEPRP	African Economic Policy Reform Program
A.I.D.	Agency for International Development
CASA	Agricultural Sector Adjustment Credit
CASEP	Public Sector Adjustment Credit
CASPIC	Industry and Trade Credit Adjustment Program
FAA	Foreign Assistance Act
FED	European Development Fund
FMG	Malagasy Franc(currency unit)
FOB	Free on Board
GDP	Gross Domestic Product
GDRM	Government of the Democratic Republic of Madagascar
IBRD	International Bank for Reconstruction and Development (World Bank)
IEE	Initial Environmental Examination
IESC	International Executive Service Cor
IQC	Indefinite Quantity Contract
IMF	International Monetary Fund
INSCAE	National Institute for Accounting and Business Administration
IRRI	International Rice Research Institute
LIR	Liberalized Import Regime
MARS	Madagascar Agricultural Rehabilitation Support (AID Project)
MAELP	Madagascar Agricultural Export Liberalization Program
MPAEF	Ministry of Animal Production, Water and Forests
MPARA	Ministry of Agricultural Production and Agrarian Reform
MRSTD	Ministry of Scientific Research and Technology for Development
MTP	Ministry of Public Works
OAR	Office of the AID Representative
OGL	Open General Licensing System
OYB	Operational Year Budget
PAAD	Program Assistance Approval Document
PAIP	Program Assistance Identification Paper
PASAGE	Economic Management and Social Action Support Project
PFP	Policy Framework Paper
PIO	Project Implementation Order
PSC	Personal Services Contractor
REDSO	Regional Economic Development Services Office
RFMC	Regional Financial Management Center
SDR	Special Drawing Rights
TA	Technical Assistance
UNDP	United Nations Development Program

I. SUMMARY AND RECOMMENDATIONS

The proposed Madagascar Agricultural Export Liberalization Program grows out of a clear need to address policy impediments which limit the ability of Madagascar's small agricultural producers to respond to the pattern of improved incentives which they now face as a result of successful stabilization measures implemented by the government. The program is intended to stimulate the production of agricultural export goods so as to improve rural incomes and employment. This is expected to broaden the domestic market for mass consumption goods and provide a firmer basis for the expansion of output and employment for the economy as a whole.

After growing at an average annual rate of about 3 percent per year in the 1960s, based largely on strong agricultural performance, the economy of Madagascar underwent a drastic deterioration following the 1972 and 1975 revolutions. The socialist regime which came to power in 1972 emphasized state control of the economy, nationalized most large private firms, and established a government monopoly over the marketing of agricultural products and inputs. These policies resulted in stagnating agricultural output, steadily rising agricultural imports, and declining per capita output and consumption for the economy as a whole. By 1982, real GDP per capita had fallen by 28 percent from its 1973 level, external debt service obligations had reached 72 percent of exports of goods and non-factor services, and declining import capacity threatened still further declines in output, employment, and consumption.

Beginning in 1982, the government began moving aggressively to reduce the fiscal and balance of payments deficits. In all, the central government cash deficit was reduced from 14.9 percent of GDP in 1981 to an estimated 3.1 percent in 1988. The government was somewhat slower to adjust the exchange rate. Although adjustments of the nominal rate began as early as mid-1980, the initial adjustments were inadequate to offset accelerating inflationary pressures and the real effective exchange rate peaked in mid 1983. Subsequent adjustments including two large devaluations in the second half of 1986 and in June 1987 have left the real effective exchange rate at about half its 1978 value.

Although fiscal and exchange rate adjustments succeeded in restoring the balance of payments essentially to zero in the 1984-87 period (albeit with a great deal of debt rescheduling) while halting the decline in output, stabilization by itself has not been sufficient to restore an acceptable rate of growth. The reasons for this can be traced to a series of structural distortions, primarily introduced during the 1970s, which have prevented private sector producers, and producers of tradables in particular, from responding to an improved generalized pattern of price and market incentives. In some cases, these distortions were preventing an improved pattern of incentives from being reflected at the producer level, as in the case of price and markup controls at the retail level, price controls and regional marketing restrictions for agricultural products, especially rice, and public sector export monopolies (caisse de stabilization) for the country's principal export crops. In other cases, the structural obstacles prevented producers from responding effectively to the price signals that they received, as in the case of cumbersome export licensing procedures, rigid and somewhat arbitrarily administered exchange controls which blocked access to essential inputs and spare parts, and finally an inefficient public sector banking system burdened with a large volume of non-performing parastatal debt.

Since 1985, the Government of Madagascar has entered into a series of sectorally oriented structural adjustment credits with the World Bank to address this wide range ofstructural impediments to improved growth. The details of these programs are beyond the scope of this summary but they have attempted to deal in a systematic way with the structural impediments in each sector. As a result of these reforms, the exchange regime has been made more predictable and automatic, most price controls have been eliminated, regional transportation restrictions imposed at the national level have been eliminated (although regional government taxation and ad hoc restrictions remain a problem), and substantial progress has been made in the liberalization of the rice market.

Rice market liberalization has been by far the most controversial aspect of the reform program and the government's performance has been mixed. Prior to May 1983, the Government had an absolute monopoly of the purchase and sale of rice. Since that time, the government opened rice marketing to private sector participation except in two geographic areas which accounted for 25 percent of total production, abolished the legally established ceiling price for rice, and finally eliminated the remaining regional monopsonies. As a result of these measures, regional price differentials fell substantially, many new traders entered the market, and the number of private mills increased from 11 in 1983 to 90 by 1985.

Following a large increase in consumer rice prices in early 1986, the government established a "buffer stock" to limit upward movements in retail prices but the conditions for the release of buffer stock rice has been a major point of controversy between the government and donors in the period since 1986. Beginning in late 1987, PROCOOPS, an ostensibly private sector organization with strong political connections with the governing AREMA party, began below-market sales of rice donated by North Korea in Antananarivo and Tamatave. While not technically a violation of the agreement with the World Bank and other donors, its actions are certainly a violation of the spirit of those agreements.

The actions of the government and PROCOOPS are of considerable concern to AID. Yet they should be kept in perspective: the government has not reestablished price controls or restricted private sector milling or marketing of rice; and 1988 imports by the government and PROCOOPS are estimated at 110 to 120 thousand metric tons, approximately the same volume of imports which were undertaken in 1984 and 1985 and considerably less than the level of imports of 1986 or the period before 1984.

The GDRM has never explained its reasons for the backtracking but they clearly relate to concerns that the cumulative effect of exchange rate adjustment, government spending cuts, and price liberalization have had a disproportionate adverse impact on the living standards of the urban middle class. The toleration of this group for policy reform in general is critical to the success of the government's overall economic recovery efforts.

Because of the extreme political sensitivity of the rice pricing question, AID has chosen not to attempt to achieve further gains on that policy front at this time, but rather seeks to support further policy reforms in the area of small-farmer-produced export crops. This is a policy area which addresses the GDRM's immediate balance of payments concerns and furthers AID's objectives of improving small farmer income.

The Madagascar Agricultural Export Liberalization Program (MAELP) has two major components: (1) direct program assistance in support of policy reform in the agricultural export area, and (2) a project component made up of studies, technical assistance, and training which is designed to clarify and develop support for a broader policy reform agenda. In addition to the policy reforms to be immediately supported by the program, the policy studies will examine policy impediments to the efficient operation of the full range of markets in which small farmers transact, including rural financial markets, agricultural input and product markets, and the markets for consumer goods in rural areas. These are areas where needed changes are not yet clearly defined, despite widespread recognition that problems exist. The results of these studies and technical assistance will form the basis of future policy dialogue, whether or not supported by additional policy-based assistance.

Of the total planned $18.735 million in AID contribution to MAELP in FY 1988, $16 million will be disbursed in support of policy reform. Disbursements will be made in two tranches. The first is expected to be made shortly after signature of the grant agreement in July 1988, on the basis of the substantial dismantling which has already taken place - in part due to A.I.D.'s encouragement - of government monopolies for three of the chief traditional agricultural export crops. This action has already been announced by the GDRM. The second disbursement, which could be made as early as January 1989, will be based upon the performance of a small number of objectively verifiable indicators of the effective implementation of these same reforms. The performance of the GDRM, as reflected in these key indicators, will be examined by an external review team, which will make a recommendation to OAR/Madagascar concerning the release of the second tranche. This review team will also be tasked with recommending whether AID should obligate additional funds in FY 1989 under MAELP for agricultural market reform, and if so, what conditions should be attached to that support. OAR/Madagascar intends to continue to support the consolidation of the reforms identified in this document - or needed reforms identified by the studies to be undertaken under the MAELP - if such support is warranted.

The $2.735 million programmed for project assistance will support technical and policy studies, training, and technical assistance. The study activities will be designed both to clarify the remaining reforms needed in complementary areas (rural finance, input and product markets) to sustain the momentum generated by liberalization of agricultural export markets, and to build a constituency for the reform effort among a broad spectrum of academics, businessmen, and government officials. The most important of the studies to be undertaken early in the project is a baseline rural household income and expenditure survey. This survey will provide badly needed basic information on the components of small farmer real income and will guide future policy dialogue efforts. Beyond this, if the program is successful, the survey and subsequent follow-up surveys will demonstrate that success both to the Malagasy and to us. On the other hand, if there should be a breakdown between the program activities and the achievement of its goal and purpose, the follow-up surveys will provide us with both an early warning system to identify that breakdown and with suggestions for further study areas and corrective measures, either additional policy reforms or project interventions.

The MAELP comes at a time when the Government of Madagascar has shown its commitment to moving ahead with a far-reaching program of economic reform that extends to all key sectors so as to take advantage of the improved competitiveness so painfully won from the country's stabilization efforts. This commitment deserves support of international donors, including AID, to insure that sufficient resources are available to meet the minimum financial needs of the government and to encourage the Government of Madagascar to persist in implementation of measures so that the full benefits of the policies will be realized. In FY 1989, additional funds may be obligated if the review of policy reform progress planned for January 1989 deems continued A.I.D. support for agricultural market liberalization through MAELP appropriate and additional policy reforms are identified.

II. ANALYTICAL FRAMEWORK

A. Setting

1. Physical Environment

Madagascar is an island mini-continent located in the south Indian Ocean 250 miles off the east coast of Africa. At 590,000 square kilometers, approximately the size of Texas, it is the fourth largest island in the world. A mountain chain extending nearly the length of the island from northeast to southwest creates a central plateau region known as the Highlands which has an average altitude of 1000 meters above sea level. A steep escarpment separates this region from a sub-equatorial coastal strip to the east where most of the island's tropical export crops are grown. To the west, the land descends gradually first into rolling savannahs in the Middle West, then to delta plains and baobob forests on the west coast. The Highlands are drained by numerous fast flowing rivers and streams which empty into natural lagoons along the coasts. The south is a region of semi-desert, marked by thorny vegetation, seasonal rivers and unusual rock formations.

2. Human Environment

Madagascar's people and culture are as unique as their physical environment. The result of several waves of migration from Southeast Asia, East Africa and other Indian Ocean islands beginning some 1500 years ago, the Malagasy of today reflect these diverse origins. The peoples of the Highlands, the most numerous of whom are the Merina, have features reminiscent of Indo-Malays, while the cattle cultures of the southern Mahafaly and Antandroy in the south recall East African societies. Although divided into 18 distinct ethnic groups, all Malagasy speak dialects of one language which is comprehensible to all in its written form. The French language introduced during the colonial period continues to be widely used in government, schools and commerce. Likewise, cultural traditions centered around reverence for the ancestors can be found throughout the island. A hierarchical ranking of society that developed during the pre-colonial monarchy persists and influences social relations. Nearly half of the population practices some form of Christianity, while a small minority of descendants from Arab traders in the north, as well as members of the Indo-Pakistani and Comorian communities, follow the Islamic faith. The non-Malagasy population includes Chinese and French as well as the Indo-Pakistanis.

3. Economic Environment

Madagascar has considerable economic potential. Its fast flowing rivers and streams represent a largely untapped source of hydroelectric power and irrigation water. The country is moderately rich in minerals and gems, many of which are found in quantities insufficient to justify the cost of extraction. Chromite, mica and graphite are currently exploited for export,

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while known sources of coal, uranium and oil-bearing tar sands remain unexploited. Many years of exploration for oil in the south and west have recently resulted in the discovery by Petrocanada of a promising site near Morondava in the west. However, the most lucrative find to date is a deposit in the southeast of the strategic metal titanium, said to be one of the largest in the world. Plans for exploitation are underway despite the fact that the site is now a nature reserve harboring some of Madagascar's many unique plant and animal species. With extensive beaches along the coast and offshore islands, as well as its unique biological wealth, Madagascar also possesses strong potential for tourism.

B. Economic Analysis

The following discussion outlines Madagascar's recent social and economic history, from the revolutions of the early 1970s to the present, providing an understanding of what problems the country has faced, how it has responded, and what future actions need to be undertaken in order to further the country's development. In this discussion, the principal objectives are to describe the collapse of the economy in the early 1980s, the stabilization efforts and their successes, the need for structural adjustment, and the limits posed by social and institutional factors. The particular program intervention is derived from this analysis. The Mission Strategy concludes the discussion. A full discussion of the economic reform program and its social and institutional context can be found in Annex B.

1. Centralization and Economic Collapse

Madagascar is one of the world's poorest countries. With a population estimated at 10.6 million in 1987, the country's annual gross domestic product equals just $265 per person, a level which has been virtually stagnant for the last several years. Rapid population growth of nearly 3 percent per year compounds the problem, and has resulted in declining real per capita income. The situation has not always been quite this bleak.

In the 1960s, during the decade following independence, the Malagasy economy grew at approximately three percent per year. This was faster than the then rate of population growth, and produced small increases in real per capita incomes. Frustrated with the slowness of the growth, however, and disturbed by the unequal distribution of the proceeds of that growth, the country underwent socialist revolutions in 1972 and again in 1975. A principal concern of each revolution was reducing foreign, interpreted as French and western, interference in the country, increasing the role of indigenous Malagasy in the country's economy, and reducing individual control of and profit from the exploitation of the country's natural resource base. Specifically, the revolutions resulted in increasing state control over various aspects of the economy, including the institution of parastatal monopolies for marketing rice and other crops, banking, energy, insurance, imports, exports, and the expansion of public enterprises in several industries.

In addition, the centralized, post-independence Government structure was decentralized, allowing the fokontony, or local, government broad new rights to impose and collect taxes as well as to provide services. Regulatory intervention of the central and local governments also increased substantially, price controls were generalized, and import restrictions and exchange controls tightened. The net result of these actions was a general neglect of the productive, agricultural sector, and a promotion of inward looking production activities in a highly protected environment.

These changes did not produce the intended acceleration of growth which the Government desired. As a result, the government attempted to reverse the economic decline of 1972 to 1978 through a massive public investment program designed to hasten industrialization through capital intensive technologies while imposing further pricing and marketing policies which favored urban consumers. This industrial expansion effort began in 1978.

These attempts to stimulate the expansion of Madagascar's stagnating economy contributed to the economic crisis which began in 1980-81. The share of investment in GDP had averaged 13 percent from 1970 to 1978, but mushroomed to 25 percent for 1978-79. The financing of this massive expansion contributed to a large public sector deficit without adding to productive capacity. By 1980, the budget deficit equaled 18 percent of GDP, inflation grew at more than 30 percent per year in 1981 and 1982, and the debt service ratio exploded, from just four percent of export earnings in 1978 to 90 percent, before rescheduling, in 1985. This debt service burden has been responsible, in part, for the severe lack of foreign exchange in recent years, and has itself further stalled economic growth.

Exacerbating the foreign exchange shortage was the greatly overvalued Malagasy franc. This led to an unsustainable demand for imported goods while simultaneously undermining the profitability of exported Malagasy agricultural commodities and finished products. This, in turn, was translated back into declining real producer prices for agricultural commodities, and a sharp contraction of agricultural production for export.

By 1982, real GDP per capita had fallen by 28 percent from its 1973 level, external debt service obligations had reached 72 percent of exports of goods and non-factor services, and declining import capacity threatened still further declines in output, employment, and consumption.

2. Stabilization

Faced with a clearly unsustainable resource gap, the government undertook a series of strong and effective stabilization measures beginning in 1982. These measures included reducing capital expenditures from 11.6 percent of GDP in 1981 to 7.5 percent in 1982 (this level has been maintained in successive years). Secondly, the government limited central government recurrent expenditures, principally through a near freeze in the number of civil servants (their numbers increased by only 1.6 percent between 1983 and 1986), and a significant compromising of real public sector salaries. In all, the budget deficit was reduced from nearly 15 percent of GDP in 1981 to an estimated 3.1 percent in 1988. Concurrent with this contraction of the deficit, domestic bank borrowings by the central government have been substantially reduced from 7.4 percent of GDP in 1981 to a net repayment position in 1988.

The government was somewhat slower to correct the exchange rate. Although adjustments began as early as mid-1980, the initial adjustments were inadequate to offset accelerating inflationary pressures, and the real

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effective exchange rate peaked in mid-1983. Subsequent adjustments have been substantial, however, and have included two large devaluations in the second half of 1986 and another in June of 1987. Combined, these devaluations have left the real effective exchange rate for the Malagasy franc at just about one half its 1978 value.

Among other measures taken to reduce aggregate demand were reductions in consumer subsidies. The Government more than doubled the price of rice distributed through official channels, and consumer subsidies on imported rice were eliminated. In addition, tax measures were improved, price increases for public enterprise produced goods announced, and imports were sharply curtailed. Finally, tight bank credit ceilings were imposed to help reduce inflation. These efforts were successful and, during a time of devaluation, inflation was reduced from 30 percent in 1982 to just 11 percent by 1985.

3. Structural Reform - the need

Although fiscal and exchange rate adjustments succeeded in restoring the overall balance on the balance of payments essentially to zero by 1985, while halting the decline in output, stabilization by itself has not been sufficient to restore economic growth. There have been some responses that show that economic areas unencumbered by market distorting controls and regulations have indeed taken advantage of the stabilization efforts to date. Examples include shellfish exports, which have increased dramatically over the last several years to become the country's fourth largest foreign exchange earner. Domestically, there are many producers and exporters of this perishable commodity, and their volume of sales attests not only to their success but also to the incentives offered by undistorted stabilization efforts. In a second area, a look at the estimates of services receipts for 1988 compared to 1983 shows a projected increase of 76 percent over the earlier year, demonstrating a clear response to price incentives in a relatively unregulated field.

There are, unfortunately, more examples of how stabilization efforts themselves have been insufficient for growth. The reasons for this can be traced to a series of structural distortions, primarily introduced during the 1970s, which have prevented private sector producers, and producers of tradables in particular, from responding to an improved generalized pattern of price and market incentives. In some cases, these distortions have prevented an improved pattern of incentives from being reflected at the producer level, as in the case of price and mark-up controls at the retail level, price controls and regional marketing restrictions for agricultural products, especially rice, and public sector export monopolies (caisse de stabilization) for the country's principal export crops.

In other cases, the structural obstacles prevented producers from responding effectively to the price signals which they received, as in the case of cumbersome export licensing procedures, rigid and somewhat arbitrarily administered exchange controls which blocked access to essential inputs and spare parts, and finally an inefficient public sector banking system burdened with a large volume of non-performing parastatal debt.

The need for structural reform was discussed as early as the 1983 Consultative Group meeting on Madagascar. At that meeting, the Group developed the first phase of reform, which included the following main points (as reiterated by the World Bank, 1986):

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(a) promotion of private, smallholder production, and de-emphasis of parastatals and collective production;

(b) concentration on investment in rehabilitation;

(c) reliance on market prices;

(d) withdrawal of the agricultural ministries and parastatals from direct-production and commercial activities; and,

(e) improvement of essential public sector services.

Some progress has been made in moving toward these goals, and substantial assistance for structural adjustment has come from the Bank itself.

Since 1985, the Government of Madagascar has entered into a series of sectorally oriented structural adjustment credits with the World Bank to address this wide range of structural impediments to improved growth. The details of these programs are discussed in detail in Annex B. In sum, the World Bank and the International Monetary Fund have attempted to deal in a systematic way with the structural impediments in each sector. As a result of these reforms, the exchange regime has been made more predictable and automatic, most price controls have been eliminated, regional transportation restrictions imposed at the national level have been eliminated (although regional government taxation and ad hoc restrictions remain a problem), and substantial progress has been made in the liberalization of the rice market.

Rice market liberalization has been by far the most controversial aspect of the reform program and the government's performance in this area has been mixed. Prior to May 1983, the Government had an absolute monopoly on the purchase and sale of rice. In 1982, the retail price of rice was raised 82 percent, eliminating an explicit consumer subsidy and improving producer prices. In 1983, the government opened rice marketing to private sector participation except in two geographic areas which accounted for 25 percent of total production. In June 1985, the legally established ceiling price for rice was abolished. Subsequently, the two remaining regional monopsonies were eliminated. As a result of these measures, regional price differentials fell substantially, many new traders entered the market and the number of private mills increased from 11 in 1983 to 90 by 1985.

Following a large increase in consumer rice prices in early 1986, the government established a "buffer stock" to limit upward movements in retail prices. AID and other donors contributed rice to establish that stock whose release price was set at 40 percent above the average market price during the previous post-harvest period. The conditions for the release of buffer stock rice have been a major point of controversy between the government and donors in the period since 1986. Beginning in late 1987, PROCOOPS, an ostensibly private sector organization with strong political connections with the governing AREMA party, began below-market sales of rice donated by North Korea in Antananarivo and Tamatave. While not technically a violation of the agreement with the World Bank and other donors, its actions are certainly a violation of the spirit of those agreements. Moreover, PROCOOPS actions have the potential for disrupting newly established private sector market channels, and thus may, although there is as yet no solid evidence that they have, reduce farm-gate prices.

The actions of the government and PROCOOPS are of considerable concern to AID. Yet they should be kept in perspective. The government has not reestablished price controls or restricted private sector milling or marketing of rice. The volume of imports to be undertaken in 1988 by the government and PROCOOPS is unclear but seems to be in the range of 110 to 120 thousand metric tons. While this is higher than one would like to see, given that Madagascar has the potential to be an exporter of rice, it is approximately the same volume of imports which were undertaken in 1984 and 1985 and considerably less than the level of imports of 1986 or the period before 1984.

Not all reforms have been focussed on the rice sub-sector, however. The government also responded to recommendations for improving export crop marketing contained in major studies prepared by several international donors. Incentives to diversify exports were provided, with the elimination in 1984 of all taxes on agricultural exports, excluding the traditional crops. Real producer prices for coffee were increased at the time, and services to coffee growers strengthened. The government also removed market and price controls for groundnuts, previously an important export as well as edible oil source. Other reforms were undertaken with respect to edible oil production, livestock, and cotton.

Although many "correct" policy changes have been announced, the implementation of such reforms has been difficult for the government. An example of the difficulties arising from the implementation of the reforms comes from an AID financed study completed in October, 1987, by Elliot Berg. The report makes the following observation:

> Export marketing remains heavily controlled, with the traditional exports "reserved" for parastatal trading firms. Progress is being made in some non-traditional exports, where entry is easier; shrimp exporters are numerous, and volumes have grown rapidly in the last few years. According to some observers, a certain amount of informal privatization or decentralization is taking place in minor exports like lobsters and lychee nuts. But regulations remain endemic and monopolization typical in marketing of major agricultural exports.

This observation corroborates World Bank reflections at the time that the first phase of the adjustment process fell short of its goals due to a lack of coherence in the spectrum of government policies. "Incentives were not provided for all products, accentuating the preference of farmers for outputs with high returns. Controls on prices and markets gave room for crop retention, speculation, and black-marketing. At the same time, import policies were not tailored to overcoming shortages, and acted as a disincentive to production."

4. Structural Reform - the future

Despite the inherent political difficulties of continuing with reforms, the Government of Madagascar has made it clear that it not only intends to proceed with the comprehensive program of reforms agreed to in the Policy Framework Paper (PFP) (see Annex B for a summary), but will accelerate the implementation of several key measures in 1988. Some planned measures will, in fact, go beyond the steps agreed to in the PFP. The next steps to be taken by the Government of Madagascar in 1988 and 1989, which follow a logical progression in the effort to put the country on the path of sustainable growth, are summarized below. These measures are the result of a careful analysis of the remaining constraints to growth, and will be undertaken with the assistance of the IMF and the IBRD as well as the bilateral donors. This year, 1988, will be a year marked by major efforts to liberalize external trade and to stimulate export production. The Open General License system will be introduced on an accelerated schedule with full implementation planned for July 1988. Initial experience with the OGL has been one of low demand for foreign exchange. This appears to reflect the transition from a system where exchange was applied for in advance of needs, to one in which foreign exchange is applied for only when needed since receipt of the full amount is assured and since full payment in local currency must be made at the time of application. Also, a large percentage of foreign exchange obtained under the LIR in 1987 is still unused. Thus, it is difficult for the Central Bank to anticipate actual demand for foreign exchange under the OGL, and concerns remain that a large sudden demand will push reserves below the target and force a large devaluation. The Central Bank is therefore increasing reserves, tightly controlling credit, and encouraging donors to disburse the balance of payments assistance promised at the January 1988 Consultative Group, which to date has been slow in coming. The GDRM remains committed to an active exchange rate policy, adjusting the rate as needed to maintain an appropriate level of foreign exchange reserves so as to assure the smooth functioning of the OGL system.

Liberalization of the export sector has also been accelerated. In mid-February 1988, the Government ended the state trading company monopoly on exports of pepper and cloves, and freed internal trade and prices in these products, leaving only coffee and vanilla subject to management by the Stabilization Funds. Taxes on pepper will be eliminated, although a flat tax on cloves will continue to be collected. Pending the planned April completion of a study commissioned by the World Bank, coffee exports will continue to be carried out by the state trading company. Under the terms of structural adjustment agreements, recommended changes in the marketing arrangement for coffee are to be made prior to the 1988/89 coffee season which begins in May, while the producer price for coffee will again be raised substantially to bridge the gap that remains between producer price and f.o.b. export price. Coffee is the crop that holds the greatest potential for increasing export earnings in the short run, although non-traditional exports such as fruit and seafood also show promise.

Other steps will further lighten administrative export procedures. The Government will abolish requirements for cards, licenses, and prior authorizations for internal trade (collection, processing and storage) and export of all of the major export crops and will extend the maximum period for repatriation of foreign exchange earnings from 30 to 90 days. Also, in 1988 the Government will publish an exporters' guide to support the export sector, and will activate plans for free trade zones to stimulate investment.

In agriculture, the GDRM has already taken significant action to reverse poor policies, as noted above. Sustained and thorough implementation of the announced liberalization policies are now required. Major implementation actions are planned for 1988 and 1989 to remove pricing and marketing constraints on the agricultural export crop side. It is in this area where AID/Madagascar will provide support.

C. Social and Institutional Constraints

A major concern among all donors has been the problem of political opposition to the reform programs. It must be recognized that the various elements of the stabilization and structural reform efforts have had the effect of increasing the real incomes of rural smallholders at the expense of urban residents in general and the urban middle class in particular. The reduction in central government current expenditures has largely been accomplished through wage compression for civil servants and a substantial decline in employment on public infrastructure projects. The adjustments in the real exchange rate have disproportionately reduced the real incomes of the middle and upper class. (Imports, directly or indirectly make up 35 percent of the market basket of urban "modern households" but only 12.9 percent of the consumption of urban "traditional households" according to surveys underlying the consumer price index and almost certainly a still smaller proportion of rural consumption.) Similarly, the attempt to raise the farm-gate price of rice represented an income transfer from urban (and some rural) rice consumers to rural rice producers.

While it would be difficult to quantify the distributional impact of the reforms, the cumulative effect, although undoubtedly "favorable" in some abstract sense, has the potential for seriously, and perhaps irretrievably, undermining political acceptance of the reform effort among the urban population.

Asked in another way, the major question concerning the reform program in Madagascar is whether the present trend towards economic liberalization represents a real change in direction, or is only a forced response to the immediate economic crisis and donor demands. It is certainly true that there is a widespread perception that the reforms have been imposed by the IMF and the World Bank in return for much needed financial assistance. It is also true that understanding of the measures and popular support for them are notably lacking. During an assessment of the reform program conducted in June of 1987, an American economist Elliot Berg noted that he found little intellectual support for the free market idea outside the U.S. Embassy and the World Bank office ("Report on the Economic Reform Program in Madagascar", 1987). This raises the equally serious question as to what the outcome of the liberalization policies will be, regardless of government intentions, in the face of an uncommitted majority and well positioned groups that stand to lose from the changes that are occurring.

The implementation of the reforms needs to take into account not only the overall impact on the economy as a whole and the impact on AID's target group, the rural and urban poor, but also the impact on those identifiable groups whose opposition has the potential for blocking and even undoing the reforms. This has two implications for donor programming. First, it may require that we delay pressing the government to undertake reforms, such as complete rice price liberalization, which further aggravate the position of urban consumers, in favor of other reforms whose effect on those consumers is more neutral, such as export market liberalization. Second, it may require that we undertake assistance programs, such as the proposed Section 206 program, whose primary beneficiaries are urban middle class consumers.

D. Mission Strategy

The recently approved Concepts Paper for Madagascar states the goal of the A.I.D. strategy for the 1988-90 period to be "to assist Madagascar to increase rural incomes while improving nutritional levels and maintaining the country's natural resource base." This builds on the agricultural sector emphasis of the Mission's program to date.

The strategy outlined proposes an active role for A.I.D. in supporting the overall liberalization program, because without elimination of the constraints which presently depress their incomes, the welfare of smallholders, who form the backbone of the agricultural economy, cannot be improved in any sustainable way. U.S. support to the 1987-90 structural adjustment program entered into by the Government with assistance from the IBRD and the IMF will come in two principal forms: Balance of payments support will finance needed external resources; and local currency generated by BOP contributions will to support reform objectives through attribution to the GDRM budget. A.I.D. will be the first donor to take this approach, which is intended to reinforce the ongoing effort to reform budgeting procedures by bringing off-budget revenues into the budget. This approach will also guarantee adequate resources for the programs in the government budget which are central to the achievement of the objectives of the AID strategy, and to a sustainable growth path.

The U.S. will use food assistance to support the liberalization process by helping to stabilize prices and markets under conditions of scarcity while the GDRM implements agricultural policy reforms to stimulate domestic production. In particular, the Section 206 program will supply vegetable oil in order to assume as adequate supply of a commodity that is critical to the welfare of the urban population. A.I.D. remains prepared to support targeted feeding programs for nutritionally vulnerable groups, particularly women and children.

The major new activity, however, is the Madagascar Agricultural Export Liberalization Program (MAELP) which we present in detail in the next section. The policy reforms supported will be liberalizing external agricultural market operations. Given the current level of GDRM political sensitivity regarding the rice subsector (originally proposed as the focus of the MAELP), and in view of the need for time to allow recent reforms in the subsector to take hold, the focus of the proposed reform agenda on external agricultural markets offers the best opportunity for broadening the impact of the structural reform process. Such a focus will also enable OAR/Madagascar to maintain its dialogue with the GDRM on rural incomes. At the same time, reforms in agricultural export marketing, import liberalization, and the maintenance of a market determined foreign exchange rate will all directly contribute to the continued reform of the rice sub-sector by facilitating access by producers to imported inputs and by driving domestic producer prices upward toward world market levels.

Rural incomes are strongly affected by the production of export crops, and the importance of the export crop subsector, to the nations economy as well as to the livelihood of its rural producers, cannot be overlooked:

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> Export crops are the main means of livelihood for almost one-third of Madagascar's population, and the country's principal source of foreign exchange. Coffee alone contributes an average 40 - 50 percent of annual export earnings. Cloves and vanilla are also critically important to the economy. Together, these three account for about 80 percent of export revenues. ... They are also important for the future expansion of employment opportunities in agriculture. Growth in this sector is, therefore, critical for social and economic development. (World Bank, 1984)

Experience everywhere demonstrates that the key to improving rural incomes is to raise producer prices. In Madagascar, the best way to achieve an increase in producer prices is through liberalizing agricultural export markets. Strict government control over prices and marketing margins along with a monopoly by public enterprises on the export of the traditional export crops have until now kept producer prices very low. For example, despite substantial price increases in 1986 and 1987, the producer price for coffee remains at 55% of the f.o.b. export price. The removal of price controls and restrictions on marketing will stimulate competition among a growing number of traders to the benefit of the producer. This in fact has already happened with cloves in the brief period since clove marketing was liberalized.

As previously discussed, there is scope for expansion of agricultural exports even in the short term. Increases in agricultural export earnings which already account for over 80% of total export earnings represent the most promising means for Madagascar to increase overall export earnings in order to finance the additional imports that are needed to fuel economic growth. Additional export earnings are essential for assuring the smooth functioning of the liberalized import system. A.I.D. balance of payments support for the implementation of a liberalized import system will strengthen Government of Madagascar resolve to proceed with another urgently needed reform at the same time - a market-determined exchange rate - since the adjustment of the exchange rate will depend upon the drawdown of foreign exchange reserves under the Open General License System.

In sum, the MAELP is intended to reinforce GDRM commitment to implement the substantial program of reforms already agreed to with the IBRD and the IMF and to extend and reenforce the implementation of these reforms in an area which will bring substantial benefits to the poor majority of Malagasy. The provision of MAELP resources will depend upon the Government's sustained implementation of these selected reform measures. At the same time, a primary purpose of training, studies, and technical assistance will be to build a public and private sector constituency in support of the structural adjustment program and to sustain commitment to the reform process.

III. PROPOSED PROGRAM

A. Goal and Purpose

Within the general framework of the Mission strategy the goal of the proposed program is:

to increase rural incomes.

In order to meet this goal, the purpose of the program is:

to reduce policy and procedural impediments to liberalized Malagasy external agricultural markets.

Both the goal and purpose of the program are well grounded in the Mission's overall strategy. The concerns addressed remain focussed on the rural, agricultural sector and in particular on the livelihood of the smallholder who dominates in the production of export crops as well as food crops. It is these millions of small producers of export crops(one-third of Madagascar's population depends on export crop production for their main source of income) who are the intended beneficiaries of the MAELP, as well as the numerous private sector operators involved in the collection, processing, transport, and export of agricultural products.

The program recognizes the substantial progress which the GDRM has made in extending the liberalization effort throughout the agricultural sector, while also recognizing that reforms taken to date and those soon to be introduced need to be supported and consolidated before they can be regarded as a success. Since many of the reforms have recently been adopted, the areas of administrative and procedural resistance are just now becoming apparent. Therefore, the MAELP proposes support for the consolidation of the GDRM's reform agenda in the sector, while simultaneously exploring remaining problem areas through careful monitoring of the progress of reforms and continued policy dialogue based on a coordinated program of studies and technical assistance.

Principal among the concerns and risks facing the GDRM's reform program are political risks posed by segments of the population chiefly the urban middle class, who have been adversely affected by the reform program. The ways in which they are affected, and by which their conditions may be ameliorated, are discussed in Annex E.

B. Policy Dialogue Agenda

The policy dialogue agenda extends beyond the program purpose, which is to remove policy and procedural constraints which cause Madagascar's external agricultural markets to work inefficiently to encompass policy impediments which inhibit the efficient functioning of markets which rural producers transact in. It consists of four areas which, when taken together, address key constraints relevant to the Government's reform program in the agricultural sector. They are:

1. Liberalization of agricultural export markets;
2. Improving the efficiency of rural input markets;
3. Improving rural financial markets for both borrowers and savers;
4. Improving the availability and price of consumer goods in rural markets.

The first of these areas may be actively pursued at this time; the other three must be studied more closely to define interventions. For the first area, our objective is as follows:

Export markets will be liberalized in order to improve market opportunities and producer prices for the agricultural producer and to increase private sector participation in agricultural exports.

Liberalization will consist, first, in freeing the foreign exchange market through efforts which remove restrictions to the importation of commodities and which maintain a market clearing exchange rate. Second, liberalization will relax export controls on agricultural products, specifically the principal export crops. This twin approach to export market liberalization will ensure that the Malagasy franc provides an incentive to the current and potential exporter, while removing administrative barriers which are often a greater impediment to export growth than the exchange rate. Both aspects will be addressed concurrently.

For the other three areas of the reform agenda -- input and product markets, rural financial markets, and consumer good availability -- where there is general agreement regarding the existence of problems but for which precise interventions need to be defined, the Mission proposes a combined program of studies and technical assistance to further identify the nature of the problems and to outline policy or procedural reforms which would address them. The key issues in each of these reform areas are:

<u>Rural input and product markets</u> - inefficiencies which increase costs of commodities sold in rural areas and depress farmgate prices.

<u>Rural finance</u> - administrative and other barriers to rural financial market development, and the constraints imposed on rural production by the lack of credit and lack of opportunities to place savings in accounts which earn a reasonable rate of interest.

<u>Availability and price of consumer goods in rural areas</u> - the reduced supply of domestically produced consumer goods which result from monopoly and cartel production protected by tariff and non-tariff barriers and import controls.

These problems are explored in depth in section III.C.4. "Studies". The objective for the Mission which emerges from this segment of the program is:

> to establish, through studies and technical assistance, a framework within which the Mission can continue discussions with the GDRM regarding the implementation of agricultural market liberalization.

This approach does not commit the Mission to future policy based assistance in each area. Rather, the studies and technical assistance will provide the Mission with a series of options for appropriate next steps, with an agenda for sustained policy dialogue with the GDRM, and with a perspective on the nature of the evolving reform agenda within the agricultural sector.

C. <u>Description of Program Activities</u>

1. Introduction

The Madagascar Agricultural Export Liberalization Program has two major components: an agricultural sector grant conditioned on policy reform, and a project component made up of studies, technical assistance and training linked to the policy dialogue agenda which is intended to reinforce the implementation of announced policy and procedural changes. Of the total program funding of $18.735 million, $16 million has been targeted for policy reform support and $2.735 million for related project activities. Policy reform support will be provided through a sector grant, whereas studies, technical assistance, and training will be funded under a project grant. The PACD of the program is June 1991. Each component is discussed in detail below.

2. Policy Reform Conditioned Sector Grant

The first program component is a policy component, in which GDRM progress in meeting policy reform objectives will be used as the basis for making dollar disbursements which the GDRM is expected to use to finance imports under the Open General Licensing System. The policy reform objectives are focussed on the liberalization of agricultural export markets as the item on the policy dialogue agenda where needed interventions are well defined, and where progress can be expected to make a significant contribution to increasing rural incomes and stimulating economic growth over the next three years.

a. Reform Objectives and their Progress Indicators:

The objectives of the policy component are presented below along with the progress indicators that will be used to measure their achievement. The policy objectives are:

1) Agricultural export markets for the principal export crops (e.g. coffee, cloves, and pepper) will be liberalized.

2) Administrative requirements for the export of agricultural products will be streamlined.

3) The Open General Licensing system (OGL), or an agreed equivalent foreign exchange allocation mechanism, will continue operation, so that producers and those who produce for their needs will have adequate access to inputs and spare parts and so that a sufficient supply of incentive goods will be available for the rural producer.

As with any reform objective, the difficult task is identifying ways in which progress toward the objective can be measured. In the past, benchmarks have often been established in an inflexible way which has failed to recognize that objectives can be achieved by following more than one path. The emphasis in this program will be on measuring the overall achievement of objectives, and therefore performance will be assessed on a broad range of progress indicators. The following progress indicators proposed here should be viewed as illustrative rather than exhaustive, and are subject to modification during the monitoring process.

There are essentially two tiers of progress indicators that will be used to measure performance under the MAELP policy component. The first set of indicators concerns actions or announcements by the Government of Madagascar which indicate that policy or procedural reforms have been introduced. This set of indicators will be used to determine whether conditions for first tranche release have been satisfied. Examples of such indicators are:

- GDRM opens marketing of the traditional export crops: coffee, vanilla, cloves, and pepper, to the private sector. Actions might include the announcement that a government monopoly for export of a particular crop (cloves, coffee) has been abolished, or that restrictions on the number of operators who may purchase or export a particular crop have been lifted.

- A system for allocating foreign exchange in an open and competitive manner has been established.

However, fulfillment of these progress indicators alone will not ensure that the objectives outlined are met. As a recent World Bank report on Madagascar reminds us, "Administrative procedures are used to conceal a variety of discriminatory practices with negative impacts on export performance." ("Administrative Constraints to Agricultural Exports", IBRD, January 1987). Additional progress indicators which define the ways that implementation of the liberalization effort can be assessed are required. Such "second tier" progress indicators might include,

For agricultural export market liberalization:

-share of export volume of traditional crops marketed by private operators has increased.
-number of private operators involved in export marketing has increased.
-export volume of non-traditional crops, particularly those formerly subject to informally reserved markets, has increased.
-export of new products or processed versions of traditional products has been initiated.
-time required to process an export shipment has decreased.
-number of administrative approvals, clearances or fees for export transactions has decreased.
-an export guide has been published which provides a complete and concise summary of all regulations in effect for export operators.
-no new formal or informal disincentives or discriminatory procedures are introduced at the level of production, purchase, transport, processing or export sale.
-local government taxes on movement of agricultural commodities are replaced with alternative revenue-generating measures.

For foreign exchange allocation:

-do people all over Madagascar have equal access to foreign exchange under the OGL (i.e., do all existing bank branches, including those in outlying provinces, provide services to clients who have need of foreign exchange)?
-are applicants receiving the total amount of foreign exchange requested within the six day period decreed for the OGL?
-are any hidden or excessive charges being imposed which discriminate against certain categories of applicants, or certain types of imports?

The reference points for these indicators will be established by a baseline survey. These indicators will be used to measure whether the implementation of announced reforms is proceeding, and it is upon the basis of sustained implementation that the second tranche of the sector grant will be disbursed.

The concept of progress indicators is not appropriate for the objective of the second segment of the reform agenda namely, to establish a framework within which the Mission can continue discussions with the GDRM regarding the implementation of agricultural market liberalization. Nevertheless, the Mission has developed a set of more refined objectives for this component which parallel the progress indicators of the first objective. These are:

- Rural financial markets should be liberalized, principally by removing prohibitions against private sector participation in these markets. Studies should be undertaken, with the participation of the GDRM, to explore the operation of informal rural financial markets in Madagascar and to identify ways in which liberalization of those markets may improve and increase financial services for small producers.

- The distortion effects imposed by donated agricultural inputs--for example fertilizers--should be studied with a view toward developing an appropriate strategy for their elimination.

- The availability of basic consumer goods, which provide an incentive for the rural farmer to produce a marketable surplus, should be increased. Existing impediments to supply, such as monopoly and cartel production, tariff and non-tariff barriers, and administrative restrictions on imports, production and distribution of consumer goods should be removed.

The principal issue which remains is tying the reform agenda and objectives together into a set of achievable actions upon which cash disbursements can be made. Not surprisingly, these actions are derived from the progress indicators. The conditions for release of funding tranches under the MAELP are described in the following section, along with a summary of covenants to be included in the grant agreement.

b. Conditionality and Tranching

As has been indicated above, disbursements will be made in two equal tranches. The first tranche is intended to be disbursed immediately following signature of the grant agreement. The second tranche disbursement will be made following an external review of progress made in implementing reforms in agricultural export marketing. The justification for equal tranches is that the Government of Madagascar has its greatest need for foreign exchange in July of 1988 when the OGL system will be fully implemented, yet the OAR/Madagascar prefers to keep as much of the total as possible in reserve until a sufficient period of time has elapsed to be able to assess the actual implementation of the reforms introduced during the year.

If within the capacity of the GDRM and consistent with local law/regulation, Mission preference is for full amount of local currency to be generated immediately following dollar disbursement. If not, local currency generation should be tied to a percentage of the OGL system for imports. Full amount of the local currency should be generated on a periodic basis beginning in the third month with subsequent payment in each month thereafter.

The conditions for release of the two tranches are discussed below.

1) Conditions Precedent to Initial Disbursement:

Prior to the disbursement of the first tranche of $8.0 million under this Agreement or to the issuance of documentation by A.I.D. pursuant to which such disbursement will be made, the Grantee will, except as A.I.D. may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D., evidence that the Grantee has carried out the following:

i. On the basis of prior discussions and agreement with A.I.D., opened export marketing of the traditional export crops (coffee, cloves, pepper) to the private sector and continues to permit private operators to operate on an equal basis with public sector firms.

ii. Instituted the OGL or an agreed alternative system to allocate foreign exchange in an open and market-clearing manner; and

iii. Submitted a letter to USAID which outlines the GDRM's proposed schedule for meeting the conditions precedent to the second disbursement.

2. Prior to the disbursement of the second tranche of $8.0 million under this Agreement, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish, in form and substance satisfactory to A.I.D. evidence that (a) it has met all the conditions set forth hereunder for the release of the second tranche of $8.0 million, and (b) has successfully implemented policies and procedures to promote liberalized agricultural export market operations, and continued to allocate foreign exchange in an open and market clearing manner through the OGL or an agreed alternative mechanism, as determined by measurement of the following progress indicators:

i. The share of traditional crops marketed by private operators has increased to at least 50% of total value for at least two of those crops.

ii. There is free access to export markets for all non-traditional export crops.

iii. The OGL system or an agreed equivalent mechanism operates as planned with respect to receipt of the full amount of foreign exchange applied for within the six working day time period specified in the implementing regulations for the OGL.

iv. The number of administrative approvals, clearances and fees for export transactions has decreased and the time required to process an export shipment has been reduced to less than three days.

v. The Government will have published an export guide providing a complete and concise summary of all export regulations in effect.

These progress indicators will be the subject of an Implementation Letter (IL) to be issued following the signature of the Grant Agreement. The IL will establish the baseline against which the progress indicators will be measured as well as the performance targets to be met. Upon notification that the conditions precedent to disbursement of the second tranche have been met, A.I.D. will designate an external review team to assess the progress made and to determine whether performance satisfies the conditions for second tranche release. This assessment will be held as soon as feasible after notification is received, except that it shall be held no earlier than December 31, 1988.

3. Covenants

The Program Grant Agreement will contain the following covenants:

The Grantee shall covenant that unless A.I.D. otherwise agrees in writing:

i. It will not in any way discontinue, reverse or otherwise impede any action it has taken under this Agreement in satisfaction of any condition precedent to initial or subsequent disbursements except as the parties may otherwise agree in writing.

ii. It will: (a) establish a Special Account and have deposited therein local currency of the Democratic Republic of Madagascar in a sum equivalent to the dollars disbursed to the Grantee under this Agreement. The amount of the local currency to be deposited in the Special Account shall equal each dollar disbursement, and will be determined by using the highest exchange rate per US dollar which is not unlawful in Madagascar on the date of disbursement of the corresponding dollar amount. Funds will be deposited in three equal installments in the fourth, fifth, and sixth months following disbursement of the dollars.

(b) Except as provided in subsection (c) below, or except as A.I.D. may otherwise agree in writing, funds in the Special Account shall be used to finance the local costs of the Seventh Highway Project and for such other purposes as may be mutually agreed upon by A.I.D. and the Grantee.

(c) Not less than US$ 600,000 from the Special Account over three years shall be made available to the United States Government for the requirements of operating the USAID program in Madagascar.

(d) The Grantee agrees to furnish A.I.D. with such reports and information relating to activities financed with funds from the Special Account and the performance of the Grantee's obligations with respect thereto as A.I.D. may reasonably request. The Grantee will maintain, or cause to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, such books and records relating to the Special Account as are necessary to adequately show, without limitation, the receipt and use of funds from the account by the Grantee for agreed purposes. Such books and records will be audited regularly and in accordance with generally accepted auditing standards, and maintained for at least three years after the date of the last deposit into the Special Account required under this Agreement.

(e) A.I.D. or any of its authorized representatives shall have the right to inspect, at all reasonable times, the books and records maintained by the Grantee as required under this Agreement and to inspect the activities financed from the Special Account.

The Project Grant Agreement will contain the following additional covenant:

The Government of Madagascar agrees to abide by the criteria and procedures outlined in the Amplified Project Description for the selection of participants under the training programs funded by this project, and for the provision of technical assistance, which are intended to benefit operators in both the public and private sectors in Madagascar.

c. Monitoring and Assessment

Finally, the question of monitoring and progress assessment needs to be addressed. Since the reform program will be undertaken within the framework of an evolving reform environment, and not incidentally during political elections, a program of constant monitoring of the progress made toward achieving the program objectives will be required. This regular monitoring will be assured by the economist who will serve as project manager for the MAELP.

In addition to ongoing monitoring, a system of external review will be established to assess whether sufficient progress has been made under the program to fulfill the conditions for second tranche release. The review will be external to ensure objectivity in the assessment. AID/Washington, REDSO/ESA, or a private consultant in conjunction with one of the above offices, will be utilized as the external reviewer. Progress will be assessed on the basis of the illustrative indicators presented above, to be supplemented by additional indicators if deemed appropriate by the external review team, using as a baseline the situation at the end of 1987 as established by a baseline survey to be completed within the first four months of the project. After assessing reform progress, the reviewer will prepare a report with findings, conclusions, and recommendations to the OAR/Madagascar regarding progress, compliance, and the appropriateness of disbursement. The Mission will then prepare an action memorandum for the AID Representative, on the basis of the review report, which will outline the reasons for recommending release, or refusal of release, of the funding tranche. The AID Representative will approve or disapprove the recommended action with the concurrence of the Director of REDSO/ESA in Nairobi. Only on the basis of the approved memorandum will funds be released. Progress under the program will also be measured by the program evaluations scheduled for October 1989 and August 1991.

3. Policy Dialogue Linked Project Activities

The studies, training, and technical assistance activities presented below are closely inter-related, and are intended both to consolidate the implementation of reforms already undertaken, as well as to develop an understanding of the reforms which are needed to overcome remaining constraints to efficient agricultural market operations.

a. Studies

Given the evolving nature of Madagascar's overall liberalization program, this component will be instrumental in shaping and refining the Mission's policy agenda outlined in section B. Study activities and follow-on workshops will be designed to analyze remaining constraints to the liberalization of agricultural markets, and to recommend policy or procedural changes to address them. A secondary objective will be to involve as broad a spectrum of individuals as possible - academics, business, and local government leaders as well as central government representatives - to permit these people to feel a sense of participation in shaping parts of the reform program and thereby, hopefully to develop a commitment to seeing it implemented.

Sensitivity and a low key approach will be used in developing this component: although Malagasy recognize the issues and feel a need to understand them better, they are also wary of outsiders' interference. This wariness stems from two sources:

First, the government is moving from a socialist, very centralized stance, to a more market-oriented one, without changing leadership. Thus, political figures who were used to preaching one kind of market behavior, are finding that this is suddenly inappropriate, but are unclear as to what is acceptable. Political leaders feel it is their responsibility, and not that of outsiders, to clarify new policies. For this reason, high donor visibility in terms of technical assistance for economic policy related studies and seminars is at this time particularly delicate.

Second, as mentioned elsewhere, the country is approaching presidential elections in 1989, and the political leadership is reluctant to involve itself with any controversial reform-related study or seminar which might lead to loss of votes.

Three types of studies are envisaged:

--a rural household income and expenditure survey, which will first establish the baseline and later be used to measure performance in achieving policy reform objectives, as well as the project goal and purpose;

--technical studies to pursue issues directly associated with export development and diversification; and

--policy studies, to look at issues more broadly related to the MAELP program goal and policy dialogue priorities. It is this set of studies in particular where an effort will be made to involve a broad spectrum of Malagasy representatives, some through direct participation in formulating terms of reference, conducting research, reviewing drafts, etc., and others through participation in workshops or seminars to discuss study results.

Both technical and policy studies will contribute to exploring ideas and raising questions relevant to the development of the Mission's next CDSS, scheduled for submission in 1990, as well as to refining the Mission's strategic approach in the near term. The studies will build on the considerable amount of work already done by the government and/or other donors. They will synthesize available information before exploring questions of interest in more detail. Both sets of studies will include attention as appropriate to important environmental issues, and be concerned with identifying the social impact of alternative reform options that might be proposed, including possible adverse effects on women.

Rural household income and expenditure survey. A baseline survey will be initiated as soon as possible after the signing of the Grant Agreement. This baseline survey will establish the status of the key indicators at the end of 1987 as the point of reference upon which progress under the policy reform program will be measured. Given the importance of the baseline survey in measuring the achievement of project objectives, special expertise will be brought to bear on the design the baseline survey questionnaries and the sampling framework. The services of a U.S. firm under an IQC will be sought

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for this task. This firm would then be responsible for supervising the work of a local firm to be competitively selected to undertake the baseline survey. This local firm will then be retained to do follow-up surveys prior to project evaluations in order to monitor progress on the key indicators over the life of the project.

Technical studies. These studies will be concerned with finding solutions to issues that affect the export marketing process in the "here and now" -- i.e. in the context of the given policy framework. They will be conducted in close cooperation with the Office of Exports of the Ministry of Commerce and the Ministry of Industry, Energy and Mines. Insofar as possible, local consulting firms will be used. The Chamber of Commerce and various business associations will disseminate findings. There will be close linkages with the technical assistance part of the program, in that technical specialists will be made available to work directly with individual firms that might be interested in exploring some of the possibilities suggested by the studies.

The studies will look into such issues as the export prospects for specific product lines (similar to the onion and garlic study undertaken to develop information for the Niger AEPRP). They may also address questions of processing and packaging technology. One of the coffee studies recently completed identified a simple conveyor belt mechanism as a way of speeding up and improving the sorting process without reducing the labor intensity of the operation. It also suggested that sisal from the newly revitalized private plantations in the South could be used to produce bags for shipping, substituting for imports of jute from Asia. A final area in need of study is alternative arrangements for marketing agricultural products to replace the Stabilization Funds. The Kenyan auction model is an example of a system which permits the free market to function while allowing the government to closely monitor prices and sales of commodities.

Policy studies. By contrast with the former studies, this set of studies is intended to identify specific policy constraints to improvements in agricultural market dynamics that have implications for the liberalization of external markets. Three study areas have been identified which address the major constraints to medium and long term development of the agricultural sector, without which export marketing of agricultural products will quickly reach its limit. The studies will aim to help the GDRM understand the constraints that are operating in each of these markets and to identify the conditions necessary for their removal. Recommendations will serve as the basis for future reform efforts.

--Rural input and product markets.

This study area is intended to identify constraints in the production and marketing processes. It will also explore the social impact and environmental implications of reform-induced changes in these processes.

Inefficiencies exist in internal input and product markets which increase costs of commodities sold in rural areas and depress farmgate prices. The task identified here is to analyze the nature of these distortions and develop an agenda for their removal. Efforts in this regard will be greatly assisted by the nearly completed World Bank financed study of local governments and their revenue situations, a study which is expected to recommend alternative sources of revenue to the currently predominant tax on agricultural commodities and commodity transport.

The concern with distortions, however, goes beyond the revenue requirements of local governments to include such issues as problems of vehicular registration and licensing, administrative responsibility and availability of financing for road maintenance and construction, availability of and demand for agricultural inputs, distortions imposed by parastatals, and opportunities for the sale of potential surplus production. Furthermore, in the case of agricultural inputs, the terms under which donated inputs are disposed of is an important concern. Finally, distortions exist between the social and private costs and benefits of exploiting Madagascar's natural resource base, which are resulting in the rapid degradation of the resource base for short-term private gain at the expense of long-term public benefits. The Mission recognizes that distortions exist in this sector which reduce the efficiency of domestic markets, but also accepts that it is not now in a position to identify specific interventions.

--Rural financial markets.

Upcoming plans to reform the banking system are expressed in general terms and remain limited, at this point, to questions of parastatal debt and the introduction of private sector participation primarily in commercial banking. While important, these questions do not touch on the constraints imposed on rural production by the lack of credit and lack of opportunity for farmers to place their savings in accounts which earn a reasonable rate of interest. Consequently, the Government's reform agenda, as it is currently evolving, does not directly consider removal of administrative and other barriers to rural financial market development.

Another critical question is the availability of credit for purchases of agricultural crops. A shortage of credit during the 1987 rice harvest reduced the number of buyers substantially, and thus drove down the producer price. The elimination of the Stabilization Fund role in the marketing and export of cloves and pepper has removed the vehicle by which traders, processors and warehousers of these crops had traditionally obtained credit, and generated fears about future access to credit. These questions should be addressed as part of the reform agenda to ensure that proposed reforms take into account the particular problems of rural finance in Madagascar. Any studies undertaken should take as a starting point the work that has already been done on rural credit in Madagascar and the lessons learned in credit projects, including the ongoing World Bank project in agro-industry credit with the Agricultural Development Bank (BTM), and the experimental program in farmer credit in the Lac Alaotra area.

--Availability of consumer goods in rural areas

Basic consumer goods provide an incentive for the rural farmer to produce a marketable surplus. Thus, the adequate supply of consumer goods, and their prices, are important considerations in sustaining the impetus to produce marketable surpluses provided by the initial price and marketing liberalization measures. Many of the impediments to the supply of consumer goods to rural areas are addressed in the discussion of internal markets, above. However, there are certain additional impediments to supply which confront consumer goods.

One example of an additional constraint is the reduced supply of domestically produced consumer goods resulting from monopoly and cartel production which characterizes much of the Malagasy economy. Protection offered by tariff and non-tariff barriers assists in the establishment and maintenance of these monopolies and cartels, and has the added negative effect of imposing higher prices for consumer goods on one of Africa's poorest populations. Administrative restrictions on imports, production, and distribution, are additional factors that could result in further distortions to the supply of domestically produced and imported consumer goods. The role of an open and market determined foreign exchange system is clearly instrumental to eliminating distortions in the supply of consumer goods.

This study will utilize domestic cost methodology to highlight the impact of the tariff regime on the domestic production of manufactured goods and to identify corrective policies. This study is important because it will lead to a discussion of opportunities for efficient domestic transformation of agricultural products for both internal and external markets, an issue likely to be of central concern for growth prospects over the medium to long term.

b. Training and Technical Assistance

1) <u>Introduction</u>:

There are several important constraints now preventing announced policy reforms intended to encourage a larger role for the private sector in economic development from achieving their desired results which the training and related technical assistance activities under MAELP are designed to address. The first is a widely recognized lack of business skills which inhibits the Malagasy from taking advantage of opportunities arising from economic liberalization, particularly in export markets. A related constraint is the inability of most Malagasy businesspeople to work in English, which limits the number of countries to which Malagasy desiring to export can market their products, and also the number of countries from which the Malagasy can obtain needed imports of goods and services. Taken together, this language barrier results in a less than optimal trade pattern and loss of potential revenue. A final constraint is a lack of understanding of the policy changes needed to remove remaining obstacles to the efficient operation of agricultural markets and a corresponding lack of commitment to the economic liberalization process. Training in all three areas is considered critical to the success of the reform process. While the resources provided under the MAELP will not address all the identified needs in these areas, they will make a substantial contribution toward achieving this goal.

<u>Business Know-How</u> - is an area repeatedly mentioned by the Malagasy when discussing what is needed in Madagascar for economic liberalization to succeed.

To address the lack of in-country business training programs, the World Bank in 1983 established an accounting and business administration school, the Institut National des Sciences Comptables et de l'Administration d'Entreprises (I.N.S.C.A.E.). This school was established on the North American model, with Canadian faculty and technical assistance from an American professor. Independent of the university system, the school is free to adopt innovative programs. It has wide-ranging support through its board of directors, which includes high level representatives from the public and private sectors, as well as from political parties. INSCAE is under the supervision of the Ministry of Finance.

Today INSCAE offers degree and non-degree, part-time and full-time courses. In September 1988 a two year MBA program will be added with funding provided by the World Bank and new French and Canadian faculty. In addition, to reach private sector and professional people who cannot leave their jobs for full-time training, INSCAE in 1989 plans to develop part-time, non-degree MBA type courses.

MAELP will strengthen this new program in several ways: 1) by first sending the INSCAE Director to the U.S. to visit schools with business programs that could serve as models in developing INSCAE programs, and to investigate resources for both the training of INSCAE faculty and for technical assistance in program development; 2) by providing short-term specialized business training for four members of INSCAE's faculty; 3) by assisting the establishment of a business English training program by training the future director of this program; and 4) by providing technical assistance for program development and possible in-country seminars. Likely program areas for assistance to INSCAE include: marketing, particularly for agricultural export; management information systems; and policies and strategies for enterprise development, particularly within free trade zones. INSCAE's facilities will be used as the site for in-country workshops and seminars sponsored by MAELP, since its high-level backing and contacts with the private sector will guarantee the desired broad spectrum of participation. INSCAE will thus be the primary vehicle for in-country business skill development and policy reform dialogue under MAELP.

A.I.D. under MAELP will contract with an American organization skilled in both business skill training and in developing business training programs in francophone third world countries. This contractor will work with INSCAE's Director to strengthen the INSCAE program by arranging the Director's visit to the U.S., by arranging the training programs for INSCAE faculty and business English director, and by identifying and coordinating technical assistance for program development. This contractor will also have primary responsibility for organizing approximately thirty 3-6 month specialized business courses and on-the-job training experiences in the U.S. for Malagasy, which is the second means by which MAELP proposes to strengthen business skills and economic policy formulation for private sector development. (Although the MAELP PAIP recommended one year MBA degree training, the Ministry of Finance has argued against this training because in the past, year long separations from work and internationally marketable U.S. degrees have induced Malagasy participants to remain indefinitely in the U.S.) INSCAE will work with the U.S. contractor in the selection of candidates and in the identification of training needs. Although some candidates for this training in the U.S. will hail from administrative offices and government parastatals, more than two-thirds will come from the private sector, and to the extent possible, will be women.

As noted earlier, a key impediment to the development of Madagascar's export trade is the inability of Malagasy businessmen to negotiate in English. Although the World Bank is in the process of setting up a language laboratory for INSCAE, it will not provide assistance for the design and management of language programs. MAELP will fund the training of a person to design and manage the English language program at INSCAE and will use INSCAE for English language training of participants to be sent to the U.S.

Intellectual understanding of the policy reform program and support for economic liberalization - were found to be notably lacking in a "Report on the Economic Reform Program in Madagascar" prepared by Elliot Berg in October 1987. Although high government officials, particularly the Minister of Finance, have begun the process of educating the population on the need for reform and the reasons for the policies selected, much more needs to be done.

The obvious institution to transmit understanding of and leadership for economic reform, as well as to provide training in business skills, is the University of Madagascar, in particular the Faculty of Law, Economics, Business and Sociology (E.E.S.D.E.G.S.). However, key ministers and presidential advisors have cautioned that the GDRM is still deliberating over major reforms of the university which must be in place before the university will be in a position to benefit from donor assistance. They estimate that these reforms will take effect around 1990.

While it is too early for the MAELP project to provide direct technical or other assistance to strengthen the business program in the E.E.S.D.E.G.S., it is timely to send the Dean of the faculty and a senior staff member to the United States to visit public policy and business education programs such as those at Harvard's Kennedy School and at the University of Michigan which could serve as models when plans to restructure the university with World Bank assistance go forward. In addition, professors from this faculty will be used to work on MAELP studies, as appropriate, and will be encouraged to participate in seminars and workshops sponsored by the project. This collaboration will enable USAID to explore where future training and TA to strengthen economic and public policy programs can be most effective once the working environment at the university improves.

In the interim, the project's studies, study tours and workshops will be the primary vehicles for increasing understanding of the policy changes now underway and those still needed to remove remaining impediments to medium and long-term development of the agricultural sector(in input supply, product, financial and consumer goods supply markets in rural areas), without which real growth cannot be sustained.

To summarize, MAELP training activities will include the following:

1. Strengthening in-country institutions to carry out training of Malagasy entrepreneurs, particularly in marketing and other skills needed to expand operations in export markets. This strengthening will be targetted primarily to INSCAE and will include: U.S. visits for the E.E.S.D.E.E.G.S. Dean and colleague, and the INSCAE Director to investigate resources available to strengthen economic, public policy, and business programs in Malagasy training institutions; U.S. business training for INSCAE teachers, who will receive short-term training in preparation for launching the part-time MBA type courses in 1989; and business English training, and other relevant skills, in the U.S. for the Malagasy trainer hired to set up and manage the business English language program at INSCAE.

2. U.S. classroom and on the job business programs: for an estimated thirty Malagasy businessmen from the private and parastatal sectors. Training programs will include business English(to be started at INSCAE prior to departure for the U.S.), macro-economic planning, management, and on-the-job training, as well as strictly business courses.

Participants will hail primarily from private businesses, but some will be selected from parastatals as well, for it is here that many Malagasy private sector operators begin their careers. In addition, participants may include the top graduates from INSCAE's accounting and business programs. Criteria for participant selection will include academic background, English proficiency, work experience and areas of interest for training.

3. Study tours, studies and workshops in support of external agricultural market liberalization: The purpose of these activities is to let key Malagasy policy-makers see for themselves how policies adopted in other countries have contributed to economic development, and to discuss with colleagues from the business and university communities as well as other government agencies in an open forum the relevance of those experiences for Madagascar.

For example, one planned study tour will take Malagasy in various political, technical and administrative roles to visit other coffee exporting countries to learn about alternatives to a state monopoly marketing agency for handling exports. Such a visit will be organized to Kenya, to observe the functioning of its auction process. All of the MAELP studies outlined in the preceding sections of this PAAD would benefit from the above study tour/workshop formula, namely: rural input and product markets, rural financial markets, availability of consumer goods in rural areas, and improved techniques for transforming and marketing agricultural exports.

Participants in study tours will be expected to prepare reports that will serve as discussion papers for the seminars, and to take an active role in the discussions. A U.S. economist or technical expert will travel with study tour participants, will assist them in report preparation, and will participate in the seminars. The workshops will aim to inform, and not to produce decisions. It will allow Malagasy to assimilate what they do understand, and to identify what they need to learn, in order to formulate and implement policies and programs conducive to Madagascar's economic development.

4. In-country seminars on such subjects as marketing, business start-up, preparation of proposals for bank financing, and negotiation of export contracts with foreign firms, for Malagasy businessmen. These seminars will be held at INSCAE and be led primarily by the technical advisors who travel to Madagascar to work on INSCAE program development.

5. USAID will contract with a U.S. institution experienced in business training, either a business school association such as the American Assembly of Collegiate Schools of Business (AACSB) or a firm/consortium to manage the training component of the project. This contractor will work in collaboration with INSCAE on participant profile development, selection in Madagascar, and placement and monitoring in the U.S. This contractor will also arrange the visits to the U.S. of the INSCAE Director and university business school dean, and the placement and monitoring of INSCAE faculty who will receive training in the U.S. Finally, this contractor will have responsibility for assessing with INSCAE its needs for program development, and for identifying and coordinating technical assistance to meet those needs. The Entrepreneurs International (EI) may prove helpful in assisting the contractor in planning on the job training.

Technical Assistance:

Some of the technical assistance activities under the MAELP are linked to the training, studies and study tours discussed in preceding sections. This technical assistance includes:

1) Technical assistance to INSCAE for developing its part-time business management courses. This assistance is expected to pave the way for short-term training in the U.S. for INSCAE faculty, and may well lead to longer term exchanges of faculty and students between INSCAE and U.S. institutions. Technical advisors who travel to Madagascar to work on program development may also be utilized to lead short-term intensive seminars on such subjects as marketing and setting up a business.

2) Economic reform related study tours, studies, and workshops: The MAELP will assure technical assistance for combinations of study tour, studies, and workshop activities focussed on economic liberalization policy and technical issues, especially those related to export markets.

Other technical assistance is targetted to meeting specific needs of entrepreneurs in expanding export operations, and in assessing the overall progress of the economic reform program.

3) Business consultancies for the Malagasy private sector: Malagasy businessmen have repeatedly emphasized to A.I.D./Madagascar staff the difficulties they face in entering export markets simply because they don't know where to start in identifying potential markets or buyers. Marketing thus appears to be a major constraint to increased exports by private sector operators. Under the MAELP, a variety of types of short-term technical assistance will be provided to primarily small Malagasy businesses interested in entering or expanding export trade.

One possible source of technical expertise for this program is the International Executive Service Corps(IESC), which provides the services of retired businessmen at no salary cost to private sector operators in developing countries. The director of IESC's regional office in Nairobi visited Madagascar in January of 1988 and informed A.I.D. that he saw many opportunities for IESC to work with the Malagasy.

4) Assessment of economic reform progress: Also included under technical assistance will be annual assessments of economic reform progress (or lack thereof) by a senior macro economist whose conclusions will be shared with both the GDRM and the other donors. Professor Elliot Berg has performed this function twice for A.I.D./Madagascar in the past.

5) Technical assistance for program management: An economist will be hired under a personal services contract(PSC) to manage the MAELP program over a two-year period. The scope of work for this manager is discussed in Section V below. This individual will be replaced at the end of his/her term by a U.S. Direct Hire economist.

4. Social, Political and Environmental Implications

Perceptions

In assessing change in Madagascar's political economy, it is important to keep in mind both the historical context (discussed in Section II B above and in Annex B), and the fact that societies and institutions can both maintain their continuity and change at the same time. In both personal and social behavior in Madagascar, there is a historical pattern of accepting change until it becomes too oppressive, when suddenly there is an explosive reaction that requires compensatory action on the part of the political authorities. This pattern has been evidenced in the country's historic swings between introverted nationalism and extraverted acceptance of foreign ways; in the explosive rebellion against the French in 1947; and in the rather unusual phenomenon in late 1984 of the Antananarivo kung-fu clubs which beheaded several members of a special youth organization (the TTS) of the ruling party. This phenomenon of action and compensatory reaction can make assessment of progress on the basis of a specific set of actions at any given moment an inappropriate representation of long term processes. On the other hand, tracking of processes can be a useful way of determining the direction of current change.

At the moment, Madagascar is clearly swinging towards an open free market economy; yet it is unclear where the extremes lie that would cause an opposing reaction. There is a significant lack of understanding of, dialogue on, and commitment to the new policies that are being advocated by, and blamed on, the major donors, particularly the World Bank and the IMF. There is little question that donor presence, behavior and involvement are not only important elements in the ongoing process but are also critical factors in how it will progress in the years to come. The perception of donor modus operandi is likely to be particularly important. If strict and almost dictatorial conditionality becomes too obvious for too long it might well prove the undoing of the policies. The Malagasy have repeatedly demonstrated throughout their history their respect for, and capability in, exercising power through negotiation and controlled resource distribution, but they have also demonstrated a strong resentment of foreign domination, particularly when it usurps the Malagasy role in decision-making.

The present period can be characterized as one of socio-economic disequilibrium, as the new policies that have been introduced, particularly a larger role for the private sector, require a major readjustment in the way resources are accessed and distributed. The population seems more divided between those taking a wait-and-see attitude and those trying to position themselves to take advantage of the changes, than between proponents and adversaries of the announced liberalization policies. A pronounced fear is that a small group of individuals or families now advantageously placed in the public or private sector will use their positions to gain new and anticompetitive positions in the evolving private sector. (A model of this outcome is the Philippines, where opportunism and greed on the part of a few strangled off the advancement of the majority.) There are bound to be winners and losers in the liberalization process. However, a critical determinant of a positive outcome to the policy changes will be the extent of participation by all elements of the population. It is essential that the number of winners is expanded and far exceeds the number of losers. For this reason it will be important - as this program advocates - to monitor not just the macro-economic indicators that often hide the distribution curve of benefits, but also the actual on-the-ground implementation of the policy changes, and to expand the scope of this monitoring beyond the capital to the outlying regions. Also, the Government and the World Bank should be encouraged to assess the social impact of proposed structural adjustment measures, and, to the extent possible, both to tailor the phasing of measures and to initiate compensatory programs so as to mitigate adverse consequences for the least advantaged segments of the population.

Realities

The two realities of the current situation that are of particular relevance to the reform agenda proposed in this program are rural insecurity and the ability of participants in the agricultural export sector to benefit from the new opportunities presented. These issues are discussed separately below.

a. Increasing rural insecurity is one of the most puzzling dimensions of socio-economic change in Madagascar. Very high and growing losses of crops, but particularly cattle, to theft and banditry are being reported throughout an increasing area of the country. To some extent this phenomenon, which began in the 1970's, and has gathered momentum in recent years, can be attributed to increased impoverishment and a lack of legitimate economic opportunities. However, the fact that official exports of cattle are extremely low in the face of a known and expanding clandestine export of cattle to Reunion indicates the collusion of at least some local authorities. This phenomenon represents a perverted form of a growing private sector economy.

One oft-heard criticism of the economic liberalization is that it is really a way of legalizing the black market. In fact, this may in a very positive sense be the ultimate test of its success; i.e., will the government be willing and able through policy and administrative reforms to convert clandestine economic activities into legitimate competitive market operations? The regulation of foreign currency will be a major factor in determining such an outcome, since it is the lack of readily available foreign exchange and fears of continued devaluations that encourage illegal export and the retention of profits overseas. An assurance that profits can be legitimately made and that repatriated earnings will retain their value is a prerequisite for the successful operation of an open market system.

b. Agricultural Export Sector

Due to its potential, the agricultural export crop sector has a critical role to play in revitalizing Madagascar's economy. Numerous rural producers and intermediaries are poised to respond to increased export opportunities, but have been held back not only by lack of inputs and technology and poor transport infrastructure, but also by rural insecurity and uncertainty over government policy. Although progress will be difficult to measure over the short term, the best indicators of progress toward or away from effective liberalization are likely to be qualitative assessments of changing behavior, strategies, and the spectrum of actors in the intermediary roles between producers and exporters/importers (buyers, transporters, processors, and local distributors of inputs and consumer goods).

Another measure of the progress of liberalization will be the flow of benefits. During more prosperous times before the socialist revolution, the traditional movement of export goods was from the regions either directly to external markets or via the capital, while the flow of benefits (primarily in the form of imported goods) was predominantly to the capital, with extremely low inter-regional exchange. If this pattern repeats itself or becomes even more pronounced in a revised export-oriented economy the benefits will be restricted and regional discontent and disparities may actually increase. Efficient, prosperous and expanded internal markets may be a pre-condition for increased general prosperity.

c. <u>Environment</u>

A categorical exlusion has been approved by the Africa Bureau Environmental Officer. A discussion of the environmental implications of the policy reform program supported by MAELP funds is presented in Annex E, which also contains the Initial Environmental Examination. The environmental impacts of the policy reform program will be monitored by the Natural Resources Advisor expected to join the AID/Madagascar staff by the end of CY 1988.

5. <u>Relationship with Other Donor Activities and Relevant USAID Projects</u>

Madagascar's structural reform program outlined in Section II and Annex B has evolved since 1983 in close coordination with the World Bank and the IMF. Without the Government's commitment to this program, A.I.D. would not have decided to re-engage in Madagascar as it did in 1984. Since that time, A.I.D. activities have been designed and conducted in direct support of the reform program, and consequently, in close coordination with the World Bank. Evidence of the unusually close working relationship between A.I.D. and the World Bank in Madagascar abounds, but is most evident in the rice liberalization and environmental action plan programs.

The MAELP builds upon lessons learned in the rice market liberalization through the PL 480 Food for Progress program, lessons which have also been applied in the development of a complementary PL 480 Section 206 reform program intended to extend agricultural market liberalization to the edible oils sector. The MAELP has also been designed to specifically complement the ongoing World Bank Structural Adjustment operations in agriculture (CASA), and Industry and Trade (CASPIC), as well as the proposed 1988 Public Sector Structural Adjustment Credit (CASEP). Coordination will be continued when the World Bank moves forward with a planned CASA II in 1989 or 1990 which will focus exclusively on agricultural exports.

Support for the liberalization of the import (and foreign exchange rate) systems in 1988 is expected to be provided by all of the major donors. To date, pledges have been made by the World Bank ($65 million remaining from CASA, and $60 million from CASEP), the African Development Bank ($20-30 million as part of CASEP), and the French (FF 230 million, or $45 million). France has been providing program type assistance since 1982. However, the French assistance for 1988 has been held up pending a review of GDRM credit policy. The U.S. contribution of $16 million will cover about two weeks of imports. Additional assistance may be provided by Germany, Switzerland and the EEC. Total donor commitments to date cover $206 million, compared with anticipated total requirements for imports of SDR 400 million per annum.

A number of donors provide assistance in support of the agricultural export sector. World Bank structural adjustment programs have promoted policy and procedural improvements in export administration, export crop pricing, tax structures, credit systems and the role of public enterprises, while projects support the rehabilitation of critical road and port infrastructure and the lending program of the Agricultural Development Bank. France has provided significant assistance for the rehabilitation of the coffee sector in the South East (with some attention to cloves and pepper) as well as for cotton and sugar production and processing. Other projects are directed at livestock, maize and rice, all products with potential for increased export. Both UNDP and the European Development Fund gave supported initiatives in fisheries development, as have the Japanese. The African Development Bank provides project assistance for infrastructure improvement, while the German aid agency has been working with livestock development.

A.I.D.'s proposed activities in technical assistance, studies and training in the areas of rural credit, input and product distribution systems, export market development, and export policies will build on earlier work done by other donors (the French in coffee technology and input supplies, the World Bank in rural credit and free trade zones) and complement planned initiatives, particularly the development of in-country business training by the Canadians, French and the IBRD. It will also build upon A.I.D.'s experience in Madagascar under the centrally funded AFGRAD and AMDP training projects, as well as the Madagascar Agriculture Rehabilitation Support Project (MARS). Several successful MARS activities will be continued under MAELP, including: visits and reports on policy reform progress by a senior and widely-respected U.S. macro-economist, the study tour/workshop formula, and in-country seminars organized by a local training institution.

IV. FINANCIAL ARRANGEMENTS

A. Illustrative Budget

The budget for the activities described in the preceding sections may be summarized as follows:

TABLE 1 Summary Cost Estimate and Financial Plan

(US Dols '000)

	A.I.D.	GDRM	Private	Total
Agricultural Sector Support:	16,000	6,100		22,100
Studies:				
Baseline & Monitoring	100	10		110
Technical	85	5		90
Policy	250	10		260
Subtotal	435	25		460
Training:				
Local institution strengthening	114	15		129
30 Business courses/OJT in U.S.	750	20	30	800
Training contractor	150	10		160
Study Tours -				
	96	5		101
Workshops - 6 @ 15,000	90	10		100
Subtotal	1200	60	30	1290
Technical Assistance:				
INSCAE program development and seminars	140	25		165
Study tours/workshops - 9 PM @ 15,000/month	135			135
Macro-economist - 3 PM @ 20,000/month	60			60
Business consultancies - 15 consultancies @ 15,000	225		20	245
Program manager	240	25	20	265
Subtotal	800	50	20	870
Evaluation and Audit:	100			100
Contingency:	200	10		210
TOTAL	18,735	6,245	50	25,030
PROJECT TOTAL				25,030

TABLE 2 - Projection of Expenditures by Fiscal Year

(U.S. Dols. '000)

FISCAL YEAR/ SOURCE	1988 AID	1988 HC	1989 AID	1989 HC	1990 AID	1990 HC	199[illegible] AID	199[illegible] HC
PROJECT COMPONENT								
Agricultural Sector Support	8,000	500	8,000	2,000	-	2,000	-	1,600
Studies	50		250	10	100	10	35	5
Training	-		500	20	400	30	300	10
Technical Assistance	120		380	30	200	15	100	5
Evaluation and Audit	-		15		40		45	
Contingency	-		40		100	10	60	
TOTAL	8,170	500	9,185	2,060	840	2,065	540	1,620

B. FAA Section 110A Contribution

Under the proposed Madagascar Agricultural Export Liberalization Program, the Government of Madagascar has agreed to contribute a minimum of $6.245 million in foreign exchange or local currency equivalent over three years to programs that support the development of the agricultural sector, such as research on export crops, rehabilitation and maintenance of transport infrastructure in export crop growing areas, and the financing of needed inputs and services for producers. An additional contribution will be made in-kind for training, technical assistance and studies. These contributions satisfy the requirement of Section 110A of the Foreign Assistance Act that a recipient of U.S. development assistance contribute at least 25% of the total cost of a proposed project from its own resources.

C. Obligation Plan

Obligations are currently planned for FYs 1988 and 1989. $18,735 million will be obligated in FY 1988. Any future obligations beyond FY 1988 will be dependent on the outcome of the project evaluations, one of whose objectives will be to review Government of Madagascar performance on policy reform and to recommend whether additional U.S. assistance should be provided to support policy reform in Madagascar.

D. Disbursement Mechanism

The dollars provided under the policy reform part of the grant will be disbursed in two equal tranches to the Central Bank of Madagascar, via electronic funds transfer, to an account to be designated by the Central

Bank. The GDRM has indicated its intention to use these dollars in support of the Open General Licensing (OGL) system for imports. Grant funds for project activities will be disbursed directly by A.I.D. primarily through the Regional Financial Management Center in Nairobi, Kenya.

E. Local currency

1. Mechanics.

The mechanisms for generating and depositing local currency counterpart are described in Section III.C.2.b. above.

2. Use.

A small proportion of this counterpart will be reserved for the Mission's Trust Fund. The bulk of the funds, however, will be allocated within the government budget to support the rehabilitation of roads in key agricultural areas under the Seventh Highway Project. A key consideration in the choice of use of counterpart funds has been the Mission's limited management capacity in the face of new local currency guidelines, which has necessitated the selection of an option which will be the least management intensive, while meeting a priority objective of the USAID development strategy.

a) Trust Fund

Local currency counterpart in the equivalent of $600,000 will be made available to USAID to cover local currency costs of operating the A.I.D. program in Madagascar over a period of three years. Disbursements of funds to the Trust Fund will be made quarterly in accordance with existing procedures.

b) Budget Attribution

The Ministry which A.I.D. has selected to receive counterpart generations from the MAELP is the Ministry of Public Works, MTP. It has become evident in preparing the MAELP that one of the principal constraints to agricultural marketing and exports, and thus an improvement in rural incomes, is the abysmal state of road infrastructure. This hampers input delivery, the collection and processing of crops, as well as transport to export centers. The French-financed coffee rehabilitation project (ODASE) has found it essential to give priority attention and resources to the repair and maintenance of key rural and trunk roads in the coffee-growing areas. The GDRM recognizes the magnitude of the problem and has sought donor assistance for a well-thought out program to address the problem. The 7th Highway Project is now being negotiated with the World Bank for $200 million of multi-donor financing and is expected to come onstream in 1988. This project will address road rehabilitation and maintenance in key agricultural areas. The local currency requirements of this project are estimated to be the equivalent of $50.2 million. The GDRM's difficulty in meeting road repair needs is illustrated by the fact that in 1988 only FMG 13.5 billion($11 million) was allocated to MTP for all its activities. An A.I.D. allocation of $16 million in counterpart funds will thus make a substantial contribution to the realization of this key program.

Channeling counterpart funds through the budget will be a new undertaking for the GDRM. This effort is being undertaken upon the recommendation of the IBRD and the IMF in order to improve the efficiency of resource use by the GDRM and the transparency of Treasury operations. Until now, counterpart funds arising from donor balance of payments assistance have been used off-budget.

One of the objectives of the budget reform program now being carried out with the IMF and the IBRD is to bring all items now off-budget into the budget, so as to achieve a consolidated budget presentation by 1990. Using counterpart funds for budget attribution will also reinforce the new program-based budgeting approach which has already been introduced in MPARA (Agricultural Production) and MTP (Public Works), and is scheduled for introduction in the Ministries of Health and Education in 1988, and the assessment of competing priorities for Government resources which the new Public Investment Program guidelines are intended to strengthen. Finally, the allocation of counterpart funds will guarantee that funds will be available for identified priority activities.

These MAELP resources will be integrated into the GDRM budget beginning in FY 1989(which starts in January).

c. Reporting and monitoring

Section III.C., Conditions Precedent and Covenants, specifies certain reporting requirements. On a quarterly basis, the Treasury will inform USAID of deposits into the Special Account and of attributions of these receipts to the agreed program in the budget. On a yearly basis, the recipient ministry will certify that an amount at least equivalent to the U.S. counterpart allocation has been attributed to the agreed program. The Treasury has agreed to coordinate these responses.

Monitoring will take place through the program review which is due to take place before the disbursement of the second dollar tranche; through periodic reviews or audits (as stated in the Covenant, USAID will have access to books and records as appropriate); and through regular meetings with the World Bank and MTP to review the progress of work and the use of funds under the Seventh Highway Project. While relying on the World Bank as the principal implementing agency, AID/Madagascar, with assistance from REDSO/ESA Engineers, will also monitor the project through the review of all project reports and periodic site visits.

V. MANAGEMENT ARRANGEMENTS AND EVALUATION PLAN

A. Management

The MAELP will be managed jointly by the Office of the A.I.D. Representative to Madagascar and the Government of Madagascar. GDRM counterpart agencies will be the Central Bank as the recipient of cash disbursements under the agricultural sector grant, and the Ministry of Finance and Economy for review of policy performance and for the implementation of training, technical assistance and studies. The Ministries of Commerce and Industry will be key participants in the planned technical studies and seminars, while the policy dialogue under MAELP will be carried out with the Ministries of Agriculture and Commerce as the two ministries having primary responsibility for agricultural exports. Training activities will be implemented with the assistance of INSCAE and a U.S. contractor. REDSO/ESA and RFMC or RIG/A/N assistance will be required for evaluation, financial review or audit and monitoring of local currency disbursements. The responsibilities of each of these parties is discussed in detail below.

1. AID/Madagascar

Within the A.I.D./Madagascar office, an economist will be the principal project manager with primary responsibility for tracking performance under the reform program in close collaboration with host country counterparts, the World Bank and other donors; for preparing scopes of work and overseeing implementation of studies and technical assistance; and for supervising the work of a U.S. contractor and INSCAE in implementing training activities under the project. The economist will also monitor disbursements from local currency accounts and verify that expenditures follow agreed uses. The economist will report directly to the A.I.D. Representative, and will work closely with the project development officer and program assistant.

In view of the unavailability of an A.I.D. direct hire economist for assignment to Madagascar within the next year, a PSC economist will be hired to manage the project for a two year period using project funds. It is expected that a direct hire economist will assume project management responsibilities at the end of the second year.

The economist will be assisted by a direct hire project development officer and an FSN program assistant. The program assistant will have primary responsibility within the A.I.D. office for the implementation of the training component of the project. The project development officer will assist the program assistant and the economist as needed in the implementation of project activities (technical assistance, studies and training) and will have primary responsibility for coordinating program assessments, evaluations and financial reviews or audits.

The environmental impact of the program will be monitored by a Natural Resources/Agricultural Advisor who is expected to join the A.I.D./Madagascar staff during the 1988 calendar year.

The Mission will monitor carefully its capacity to manage this program. If the management burden intensifies beyond Mission ability to service program requirements as currently structured, alternative means will be considered.

2. A.I.D. Contractors

In addition to a PSC economist, AID/Madagascar will also contract with a U.S. institution to manage the training component of the project in coordination with the in-country business training institution, INSCAE. This contractor will have the following responsibilities: 1) to make arrangements for a visit to the U.S. for the Director of INSCAE and the Dean and a colleague from the University of Madagascar's business college to investigate the curricula and resources available at U.S. business and public policy schools that could be used to strengthen training programs in these areas in Madagascar; 2) to place and monitor the training of INSCAE faculty in short-term business training programs in the U.S.; 3) to develop participant training profiles, to interview and select participants, and to organize training programs(academic or on-the-job, and business English) for 30 Malagasy participants in the U.S.; and 4) to assess the needs for the development of business programs at INSCAE, to identify technical advisors who could meet those needs, and to arrange for the visits of selected advisors to Madagascar.

AID/Madagascar also proposes to obtain the services of the International Executive Service Corps to handle the provision of technical assistance to Malagasy entrepreneurs.

AID/Madagascar will use the services of IQC firms to develop the scopes of work for studies, to recruit a senior macro-economist to undertake annual reviews of policy performance, to organize and lead study tours and workshops, to undertake project reviews or audits, and to participate in project evaluations as needed.

3. REDSO/ESA and RFMC

REDSO/ESA assistance will be needed in several areas: 1) the services of a Contracting Officer to contract for the PSC economist and the U.S. institutions/firms which will manage training and technical assistance activities; 2) the services of an Engineer to review progress on the implementation of the 7th Highway project, for which local currency counterpart generated by dollar disbursements will be programmed; 3) the services of an economist, an agriculturalist and a social scientist for the planned project evaluations; and 4) the assistance of the RLA, RCO and the Director in providing concurrence for certain implementation actions as required by DOA 551.

RFMC or RIG/A/N assistance will be needed as described below for financial reviews or project audits.

4. Government of Madagascar

The Government of Madagascar entities to be involved in this project include the Central Bank, the Ministry of Finance and Economy, the Ministries of Commerce and Industry and INSCAE.

The Central Bank will receive disbursements of dollars from the sector grant, will establish a special project account, and will have primary responsibility for assuring the timely deposit of local currency into the special account.

The Ministry of Finance and Economy will be the counterpart ministry for the implementation of project funded training, studies, and technical assistance, as well as for the management of local currency generations. It will review performance on policy reform with A.I.D., and will participate in the development of scopes of work for studies and technical assistance, and in the selection of in-country contractors to implement studies. It will co-sponsor seminars on the results of policy studies and study tours, and will participate in project evaluations. The Treasury Department within the Ministry will have primary responsibility for managing local currency generations as discussed above, and will prepare periodic reports on the status of the special account. A Project Manager will be hired to manage the project within the Ministry of Finance and Economy, who will provide all necessary coordination with other government ministries involved in studies and training. The other government ministries expected to be involved in project activities are the Ministries of Commerce and Agriculture, with whom the policy dialogue on agricultural export market liberalization will be continued, and the Ministries of Commerce and of Industry which will be key partners for technical studies and seminars.

AID/Madagascar has worked with the Treasury Department in the past on the disbursement of local currencies from special accounts, and believes that the staff of the Department are fully competent to carry out this role in the future. AID/Madagascar has not worked with the Ministry of Finance and Economy for project activities such as those proposed under MAELP. However, an initial assessment indicates that with close collaboration on implementation, the Division of Programming should be an excellent counterpart for A.I.D. in Madagascar. This choice of a counterpart was recommended by high-ranking officials within the Government because of its position of coordination with all line ministries involved in the reform process, its receptivity to and lead within the GDRM in promoting the private sector, and its ongoing role in managing counterpart funds. The Ministry of Finance has also been instrumental in establishing the business institute INSCAE, and is particularly interested in developing in-country business skill training.

INSCAE will work with the U.S. institution in the selection of participants for training in the U.S. and in the organization of in-country seminars and workshops which will be held at INSCAE facilities.

An implementation schedule is presented in Annex F.

B. Contracting Mechanisms

The key factors considered in determining the most appropriate mechanisms for procuring services required by MAELP were: 1) AID/Madagascar's small staff and resulting limited administrative capability, 2) the relative inexperience and limited capacity of the host country institutions in contracting, and 3) a desire to use local institutions and resources to implement project activities wherever possible. Thus, the services of contractors to manage the activities discussed above will be obtained through competitively-selected direct AID contracts and IQCs. The Design Team considered the feasibility of setting aside any project activities for firms or institutions which qualify for special consideration under the Gray Amendment(small, disadvantaged or women-owned firms). The team was unaware of any small or minority owned firm with experience in the implementation of a combined business training/business training institution strengthening program, or that offered business consultants to private entrepreneurs at no salary fee as provided by the IESC. However, the RFP for the training component technical services requirements will be sent to the AID small business office with a request that the contract requirements be brought to the attention of small businesses with experience and expertise in the required areas.

C. Methods of Implementation and Financing

The chart below shows the proposed methods to be used to implement and finance MAELP project components.

Activity	Method of Implementation	Method of Financing	Amount
Policy Support	Cash Transfer	Electronic Funds Transfer	$16,000,000
T.A.			
-Program Mng'r.	AID Direct Contract	Direct Payment	$240,000
-Business Cons.	AID Grant to IESC	Direct Payment	$225,000
-Macro-Econ.	AID Direct Contract	Direct Payment	$ 60,000
-Study Tours	AID Direct Contract	Direct Payment	$231,000
Training			
-Institution-building/business courses in U.S./ INSCAE program development	AID Direct Contract	Direct Payment	$1,124,000
-Workshops and seminars	AID Direct Contract	Direct Payment	$120,000
Studies	AID Direct Contract	Direct Payment	$435,000
Evaluation/ Audit	AID Direct Contract	Direct Payment	$100,000
Contingency	AID Implementation	Direct Payment	$200,000

The review of alternative methods of implementation and financing from the standpoint of project needs and funds accountability has led the design team to select direct AID contracting using direct payment or direct reimbursement procedures for project costs. This method is consistent with AID/Madagascar's current policies on program financing and implementation.

D. Logistics

AID/Madagascar will provide full support in the way of housing, office, secretarial and official transportation for the PSC Economist Program Manager. This support will be funded through the Mission's Trust Fund. Some support in the form of office space and secretarial support will be provided to IQC contractors for study scopes of work and evaluations/audits and, as available, to the training and technical assistance contractors. However, the latter two contractors will receive their primary in-country support from, respectively, INSCAE and the private entrepreneurs who will benefit from IESC consultancies. Funds will be provided under the contracts for other logistical support as may be needed.

E. Evaluation and Audit Plan

In addition to the ongoing monitoring of the project that will be carried out by the economist program manager, two special types of evaluation will be used to track project progress. The first type of evaluation is linked to performance under the policy reform component of the project and will be used as the basis for cash disbursements. The first such assessment will be conducted following the notification by the GDRM that conditions for second tranche of policy support assistance have been satisfied. The progress indicators upon which performance will be measured during this assessment and the composition of the external review team are described in Section III.C. above. In addition to making a recommendation on the release of the second tranche of the cash disbursement, the review team will be tasked with reviewing Government of Madagascar performance on the overall policy reform agenda and recommending whether or not A.I.D. should provide additional balance of payments support during FY 1989. If so, the team will advise what changes if any should be made in the policy reform agenda of the program. These recommendations will serve as the basis for designing a PAAD amendment in FY 1989.

The second type of evaluation will be for overall project performance. One interim project evaluation is planned for October of 1989. The scope of work for this evaluation will be as follows:

- to assess whether project activities are proceeding as planned, and whether the project environment has changed in any substantial way;

- to review disbursement of project funds as well as the disbursement of local currency counterpart to the GDRM budget;

- to assess the degree to which project activities are contributing to the achievement of the project purpose;

- to determine whether the policy reform agenda remains valid, and if so, whether additional A.I.D. resources for balance of payments support should be made available to the GDRM during fiscal year 1990;

- and finally, to make recommendations for any changes in the policy reform agenda, project activities, or implementation arrangements needed to assure achievement of the project goal and purpose.

A team consisting of an economist, an agricultural officer and a sociologist from REDSO/ESA if possible, or on contract as needed, will conduct this evaluation. A training expert with experience in business and management will form the final members of this team.

A final evaluation will occur after the expiration of the PACD in June 1991 to assess the degree to which project activities resulted in the achievement of the project purpose and goals, and to make recommendations on the basis of lessons learned for future A.I.D./Madagascar involvement in similar types of activities.

Twice during the project life, AID/Madagascar will arrange for REDSO/RFMC to issue work orders to a certified public accounting firm to be selected through an indefinite quantity contract (IQC) to carry out a financial review of the dollar and local currency accounts under the project. The scope of work for the accounting firm is limited to financial and compliance matters and will be prepared by AID/Madagascar's PDO with assistance from REDSO/RFMC.

Project funds have been budgeted for the planned evaluations and financial reviews/audits.

VI. NEGOTIATING STATUS

All the elements of the project have been discussed at length with Government of Madagascar ministries which will have responsibility for approving or implementing project activities. These discussions have included AID requirements for GDRM reporting and management of special accounts, and the substance of proposed conditions. To date, full concurrence has been given and the GDRM has indicated its eagerness to sign an agreement at the earliest possible date. When RLA clearance has been obtained for proposed conditions and covenants, AID/Madagascar will review them with the GDRM prior to the finalization of grant agreements.

ANNEX A

STATISTICAL ANNEX

(MAELP)

Annex A

LIST OF TABLES

Table 1

Origin and Uses of Gross Domestic Product
(Billion 1984 Malagasy Francs)

	1981	1982	1983	1984	1985	1986
Agriculture	528.5	549.7	562.7	580.6	591.7	605.0
Mining & Manufact.	235.1	201.5	203.3	213.9	223.5	219.6
Pub. Sect. Services	142.7	144.1	145.4	128.0	129.2	130.0
Other Services & Other	452.4	438.9	434.8	446.6	455.8	456.1
GDP at Market Prices	1358.7	1334.2	1346.2	1369.1	1400.2	1410.7
Net Import of Goods & NFS	108.5	113.9	85.7	59.7	49.2	59.6
Consumption	1248.7	1269.9	1255.0	1243.0	1260.1	1272.3
Private	1042.4	1070.3	1054.1	1058.0	1070.5	1081.9
Public	206.3	199.6	200.9	185.0	189.6	190.4
Gross Investment	218.4	178.2	176.8	185.7	189.3	198.0
GDP at Market Prices	1358.6	1334.2	1346.1	1369.0	1400.2	1410.7

(Percent of total)

	1981 %	1982 %	1983 %	1984 %	1985 %	1986 %
Agriculture	38.9	41.2	41.8	42.4	42.3	42.9
Mining & Manufact.	17.3	15.1	15.1	15.6	16.0	15.6
Pub. Sect. Services	10.5	10.8	10.8	9.3	9.2	9.2
Other Services & Other	33.3	32.9	32.3	32.6	32.6	32.3
GDP at Market Prices	100.0	100.0	100.0	100.0	100.0	100.0
Net Imports of Goods & NFS	8.0	8.5	6.4	4.4	3.5	4.2
Consumption	91.9	95.2	93.2	90.8	90.0	90.2
Private	76.7	80.2	78.3	77.3	76.5	76.7
Public	15.2	15.0	14.9	13.5	13.5	13.5
Gross Investment	16.1	13.4	13.1	13.6	13.5	14.0
GDP at Market Prices	100.0	100.0	100.0	100.0	100.0	100.0

(percent change)

	1982 %	1983 %	1984 %	1985 %	1986 %
Agriculture	4.0	2.4	3.2	1.9	2.2
Mining & Manufact.	-14.3	0.9	5.2	4.5	-1.7
Pub. Sect. Services	1.0	0.9	-12.0	0.9	0.6
Other Services & Other	-3.0	-0.9	2.7	2.1	0.1
GDP at Market Prices	-1.8	0.9	1.7	2.3	0.7
Net Import of Goods & NFS	5.0	-24.8	-30.3	-17.6	21.1
Consumption	1.7	-1.2	-1.0	1.4	1.0
Private	2.7	-1.5	0.4	1.2	1.1
Public	-3.2	0.7	-7.9	2.5	0.4
Gross Investment	-18.4	-0.8	5.0	1.9	4.6
GDP at Market Prices	-1.8	0.9	1.7	2.3	0.7

Source: IMF, RED, FEB. 13, 1987 Table 1 and mission estimates

Table 2

Production of Major Cash Crops, 1981-86 (1)
(in thousands of tons)

		1981	1982	1983	1984	1985	1986 (Prelim.)
Export crops							
Coffee (2)	Production	83.5	81.2	80.8	81.4	78.5	78.5
	Marketed	58.5	52.7	47.1	65.2	46.6	50.0
Vanilla	Production (3)	4.3	5.5	2.2	6.9	7.0	3.3
	Marketed (4)	1.0	1.2	0.5	1.5	1.6	0.7
Cloves	Production	10.8	9.9	4.2	18.0	13.5	7.1
	Marketed	10.2	15.0	2.3	16.0	8.0	6.0
Pepper	Production	2.9	2.6	2.6	2.6	2.8	2.8
	Marketed	1.9	2.2	2.0	2.2	2.1	2.3
Cocoa	Production	1.8	1.9	2.8	3.0	2.3	2.4
	Marketed	1.7	1.8	2.7	2.9	2.2	2.3
Butter beans	Production	5.0	6.2	5.8	7.1	5.8	6.0
	Marketed	3.0	...	3.9	6.0	5.0	5.0
Sisal	Production (5)	15.4	15.1	12.5	19.8	19.8	19.8
Industrial Crops							
Cotton (6)	Production (5)	28.0	25.9	26.3	32.5	42.9	43.0
Sugar (7)	Production	1420.4	1408.6	1615.8	1660.0	1744.0	1950.0
	Marketed	1055.0	848.0	958.8	1069.7	1138.2	1380.0
Groundnuts	Production	32.9	29.6	32.3	31.5	31.5	32.0
	Marketed	20.0	20.1	23.3	18.6	18.6	18.5

Sources: Data provided by the Malagasy authorities; and staff estimates.

(1) Data on total production are approximate; data on marketed production are more accurate.
(2) Unroasted coffee.
(3) Green vanilla.
(4) Prepared vanilla (4.6 kg green = 1 kg prepared).
(5) Most of the production is marketed.
(6) Seed cotton.
(7) Sugarcane.

Table 3

Madagascar: Agricultural Production 1980-1988
(Metric Ton)

	1980	1981	1982	1983	1984	1985	1986	1987	Prev. 1988
CEREALS									
Paddy	2,108,910	2,011,910	1,969,905	2,147,000	2,131,100	2,177,680	2,230,205	2,296,132	2,235,200
Maize	127,570	120,656	113,000	132,100	141,000	140,200	152,890	158,100	156,400
Sorghum	1,280	1,280	1,315	1,560	1,500	1,380	1,400	1,485	1,380
LEGUMINOUS									
Beans	38,415	35,570	36,845	38,670	36,800	35,700	42,210	39,500	38,000
Butter Beans	5,920	5,000	6,200	5,800	7,100	5,800	6,350	6,560	7,000
Soya Beans	5	10	15	50	60	60	80	65	60
TUBERS & ROOTS									
Potatoes	166,150	160,630	200,810	252,695	263,510	263,600	263,900	266,640	270,100
Cassava	1,683,165	1,670,070	1,898,340	1,992,225	2,047,100	2,142,000	2,190,000	2,178,400	2,186,300
Sweet potatoes	373,255	398,575	356,090	463,000	462,500	450,000	467,140	466,760	466,900
Taro	79,625	77,370	78,165	85,460	93,200	93,500	94,000	92,750	93,000
INDUSTRIAL AND EXPORT CROPS									
Sugarcane	1,394,985	1,420,380	1,408,565	1,615,800	1,660,000	1,744,150	1,950,000	1,980,600	1,985,000
Groundnuts	39,075	32,930	29,610	32,300	31,500	31,500	32,540	31,800	30,200
Tobacco	3,576	3,055	2,612	2,140	3,400	4,680	5,455	4,502	
Cotton	23,210	28,010	25,880	26,343	32,500	42,700	41,000	33,000	
Coffee (green)	79,880	83,460	81,225	80,855	81,400	78,500	82,210	80,725	31,000
Cocoa	1,690	1,855	1,895	2,800	3,000	2,300	2,400	2,720	81,300
Pepper	2,755	2,955	2,585	2,600	2,610	2,800	2,880	3,000	2,700
Vanilla	2,960	4,295	5,500	2,400	6,900	7,000	3,300	6,200	3,500
Cloves	12,250	10,800	9,905	4,230	18,000	13,500	7,100	6,500	6,800
Sisal	16,020	15,380	18,410	16,700	19,510	19,800	19,800	19,700	10,100
									19,500
VEGETABLES									
Green Peas	1,547	1,613	1,630	1,645	1,670	1,635	1,625	1,650	1,700
Carrots	4,261	4,528	4,670	4,900	4,955	5,000	4,720	4,700	5,000
Turnips	241	168	160	165	170	170	180	180	160

Table 3

(continued)

Onions	4,502	4,787	4,935	5,100	5,150	5,300	4,960	5,200	5,500
Cauliflowers	535	57	110	220	440	5,000	4,060	5,130	5,000
Tomatoes	8,644	8,195	10,485	13,500	17,200	17,700	18,000	17,400	17,100
Cucumbers	575	645	580	700	730	750	780	800	800
Cabbage	8,707	10,179	10,320	10,420	10,400	10,400	10,500	10,600	9,560
Watercress	754	651	790	810	880	900	980	1,000	1,050
FRUITS									
Bananas	270,175	280,300	284,525	285,700	224,000	224,500	225,200	225,900	226,000
Citrus fruits	58,860	59,435	80,345	80,700	81,320	81,900	81,900	80,800	80,800
Pineapples	53,320	48,575	50,275	50,485	50,400	50,890	50,655	50,800	50,100
Apples & Pears	5,618	5,683	5,704	5,800	5,830	5,872	5,780	5,660	6,000
Grapes	8,920	8,070	8,420	9,045	9,500	9,700	9,900	10,000	10,000
Lychis	31,950	32,815	33,565	34,300	35,300	35,380	34,880	35,000	35,500
Apricots	650	710	980	1,035	1,180	1,200	960	980	960
FORESTRY									
Raffia	7,640	7,640	7,690	7,720	7,800	7,870	7,890	–	–
Paka	430	430	540	570	580	680	525	–	–

Source: Data Provided by Mpara.

Table 4

Madagascar Exports of Agricultural Products and Manufactured Agricultural Goods, 1981-1987 (Tons) 1/

AGRICULTURAL PRODUCTS	1981	1982	1983	1984	1985	1986	1987 2/
Coffee 2/	56,941	53,918	50,034	51,337	41,662	44,937	–
Vanilla	635	887	1,099	827	628	714	1,156
Cloves	7,712	9,444	1,973	6,268	12,031	11,241	3,023
Pepper	2,040	2,163	3,232	2,805	2,618	1,774	1,777
Cocoa	1,800	1,388	2,315	2,495	1,624	2,119	2,963
Rice 3/	193,000	351,000	179,000	114,000	116,000	159,000	99,965
Butter Beans	447	1,911	5,668	5,172	4,881	2,298	–
Bananas	1,334	226	660	94	46	46	750
Sisal	13,383	15,395	10,571	13,089	8,330	8,574	7,303
Raffia	2,041	1,787	1,461	1,665	1,056	1,085	2,088
Medicinal & Perfumery Plants	–	–	900	1,209	890	923	1,028
MANUFACTURED AGRICULTURAL GOODS							
Fish	3,264	3,990	3,590	4,124	4,439	4,682	–
Meat	2,163	1,180	783	3,488	1,272	5	–
Sugar	12,200	10,507	32,300	28,082	32,800	–	18,582
Molasses	–	–	–	20,500	14,350	13,000	17,000
Tapioca	–	–	465	374	120	120	–
Cloves Oil	688	656	791	1,781	1,135	1,028	1,394
Ylang Ylang Oil	18	13	11	8	13	8	–
Oil Cake	–	–	2,633	1,729	3,076	3,310	2,720
Cotton Fabrics	–	–	4,396	7,755	–	–	–
Wood	–	–	336	363	293	–	–

SOURCES:
1/ BDE

2/ Ministry of Commerce

3/ Peter ROBINSON, Composition of PL480, Title I Commodities, 1987-1991

Table 5

Madagascar Exports of Major Agricultural Products

Quantity in MT

	1983	1984	1985	1986
AGRICULTURAL PRODUCTS				
Green Coffee	50,034	51,337	41,662	44,937
Vanilla	1,099	827	628	689
Cloves	1,973	6,268	12,031	10,183
Pepper	3,232	2,805	2,618	1,841

Value in Million of FMG

	1983	1984	1985	1986
AGRICULTURAL PRODUCTS				
Green Coffee	48,987.7	77,964.6	63,566.1	91,978.3
Vanilla	27,211.5	30,400.2	28,805.7	29,820.3
Cloves	6,963.7	20,485.2	24,463.3	15,141.4
Pepper	1,442.6	2,263.6	3,454.1	3,559.4

FMG per kilogram

	1983	1984	1985	1986
AGRICULTURAL PRODUCTS				
Green Coffee	979	1,518	1,526	2,046
Vanilla	24,760	36,759	45,869	43,281
Cloves	3,529	3,268	2,033	1,487
Pepper	446	807	1,319	1,933

Table 6

New York Spot Prices for Vanilla
and Madagascar Producer Prices
1973-1987

Actual	Madagascar Origin	Nominal Producer Price	Export Price	% Producer Price of Export Price
Year				
1973	660-680	220	3,079	32.9
1974	675-700	240	3,308	33.4
1975	785-810	240	3,457	31.9
1976	900-950	250	4,300	26.7
1977	900-950	280	5,109	25.2
1978	1,043	305	5,925	23.7
1979	2,800-3,000	500	7,126	32.3
1980	5,500-6,500	600	9,621	28.7
1981	3,150	700	11,018	29.2
1982	2,800	700	18,664	17.3
1983	3,000-3,100	1,000	21,849	22.3
1984		1,000	36,759	
1985		1,000	45,869	
1986		1,100	43,281	
1987		1,200		

Table 7

New York Spot Prices for Cloves and Madagascar Producer Prices

Year	Madagascar Origin	Nominal Producer Price	Actual Export Price	Producer Price as % of Export Price
1973	179	280	650.3	43.1
1974	260	320	790.6	40.5
1975	261	320	779.6	41.1
1976	295	320	977.8	32.7
1977	330	340	1,357.0	25.1
1978	325	340	1,166.0	29.2
1979	385	385	1,111.0	34.7
1980	440	395	1,510.0	36.2
1981	445	430	2,280.0	18.9
1982	530	435	2,790.0	15.6
1983	470	435	3,347.0	13.0
1984		435	4,950.0	
1985		435	2,860.0	
1986		525	2,000.0	
1987		600	2,140.0	

Table 8

New York Spot Prices for Pepper and
Madagascar Producer Prices
1973-1987

Year	New York Spot	Nominal Producer Price	Actual Export Price	Producer Price as % Export Price
1973	58.0	150	-	-
1974	82.2	175	-	-
1975	89.4	175	-	-
1976	88.1	180	-	-
1977	115.1	190	-	-
1978	106.6	190	497	38.2
1979	106.5	200	378	52.9
1980	89.7	225	362	62.2
1981	84.3	225	401	56.1
1982	71.6	230	480	47.9
1983	72.7	235	396	59.3
1984		255	807	
1985		300	1,319	
1986		liberalized	1,933	
1987		liberalized		

Table 9

New York Spot Prices for Coffee
and Madagascar Producer Prices
1981-1987

Year	Madagascar Origin	Nominal Prod. Price	Actual Exp. Price	Producer Price as % of Exp. Price
1981	-	250	-	-
1982	-	260	-	-
1983	-	280	979	-
1984	-	330	1,518	-
1985	-	395	1,526	-
1986	-	600	2,046	-
1987	-	800	-	-

Table 10

Madagascar: Nominal and Real Paddy Producer Prices, 1961-86

	Producer price paddy (FMG/kg)	Producer Prices (1) Nominal (1975=100)	Producer Prices (1) Real (1975=100)	Estimated Effective Producer Price (2) FMG/kg	Nominal (1975=100)	Real (1975=100)
1961	8.0	27	54			
1962	9.0	30	59			
1963	9.0	30	58			
1964	11.0	37	67			
1965	11.0	37	64			
1966	12.6	42	71			
1967	13.0	43	73			
1968	13.4	45	74			
1969	13.6	45	73			
1970	14.2	47	74			
1971	15.0	50	74			
1972	15.0	50	74			
1973	15.0	50	66			
1974	25.0	83	90			
1975	30.0	100	100			
1976	35.0	117	111			
1977	35.0	117	108			
1978	35.0	117	101			
1979	38.0	127	96			
1980	43.0	143	92			
1981	47.0	157	77			
1982	60.0	200	75			
1983	65.0	217	68	81	271	85
1984	75.0	250	71	90	300	86
1985	83.0	277	71	103	343	89
1986	100.0	334	73	215	716	159
1987	120.0					

Sources: Data provided by the Malagasy authorities; and staff estimates.

(1) Until 1983 the minimum producer price was the effective producer price. With the liberalization measures introduced in May 1983 the actual prices paid to producers exceeded the minimum producer price.
(2) Prices reportedly paid to producers in areas adjacent to Antananarivo.

Table 11

Distribution of Farmtypes
(October 1983)

	AREA IN HA		AREA CULTIVATED BY:		(in %)
CROP	TOTAL Planted	TOTAL in production	Small traditional farmers	Small and medium commercial farms	Plantations 1/
EXPORT CROPS					
Coffee	220,000 2/	210,000	85	10	5
Cloves	110,000	73,000	60	23	17
Vanilla	27,000 3/	22,000	80	20	negligable
Pepper	6,120 4/	5,500	90	3	7
Cocoa 5/	4,800	4,500	17	--	83
Sisal	19,000	N/A	2	--	98
Butter beans	7,500	7,500	100	--	--
FOOD CROPS					
Rice	1,200,000	1,200,000	75	25 6/	--
Cassava	350,000	350,000	98	1	1
Groundnuts	N/A	N/A	100	--	--
Maize	120,000	120,000	N/A	N/A	
TOTAL AGRICULTURE	3,000,000	2,900,000	83	2	

SOURCES: MPARA, various reports; World Bank mission estimates.

1) Including statefarms.
2) Excludes an area in Mahajanga (about 6,000 ha; also excludes arabica-coffee, produced on a small scale in the plateaux and Lac-Alaotra areas (estimated: 5,000 ha).
3) Assumes an unproductive period of 2-4 years and a productive period of 6-7 years. About 20% is in the phase of replanting.
4) Assumes a replanting period of 8-10 years of production, and 3-4 year unproductive period (the Stabilization Fund mentions 4,200 ha).
5) Small planters only recently started planting. Area is estimated, and will increase in future.
6) Area included in rice-schemes.

Table 12

Number of producers and farm size (1983)

Farm type	Coffee Cafe	Vanilla Vanille	Cloves Girofles	Pepper Poivre	Cocoa Cacao
Total area cultivated (ha)	220,000	27,000	110,000	6,120	4,800
1. small traditional	187,000	22,000	66,000	5,540	800
2. small commercial	22,000	5,000	25,000	180	-
3. plantation type	11,000	- 3/	19,000	400	4,000
Total number of producers	350,000	70,000	80,000	60,000	2,000
1. small traditional	345,000	65,000	70,000	59,500	2,000
2. small commercial	5,000	5,000 1/	8,000	500	-
3. plantation type	10-50	1 3/	2,000	1	N/A
Average farm size	0.63	0.38	1.38 2/	0.1	not applicable
1. small traditional	0.5	0.34	0.9	0.1	0.40
2. small commercial	4.5	1.0	3.1	0.4	-
3. plantation type	50-2000	12.0	9.5	400	500-2000
Average number of labor days employed (per ha) 4/					
1. small traditional	50	40	not appropriate	30	30
2. small commercial	80	300		60	80
3. plantation type	200	500		200	200

1/ Small commercial farmer defined as a producer growing vanilla in pure stand owning about 1000 plants. This average population is below standard.

2/ The definition of size is misleading because most small plantings are planted along slopes or farm borders and oftern widely spaced. On the average farmers own 50-60 trees.

3/ Only one big producer of about 10-15 ha.

4/ Rounded off estimated figures.

SOURCES: MPARA, OCGCP and various reports, synthesized by World Bank mission.

Table 13

Participation of women in agricultural activities 1/
(% of total labor)

	Planting	Maintenance ground cover	Maintenance crop	Harvesting	Post Harvestir activities
Coffee	30	30	---	50-100	65
Cloves	---	---	---	50	80
Vanilla		50	50	75 2/	N/A
Pepper	30	50	50	50	30
Cocoa	50-100	50-100	---	50-80.	50
Rice 3/	50	50-100	---	50	100

1/ Clearing, land preparation, plant holes, drainage are carried out 100% by men (these activities are not mentioned in the columns). On rare occasions women assist with underbrush cutting.

2/ Fertilization of flowers is done 100% by women.

3/ Rice in rizieres, tanety and tavy.

SOURCE: Bank mission estimates based on FAO study and local sources.

Table 14

Estimated State Control of Economic Activity
(per cent)

Sector	June 1975	1978
Banking	25	100
Insurance	15	100
Imports	20	60
Exports	-	78
Sea transport	14	14
Water and Energy	100	100
Internal trade	30	70
Industry	18	33
Total	13	61

SOURCE: De Gaudusson, J. du Bois, "Madagascar: Des entreprises publiques aux entreprises socialistes" in F. Constantin (ed), Les Entreprises Publiques en Afrique Noire, Vol. I, pp 197-285, Paris, Pedone, 1979.

Table 15

Pattern of Household Consumption in CPI

(in percent)

	Domestic unprocessed (1)	Processed, domestic content only (2)	Processed, domestic, & imported content (3)	Imported, finished products (4)	Total
Traditional households					
Food	47.35	10.79	1.67	0.54	60.35
Rice	(15.98)	(--)	(--)	(--)	(15.98)
Fruits and vegetables	(6.21)	(--)	(--)	(--)	(6.21)
Other	(25.16)	(10.79	(1.67)	(0.54)	(38.16)
Fuel and electricity	1.99	5.97	1.18	--	9.14
Domestic services	--	1.82	--	--	1.82
Maintenance, clothing, and medicine	--	9.06	3.66	2.13	14.85
Miscellaneous	--	10.16	2.71	0.97	13.84
Total	49.34	37.80	9.22	3.64	100.00
Modern households					
Food	12.67	21.93	5.57	4.99	45.16
Fruit and vegetables	4.43	--	--	--	4.43
Other	8.24	21.93	5.57	4.99	40.73
Fuel and electricity	0.11	3.79	2.18	--	6.08
Domestic services	--	11.26	--	--	11.26
Maintenance, clothing and medicine	--	8.08	2.21	7.70	17.99
Miscellaneous	0.56	6.58	7.59	4.78	19.51
Total	13.34	51.64	17.55	17.47	100.00

Source: Data provided by the Malagasy authorities.

(1) Domestic, unprocessed - All domestically produced goods and services which do not require extensive processing.
(2) Processed domestic content only - All locally manufactured products for which all raw materials are domestically produced.
(3) Processed, domestic and imported contents - All locally manufactured products for which raw materials are wholly or partly imported.
(4) Imported finished products - All goods which are imported in the form in which they are consumed, i.e., no local value added.

Table 16

Central Government Budgetary Position

(percent of GDP)

	1983 %	1984 %	1985 %	1986 %
Total budgetary rev.	11.5	12.3	12.6	11.7
Tax revenue	11.1	11.7	12.2	11.4
Taxes on inc. & prof.	2.2	2.7	2.1	2.2
Companies	1.0	1.3	1.0	0.8
Individual	1.0	1.2	1.0	1.2
Capital income	0.1	0.2	0.2	0.1
Other	.0	0.1	.0	.0
Taxes on property	0.1	0.1	0.1	0.1
Taxes-goods & serv.	4.1	3.9	3.6	3.6
Value added	1.9	1.8	1.7	1.6
Excises	1.2	1.2	1.1	1.1
Fisc. Monop. Prof	0.9	0.9	0.8	0.8
Other	0.1	0.1	0.1	0.1
Taxes on foreign trade	4.6	4.8	6.2	5.4
Import duties	3.5	3.7	4.4	3.8
Export duties	1.1	1.1	1.8	1.6
Other taxes	0.1	0.1	0.2	0.2
Non-tax revenue	0.4	0.6	0.3	0.3

Central Government Expenditure

	1983 %	1984 %	1985 %	1986 %
Total current exp.	11.9	12.6	12.6	11.5
Personnel exp.	7.2	7.2	7.0	6.5
Goods & Services	2.1	2.1	2.6	1.8
Interest-Gov't debt	1.2	1.9	1.8	1.8
External	1.0	1.6	1.4	1.4
Internal	0.3	0.3	0.3	0.4
Transfers	1.4	1.5	1.3	1.4
Total budgetary capital expenditures	4.0	4.1	4.2	3.8
Memo: non-budgetary capital expenditures	3.1	4.0	3.2	3.1

80

Table 17

Government Personnel Expenditure and Number of Civil Servants, 1981-86

	1981	1982	1983	1984	1985	1986 Proj.
Personnel expenditure						
Outlays in billions of Malagasy francs (1)	73.0	85.8	88.1	98.6	109.0	118.0
Of which: wages and salaries	(68.0)	(80.7)	(81.9)	(92.0)	(101.7)	(109.0)
Annual change in percent	14.1	17.5	2.6	11.9	10.6	8.3
As percent of current budgetary expenditure	65.1	67.3	61.6	57.1	55.5	56.6
As percent of total budgetary expenditure (2)	48.9	55.4	51.1	49.6	47.4	48.0
As percent of total government expenditure	30.7	35.9	33.0	31.8	33.6	33.5
As percent of GDP	9.2	8.6	7.2	7.0	7.2	6.4
Civil servants						
Total number at end-December	121,156	126,023	127,500	128,500	129,000	129,500
Annual change in percent	2.6	4.0	1.2	0.8	0.4	0.4

Sources: Data provided by the Malagasy authorities; and staff estimates.

(1) Excluding medical expenses.
(2) Consisting of current budgetary expenditure and locally financed capital outlays.

Table 18

Revenue and Expenditure of the Export Stabilization Fund (FNUP), 1981-86

(in billions of Malagasy francs)

	1981	1982	1983	1984	1985	Projections 1986
I. Revenue	15.2	26.4	36.3	61.8	49.3	54.0
II. Expenditure	18.0	6.1	13.0	16.6	14.2	15.2
Current expenditure	11.0	4.2	10.5	12.6	13.1	12.2
Operating expenditure(1)	(2.6)	(2.8)	(9.5)	(10.9)	(12.2)	(12.2)
Price stabilization	(8.4)	(1.4)	(1.0)	(1.7)	(0.9)	(0.0)
Capital expenditure (2)	7.0	1.9	2.5	4.0	1.1	3.0
III. Surplus or deficit (-) (= I - II) (3)	-2.8	20.3	23.3	45.2	35.1	38.8

Sources: Data provided by the Malagasy authorities; and staff estimates.

(1) Including transportation, storage, and marketing expenses, and overhead.
(2) Mostly construction of rural roads.
(3) Deficit was financed by the Treasury, and surpluses were used for financing other government operations, as consolidated in Table 6.

Table 19

Interest Rates Applied by the National Banks, 1985-86

(In percent per annum)

	1985	1986 (1)
Deposits		
Sight deposits	0.66- 4.45	0.79- 4.46
Time deposits		
Less than 6 months	4.00- 8.75	4.00- 9.00
6 to 12 months	8.00-12.00	8.00-12.00
1 to 2 years	13.50-14.00	13.50-14.00
2 to 3 years	13.50-16.00	13.50-16.00
Over 3 years	16.00-18.00	16.00-18.00
Certificates of deposit		
Less than 6 months	7.50	7.50
6 to 12 months	7.50- 8.50	7.50-10.50
1 to 2 years	8.50-11.00	8.50-11.00
2 to 3 years	9.50-11.50	9.50-11.50
3 to 4 years	10.50-12.50	10.50-12.50
4 to 5 years	12.50-13.00	12.50
Over 5 years	12.50-13.50	12.50
Loans		
Short-term loans		
F1	14.00-16.50	14.00-16.00
F2	13.00-18.00	12.00-17.50
F3	15.00-21.00	15.00-19.00
F4	16.00-21.00	15.00-19.00
F5	13.00-16.50	12.75-15.00
F6	15.00-22.00	15.00-22.00
F7	16.50-19.00	16.50-19.00
Medium-term rediscountable loans	14.00-19.00	13.00-20.00
Medium-term non rediscountable loans	18.00-20.00	18.00-20.00
Long-term loans	11.00-19.00	11.00-19.00

Source: Data provided by the Malagasy authorities.

(1) First six months.

Table 20

Exports, f.o.b. 1981-86
(Value in millions of SDRs, volume in thousand tons, and unit value in SDR per kg unless otherwise specified)

	1981	1982	1983	1984	1985	1986 (prel.
Coffee						
Value	94.74	84.90	105.97	137.64	101.40	123.18
Volume	56.90	53.90	50.50	53.80	44.70	50.00
Unit price	1.66	1.60	2.10	2.56	2.27	2.46
Cloves						
Value	55.31	60.80	15.46	35.69	34.70	29.96
Volume	7.70	9.40	2.00	6.30	11.50	11.14
Unit price	7.17	6.40	7.84	5.69	3.01	2.69
Vanilla						
Value	23.39	42.40	58.37	51.33	43.00	39.95
Volume	0.60	0.90	1.10	0.80	0.60	0.80
Unit price	36.83	47.80	53.11	62.07	68.47	49.95
Pepper						
Value	2.85	2.50	3.09	3.90	5.14	4.48
Volume	2.00	2.20	3.20	2.80	2.62	2.00
Unit price	1.40	1.20	0.96	1.39	1.96	2.24
Shellfish						
Value	14.25	19.10	22.22	21.31	21.75	28.81
Volume	3.30	4.00	3.60	3.80	4.26	5.20
Unit price	4.37	4.80	6.19	5.61	5.11	5.54
Sugar						
Value	7.60	3.10	11.39	5.48	9.35	5.57
Volume	12.20	10.70	32.30	17.40	32.80	10.50
Unit price	0.62	0.20	0.35	0.31	0.29	0.53
Meat						
Value	3.92	2.40	1.59	4.12	1.58	0.01
Volume	2.20	1.10	0.80	3.50	1.27	0.05
Unit price	1.81	2.20	2.03	1.18	1.24	0.22
Cocoa						
Value	2.16	2.10	3.05	4.42	2.90	3.12
Volume	1.80	1.40	2.30	2.50	1.60	2.10
Unit price	1.20	1.50	1.32	1.77	1.79	1.49
Cotton clothe						
Value	13.25	15.20	10.14	11.00	12.22	8.30
Volume	7.50	8.00	4.50	4.40	4.70	3.07
Unit price	1.76	1.90	2.24	2.47	2.61	2.70

Table 20 (Ctd.)

Exports, f.o.b. 1981-86
(Value in millions of SDRs, volume in thousand tons, and unit value in SDR per kg unless otherwise specified)

	1981	1982	1983	1984	1985	1986 (prel.
Sisal						
Value	5.32	5.70	3.74	4.39	2.76	3.00
Volume	13.40	15.40	10.60	12.00	7.44	10.60
Unit price	0.40	0.40	0.35	0.36	0.37	0.28
Petroleum products						
Value	12.71	9.80	9.25	--	4.66	3.17
Volume	143.12	65.40	57.10	--	32.95	27.96
Unit price	0.09	0.20	0.16	--	0.14	0.11
Chromite						
Value	4.78	3.60	2.66	4.07	4.74	5.04
Volume	80.80	63.70	59.40	92.40	103.18	104.00
Unit price	0.06	0.06	0.04	0.04	0.05	0.05
Graphite						
Value	7.66	7.10	5.50	6.04	7.19	7.85
Volume	16.30	14.90	11.70	14.50	16.13	16.00
Unit price	0.47	0.50	0.47	0.42	0.45	0.49
Essence of cloves						
Value	2.40	2.40	2.68	6.26	3.63	2.60
Volume	0.70	0.70	0.80	1.80	1.14	0.80
Unit price	3.46	3.70	3.39	3.51	3.23	3.24
Other items						
Value	17.30	19.90	19.79	23.93	19.46	21.16
Re-exports						
Value	14.00	15.40	14.80	5.60	--	--
Total	281.64	296.40	289.70	325.18	274.48	286.20

Sources: Data provided by the Malagasy authorities; and staff estimates.

Table 21

Composition of Imports, c.i.f., 1981-86

(In millions of SDRs)

	1981		1982		1983		1984		1985		1986	
	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent
quipment goods	161.6	31.3	105.8	21.1	84.2	20.6	94.2	23.8	98.4	25.5	99.6	26.8
ood	84.0	16.3	115.5	23.1	67.9	16.6	49.1	12.4	45.3	11.7	49.1	13.2
Of which: Rice	(57.6)	(11.2)	(95.1)	(19.0)	(50.5)	(12.3)	(28.7)	(7.2)	(29.9)	(7.7)	(34.2)	(9.2
onfood consumer goods	49.9	9.7	46.0	9.2	40.6	9.9	48.0	12.1	51.6	13.3	42.2	11.4
nergy	107.6	20.9	121.3	24.2	91.9	22.5	96.9	24.5	83.9	21.7	47.0	12.7
aw material and spare parts	94.3	18.3	97.8	19.6	102.5	25.0	107.6	27.2	107.3	27.8	133.5	35.9
ther (1)	18.3	3.5	13.9	2.8	22.2	5.4	—	—	—	—	—	—
Total imports, c.i.f.	515.8	100.0	500.3	100.0	409.3	100.0	395.8	100.0	386.5	100.0	371.4	100.0
emorandum items:												
Rice import volume (in thousands of tons)	192.5		351.0		185.1		111.4		106.5		171.6	
Imports, f.o.b. (in millions of SDRs)	433.2		409.0		353.8		343.5		330.7		312.0	

ources: Data provided by the Malagasy authorities; and staff estimates.

.) Beginning 1984 "other" imports are allocated to the principal import categories.

Table 22

Balance of payments, 1981-86

(in millions of SDRs)

	1981	1982	1983	1984	1985	1986 Proj.
Exports, f.o.b.	281.5	296.4	289.7	325.2	274.5	286.2
Imports, f.o.b.	-433.2	-409.0	-353.8	-343.5	-330.7	-312.0
Trade balance	-151.7	-112.6	-64.1	-18.3	-56.2	-25.8
Service receipts	55.6	49.7	45.0	56.9	62.0	74.3
Service payments	-267.9	-272.7	-268.0	-289.2	-296.0	-317.5
Freight	-66.2	-68.1	-49.6	-48.1	-46.1	-43.7
Transport and travel	-59.3	-55.7	-54.6	-61.8	-68.9	-64.5
Investment income	-78.3	-91.4	-106.6	-134.9	-131.2	-150.7
Other	-63.7	-57.5	-57.2	-44.4	-49.8	-58.6
Services, net	-211.9	-223.0	-223.0	-232.3	-234.0	-243.2
Of which: interest (including moratorium interest on rescheduled debt)	(-75.1)	(-88.2)	(-104.4)	(-133.2)	(-129.7)	(-149.3)
Private unrequited transfers	3.4	-1.3	-1.1	9.3	37.4	28.5
Current account	-360.2	-336.9	-288.2	-241.3	-252.8	-240.5
Public unrequited transfers	53.1	65.5	56.9	66.1	59.4	87.9
Nonmonetary capital (net)	237.7	109.9	184.1	179.5	162.3	181.6
Drawings	277.2	190.1	181.1	117.9	143.4	168.4
Amortization 1/	-93.2	-164.2	-183.1	-127.0	-147.0	-136.0
Debt relief (net of down payments)	53.7	84.0	186.1	164.9	151.7	164.7 2/
Official creditors	(50.3)	(82.1)	(125.1)	(141.1)	(137.9)	(164.7)
Commercial Banks 3/	(3.4)	(1.9)	(61.0)	(23.8)	(13.8)	(--)
Petroleum financing	...	...	...	23.7	14.2	-15.5
Drawing				(23.7)	(37.9)	(22.4)
Amortization				(—)	(-23.7)	(-37.9)
National Banks (net)	-18.1	-23.8	-0.3	-12.2	1.0	—
Other 4/	5.3	77.6	-41.7	23.6	22.3	—
Overall balance	-82.2	-107.7	-89.2	15.7	-7.8	29.0
Financing	82.2	107.7	89.2	-15.7	7.8	-29.0

Table 22 (cont.)

IMF (net)	31.6	51.7	6.5	17.9	-3.4	3.4
Purchases	39.0	52.4	10.2	41.4	29.0	44.2
Repurchases	-7.4	-0.7	-3.7	-23.5	-32.4	-40.8
Net cash change in arrears (decrease -) 5/	59.0	63.8	69.6	-9.0	-8.3	-8.0
Net central bank reserves (increase -) 5/	-8.4	-7.8	13.1	-24.6	19.5	-24.4
Financing gap	—	—	—	—	—	—
Memorandum items:						
Current account deficit as percent of GDP 6/	-14.6	-13.1	-10.9	-10.4	-11.0	-10.4
Outstanding arrears 5/	...	...	95.5	81.4	77.4	69.4
Freely available reserves	...	...	7.7	15.2	12.9	26.0
Debt service ratio before rescheduling 7/	45.9	72.9	87.0	75.6	93.4	95.5
Debt service ratio after rescheduling 8/	34.0	48.9	31.4	33.4	49.2	51.3
GDP	2,463.0	2,580.0	2,665.0	2,315.5	2,308.2	2,302.0
FMG/SDR exchange rate	320.4	386.1	459.9	590.8	672.6	798.6

Sources: Data provided by the Malagasy authorities; and staff estimates.

1/ Before current year's debt rescheduling.
2/ After debt relief obtained from Paris Club V (October 1986) and from other official creditors on comparable terms.
3/ Includes small amount of debt relief from private creditors other than commercial banks. In December 1985 commercial banks rephased amortization payments on previously rescheduled debt through 1992. The impact of this debt relief in 1986 has been taken into account by reducing scheduled amortization payments.
4/ Includes valuation of adjustment, short-term capital other than petroleum financing, errors and omissions, and SDR 3.5 million in SDR allocations in 1981.
5/ Series not comparable prior to 1983 since central bank foreign liabilities have been revalued at appropriate exchange rates only beginning mid-1983.
6/ The high current account/GDP ratio reflects, in part, the impact of the depreciation of the exchange rate of the Malagasy franc on GDP expressed in terms of SDRs.
7/ Includes impact of previous year's rescheduling, but excludes that of the current year.
8/ Includes impact of reschedulings through the current year.

Table 23

Outstanding Stock of External Debt, 1980-85 (1)
(in millions of SDRs)

	1980		1981		1982		1983		1984		1985	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
fficial Creditors	533.3	61.8	824.9	63.2	1,059.6	63.8	1,038.2	57.0	1,152.3	55.3	1,297.1	58.4
Paris Club (2)	(343.4)	(39.8)	(500.0)	(38.3)	(707.6)	(42.6)	(735.1)	(38.7)	(805.8)	(38.7)	(945.3)	(42.5)
Other Countries (3)	(189.9)	(22.0)	(324.9)	(24.9)	(352.0)	(21.2)	(348.2)	(18.3)	(346.5)	(16.6)	(351.8)	(15.8)
nternational Organizations	218.6	25.3	310.9	23.8	418.9	25.2	487.2	25.7	558.3	26.8	577.5	26.0
IMF	(42.9)	(5.0)	(74.8)	(5.7)	(126.5)	(7.6)	(133.1)	(7.0)	(151.0)	(7.2)	(147.0)	(6.6)
Other oganizations	(175.7)	(20.3)	(236.1)	(18.1)	(292.4)	(17.6)	(354.1)	(18.6)	(407.3)	(19.5)	(430.5)	(19.4)
anks	101.7	11.8	162.5	12.4	177.0	10.7	184.7	9.7	193.7	9.3	153.9	6.9
rivate nonguaranteed	9.0	1.0	7.5	0.6	6.6	0.4	7.2	0.4	21.2	1.0	32.0	1.4
hort-term (4)	—	—	—	—	—	—	41.6	2.2	78.9	3.7	85.2	3.8
rrears (5)	—	—	—	—	—	—	95.5	5.0	81.4	3.9	77.4	3.5
Total	862.6	100.0	1,305.8	100.0	1,662.1	100.0	1,854.4	100.0	2,085.8	100.0	2,223.1	100.0

ources: Data provided by the Malagasy authorities; and staff estimates.

1) After debt rescheduling from the Paris Club, from other official creditors , and from commercial banks.
2) Participating countries are Austria, Belgium, Canada, the Federal Republic of Germany, France, Israel, Italy, Japan, Spain, weden, Switzerland, the United Kingdom and the United States.
3) COMECON, China, and Arab countries; includes exceptional balance of payments financing.
4) Not available prior to 1984.
5) Prior to 1983, included in outstanding amounts of principal creditors.

Table 24

External Debt Service Payments, 1986-92

	Dec. 1985 outstanding	1986			1987			1988		
		Prin.	Int.	Total	Prin.	Int.	Total	Prin.	Int.	Total
Official creditors	1,297.1	13.3	49.3	62.6	16.5	65.1	81.6	115.0	114.0	229.0
Paris Club	(945.3)	(3.4)	(41.1)	(44.5)	(0.4)	(53.3)	(53.7)	(68.5)	(79.4)	(147.9)
Other	(351.8)	(9.9)	(8.2)	(18.1)	(16.1)	(11.8)	(27.9)	(46.5)	(34.6)	(81.1)
International Organizations	577.5	58.0	18.7	76.7	44.8	17.4	62.2	47.7	17.8	65.5
IMF	(147.0)	(45.2)	(13.0)	(58.2)	(32.2)	(11.0)	(43.2)	(34.1)	(10.3)	(44.4)
Other	(430.5)	(12.8)	95.7)	(18.5)	(12.6)	(6.4)	(19.0)	(13.6)	(7.5)	(21.1)
Banks	153.9	17.9	12.7	30.6	18.6	10.9	29.5	18.7	9.3	28.0
Other private	32.0	9.2	2.3	11.5	7.6	1.9	9.5	6.6	1.7	8.3
Short-term	85.2	7.6 2/	10.3	17.9	22.4 3/	6.0	28.4	27.0 3/	6.0	33.0
Arrears	77.4	8.0	—	8.0	8.0	—	8.0	18.0	—	18.0
Total	2,223.1	114.0	93.3	207.3	117.9	101.3	219.2	233.0	148.8	381.8

Table 24 (cont.)

	1989			1990			1991			1992		
	Prin.	Int.	Total	Prin.	Int.	Total	Prin.	Int.	Total	Prin.	Int.	Total
Official creditors	132.5	106.3	238.8	145.8	94.6	240.4	149.3	83.2	232.5	185.1	71.8	256.9
Paris Club	(80.6)	(75.3)	(155.9)	(89.4)	(67.6)	(157.0)	(103.4)	(60.4)	(163.8)	(123.4)	(52.9)	(176.3)
Other	(51.9)	(31.0)	(82.9)	(56.4)	(27.0)	(83.4)	(45.9)	(22.8)	(68.7)	(61.7)	(18.9)	(80.6)
International Organizations	57.2	17.8	75.0	54.5	17.4	71.9	40.7	17.6	58.3	26.3	16.2	42.5
IMF	(41.2)	(8.5)	(49.7)	(37.7)	(6.0)	(43.7)	(24.8)	(3.9)	(28.7)	(10.0)	(2.6)	(12.6)
Other	(16.0)	(9.3)	(25.3)	(16.8)	(11.4)	(28.2)	(15.9)	(13.7)	(29.6)	(16.3)	(13.6)	(29.9)
Banks	23.8	7.5	31.3	23.8	5.4	29.2	21.3	3.3	24.6	21.3	1.4	22.7
Other private	3.0	1.6	4.6	3.0	0.9	3.9	2.9	0.7	3.6	2.9	0.6	3.5
Short-term	—	6.0	6.0	—	6.0	6.0	—	6.0	6.0	—	6.0	6.0
Arrears	20.0	—	20.0	10.0	—	10.0	10.0	—	10.0	8.0	—	8.0
Total	236.5	139.2	375.7	237.1	124.3	365.4	224.2	110.8	335.0	243.6	96.0	339.6

Table 25

Summary Accounts of the Central Bank, 1981-86

(in billions of Malagasy francs; end of period)

	1981	1982	1983	1984	1985	1986 Sept.
Net foreign assets	-47.9	-118.2	-130.8	-193.5	-137.9	-140.4
Foreign assets	6.6	9.4	17.3	44.8	31.3	76.0
Foreign liabilities	54.5	127.6	148.1	238.3	169.2	216.4
IMF	(21.8)	(39.2)	(43.4)	(54.7)	(52.3)	(57.9)
Arrears	(34.0)	(46.3)	(77.0)	(152.3)	(91.6)	(104.2)
Other liabilities	(-1.3)	(42.1)	(27.7)	(31.3)	(25.3)	(54.3)
Total claims	233.9	275.3	340.8	389.9	408.0	412.1
Claims on Government (net)	223.8	257.0	305.7	345.1	370.7	382.3
Credit to Government	267.1	339.8	422.0	514.7	599.3	663.6
Ordinary advances	(220.9)	(291.0)	(381.7)	(476.7)	(558.9)	(622.7)
Rice marketing financing	(40.0)	(42.4)	(35.7)	(34.5)	(36.0)	(36.2)
On-lending	(2.5)	(2.7)	(2.7)	(1.7)	(1.0)	(0.8)
Other	(3.7)	93.7)	(1.9)	(1.8)	(3.5)	(4.0)
Government deposits	43.3	82.8	116.3	169.6	228.6	281.3
Claims on state enterprises	8.6	18.3	26.9	35.9	32.4	29.8
Claims on banks	1.5	--	8.2	8.9	4.8	--
Assets = liabilities, net	186.0	157.1	210.0	196.4	270.1	271.7
Reserve money	103.6	99.9	96.5	104.7	108.5	162.2
Currency outside banks	83.1	90.4	75.7	89.9	96.2	114.5
Currency in banks	1.7	2.1	2.0	2.5	2.1	2.7
Bank deposits	18.8	7.4	18.8	12.3	10.2	45.0
Long-term foreign liabilities	94.1	140.8	269.2	376.3	520.0	685.5
of which: rescheduling agreements	(49.9)	(87.5)	(193.1)	(301.4)	(471.4)	(654.8)
Other liabilities (net)	-11.7	-83.6	-155.7	-284.6	-358.5	-576.0
of which: valuation adjustments	(—)	(-55.1)	(-108.6)	(-200.7)	(-220.1)	(-390.4)

Source: Data provided by the Malagasy authorities.

Table 26

Summary Accounts of the National Banks, 1981-86

(in billions of Malagasy Francs; end of period)

	1981	1982	1983	1984	1985	1986 Sept.
Reserves	20.5	12.0	20.8	14.8	12.3	47.7
Cash	1.7	2.1	2.0	2.4	2.1	2.7
Deposits with Central Bank	18.8	9.9	18.8	12.3	10.2	45.0
Net foreign assets	-1.9	7.3	9.4	19.1	20.2	19.3
Foreign assets	13.2	16.6	17.7	29.3	29.8	31.9
Foreign liabilities	15.1	9.3	8.3	10.3	9.6	12.6
Claims on Government (net)	-0.5	-3.3	-15.9	-23.4	-28.1	-28.8
Credit to Government	17.0	16.8	9.0	9.4	9.8	10.4
Government deposits	17.5	20.1	24.9	32.8	37.9	39.2
Claims on private sector and state enterprises	166.2	201.8	232.9	295.4	355.3	414.2
Assets = liabilities (net)	184.3	217.8	247.2	305.9	359.7	452.4
Deposits	142.9	161.5	171.5	206.7	238.5	307.5
Demand deposits	110.4	117.3	121.2	149.7	142.3	167.3
Time deposits	32.5	44.2	50.3	57.0	96.2	140.2
Borrowing from Central Bank	1.5	--	8.2	8.9	4.8	--
Other liabilities (net)	39.9	56.3	67.5	90.3	116.4	144.9
Of which:						
Long-term domestic borrowing	(4.9)	(4.5)	(4.8)	(5.3)	(7.6)	(8.0)
Long-term foreign borrowing	(14.7)	(16.0)	(15.0)	(11.7)	(8.1)	(5.7)
Related data						
Customs duty bills (1)	3.9	4.5	2.7	2.7	4.6	4.4
Subtotal	13.6	13.7	13.9	14.0	14.1	11.9
Post office checking deposits	(3.9)	(4.0)	(4.3)	(4.3)	(...)	(4.6)
Private sector demand deposits with the Treasury	(9.7)	(9.7)	(9.7)	(9.7)	(...)	(7.3)
Private sector savings deposited with the National Saving Fund	5.3	5.5	5.5	5.2	4.6	5.3

Source: Data provided by the Malagasy authorities.

(1) Credit to the private sector from the Treasury in the form of customs receipts to be collected.

ANNEX B

OVERVIEW OF POLICY REFORM AND CONDITIONALITY IN MADAGASCAR

(MAELP)

Overview of Policy Reform and Conditionality

Economic Reforms

This Annex presents an overview of policy reform in Madagascar, beginning with a historical perspective and following on through the most recent reforms and proposed next steps. Also included is a discussion of the institutional constraints facing the reform effort, which is intended to give the reader a more complete picture of the context within which the reform are taking place. The section concludes with the presentation in matrix form of the GDRM's policy reform program as set forth in the Policy Framework Paper, as well as the policy conditionality found in the IMF and IBRD structural adjustment programs in Madagascar.

1. Historical Perspective

The following synopsis of Madagascar's political-economic history is presented to provide an understanding not only of the economic situation that led to the current movement for economic reform, but also of the social-economic and institutional context in which these reforms operate and which will determine their long term success.

Originally inhabited before the Christian era, Madagascar has been the recipient of successive waves of immigrants beginning with rice cultivators of Indonesian origin in the 5th - 7th centuries, who were followed by East African cattle-herding peoples in the following centuries and Arab traders in the 9th century. After the 16th century, European traders, pirates and missionaries arrived in Madagascar. At the beginning of the 19th century, contemporaneous with increasing Anglo-French political and commercial competition in the Indian Ocean, King Andrianampoinimerina of the High Plateau Merina group established a somewhat fragile but clear hegemony over many of the small but competing kingdoms that occupied nearly two thirds of the island. Besides his military conquest, the King's most enduring contribution was the establishment of an administrative hierarchy extending in theory from the "Fokonolona" (people recognized as descending from a common ancestor and occupying a recognized area of control called the "Fokontany") to the King, which in practice was used primarily as a means to exercise central control and to collect taxes. His successor Radama I in 1810 began a period of modernization by welcoming to the island European missionaries and traders who introduced modern education and technologies. A consequence of this policy was a reduction in the power of the traditional governing noble class and a rise in power of the higher commoner class, who on the basis of education and competency filled new roles in military and commerce.

Radama I was succeeded in 1828 by his wife Ranavalona who in collaboration with the traditional ruling class, instituted a traditionalist reaction that included persecution of Christians, expulsion of Europeans and the imposition of a royal monopoly on external trade. A feudal economy reemerged in which officials at all levels imposed taxes on the movement of goods. Queen Ranavalona's son who acceded to the throne in 1861 had been educated by missionaries, and in a reversal of traditionalist policies he reopened the island to outsiders and granted major economic concessions to Europeans in return for projected investments in the island's development. However, Radama II was strangled two years later by discontented members of the noble class.

Following the death of Radama II, de facto power was usurped by his Prime Minister, Rainilaiarivony, who ruled as the husband of the three succeeding queens. Rainilaiarivony attempted to follow a middle road of increasing trade with Europeans without threatening the position of the traditional ruling class. He also sought to counterbalance the increasing pressure of the Catholic French with their coastal base by favoring the English Protestant presence in the Highlands. This policy failed in the 1890's, after the English abandoned their claims in Madagascar in return for French recognition of British interests in Zanzibar, and when French pressures for further commercial concessions resulted in war and finally annexation of Madagascar to France in 1896.

The colonial period saw some efforts at infrastructural development (railroad, roads, health services), yet it also witnessed the alienation of land for plantations of export crops, the reintroduction of forced labor (some of it for work on the plantations), and the increasing domination of government and commerce by the French The French not only replaced the traditional Malagasy ruling class, but they also replaced the merchant class with Indians and Chinese, and continued to favor the coastal Catholic peoples over the Highlanders.

The first decade after independence in 1960 under the pro-French coastal leader Tsiranana, saw a continuation of the French role in government and the economy, as evidenced by large numbers of French technical advisors at the highest levels of the government, military, and the educational system. A liberal investment code encouraged foreign investment and stimulated an import-substitution based industrialization that led to an impressive rate of real growth of 3% per year over the decade. However, agricultural production did not keep pace, and by 1965 food imports were needed. Furthermore, the industrial sector relied heavily on imported inputs and did little to stimulate growth in other sectors of the economy. A 1972 revolt by southern pastoralists was violently suppressed, but trigerred widespread strikes in Antananarivo by students disgruntled over the failure of the government to Malgachisize and expand the educational system (which remained dominated by French teachers - 200 of 250 at the university level, and which had not grown rapidly enough to satisfy student demand), and workers calling for social and political change. These strikes culminated in the downfall of the president.

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The new government headed by a military coalition that came to power in 1972 aimed to rid the country of its foreign control. It left the franc zone in 1973 and inaugurated a new investment code that prescribed an active role for the state in the economy. The new government nationalized many private commercial, industrial and agricultural enterprises and imposed strict controls over new investments. It established close ties with Eastern bloc nations, and replaced French technical advisors. However, dissatisfaction mounted over the slow progress made in realizing the objectives of the 1972 revolution, and following a coup attempt in 1975 President Ramanantsoa resigned. His successor was assassinated by an unknown assailant just six days after coming into office.

Following a brief period of rule by a military council, the foreign minister Didier Ratsiraka came to power and further extended the socialist policies introduced in 1972. The December 1975 Charter of the Malagasy Socialist Revolution, of which he was the primary author, espoused state control over the economy in order to consolidate national independence and to ensure an equitable economic and social development. This state control was translated into monopolies in many key economic sectors - rice collection and marketing, banking, energy, insurance, imports and exports - and the expansion of public enterprises. Decentralization of government to the fokontany structure originally introduced by King Andrianampoinimerina 175 years earlier was reintroduced, and free education and free health care were decreed.

Following several frustration years of low growth, the Government in 1978-80 launched an all-out effort to rapidly industrialize and diversify the economy. This program relied heavily on external commercial borrowing. Unfortunately, many of the projects begun at this time were insufficiently studied, undercapitalized, poorly managed, and burdened with heavy financing charges due to high interest rates, and proved to be financially and economically unviable. Instead of contributing to gross domestic product and exports, they became a heavy drain on the state for debt servicing and operating losses.

As the decade of the 1980's opened, the Government of Madagascar found itself in an untenable position. The economy was in serious disequilibrium as a result of the 1978-80 investment program's debts, a sharp deterioration in the terms of trade, and an overvalued exchange rate. The central government budget deficit, which had averaged 2.5% of GDP between 1970 and 1978, reached 18 percent of GDP in 1980. Of this, approximately half was financed through the domestic banking system. As a result, inflation (measured by the urban consumer price index for traditional households) reached 30 percent in 1980. The balance of payments deteriorated sharply while the debt service ratio rose from 4% in 1977 to 30% in 1981. An overvalued exchange rate and low producer prices from marketing parastatals discouraged exports, while a neglected agricultural sector was unable to meet the food needs of a growing population. The standard of living of much of the population had deteriorated. It was under these circumstances that Madagascar turned to the International Monetary Fund(IMF) and the other multilateral institutions for assistance.

2. Reforms to Date

Beginning in 1982, the GDRM began to take strong and effective measures to restore equilibrium in its fiscal and external accounts. Following the cancellation of its first Standby Agreement with the IMF in 1981, the Government entered into and has successfully complied with the conditions of five successive Standby Agreements. In addition, a series of sectoral reform programs have been initiated with the support of the World Bank. The primary objective of these programs has been to restore financial stability and, subsequently, to adopt structural policies which would set the stage for a revival of economic growth by rehabilitating economic infrastructure, improving price incentives, and restoring international competitiveness. The major areas of reform are discussed separately in the following paragraphs.

Public Finance - The success that has been realized in stabilizing public finances is illustrated by the table below which shows trends in key indicators from 1981-87. That these gains were made during a period in which the burden of external debt servicing was rising and parastatal operating losses were accumulating is all the more remarkable.

Percent of GDP	1981	1983	1985	1987	1988 Proj.
Gov't Current Expenditures	17.1	13.1	13.6	13.3	13.2
Gov't Cash Deficit	15.0	6.7	4.7	4.4	3.1 *
(Domestic Bank Financing)	7.4	3.0	1.3	-0.5	-0.6

* For comparative purposes the US Gov't cash deficit was estimated at 3.5% of GDP in 1987.

Money and Credit - Improvements in the functioning of the monetary system were introduced in 1986 when controls over the structure of interest rates were relaxed and when limits were imposed on new credit to financially troubled public enterprises. As a result of these measures, and a reduction of the inflation rate, most lending and borrowing real interest rates turned positive and the volume of credit available to the economy increased.

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<u>Prices</u> - In 1982, the Government began the process of dismantling the comprehensive system of price controls at each stage of the production and marketing process that had been introduced in the late 1970's. The first step in 1982 was to streamline the procedure by which price controls could be adjusted. By the end of 1987, ex-factory price controls were eliminated for all but 5 manufactured products which accounted for about 4 percent of value added in manufacturing. Controls on retailing margins have been liberalized more slowly. However, margin controls on all but 16 products were removed in April of 1987, and the Government is committed under the terms of the Industry and Trade Credit Adjustment Program (French acronym CASPIC) with the World Bank to eliminate controls on eight of the remaining products in early 1988. Inflation (as measured by low income consumer price index for Antananarivo) was reduced from 30.5 percent per annum in 1981 to 10.5 percent in 1985 before rising again in 1987 to 15 percent as a result of price liberalization and exchange rate adjustments.

<u>External Policies</u> - Madagascar's balance of payments has been under considerable pressure throughout the 1980's. In an effort to improve external balances, measures have been taken to adjust the exchange rate, to improve the allocation of foreign exchange, and to stimulate exports.

Although adjustments in the nominal exchange rate began as early as mid-1980, the initial adjustments failed to offset accelerating inflationary pressures. In April 1982, the Malagasy franc peg to the French franc was replaced by a peg to a basket of currencies reflecting actual trade patterns, and in 1984 quarterly adjustments were initiated in line with changes in the consumer price index; the cumulative adjustments from May 1982 to end 1986 totalled 62.5 percent in foreign currency terms against this currency basket. A substantial devaluation in June 1987 (57% in FMG terms) resulted in a real effective exchange rate of 60 percent of its 1978 value.

In addition to adjusting the exchange rate, the Government has also taken deliberate steps to move to a system where foreign exchange is freely available rather than administratively allocated. An export retention scheme introduced in 1983 allowed exporters to retain a portion of their foreign exchange earnings abroad to permit them to import needed inputs and consumer goods more easily. This scheme was broadened in 1985, when a modest liberalization of a small group of imports was also introduced. At the beginning of 1987, a "liberalized import regime" (LIR) was instituted for the importation of raw materials, spare parts and consumer goods, excluding those financed by donors. The LIR was designed to eliminate the discretionary aspect in the allocation of import licenses and foreign exchange authorizations. Under this system, an importer applied for a fixed amount of foreign exchange and paid a non-refundable deposit equal to ten percent of the total requested. The total amount of foreign exchange available was then divided by the total value of applications, and each applicant received the resulting percentage of the original request. The LIR was extensively modified in July 1987 to reduce the deposit to 5% and to increase the total amount of foreign exchange made available under the system each month, as well as to add capital goods and to unify allocations for all types of imports.

Despite the improvements in efficiency and transparency that the LIR represented, the uncertainties associated with the allocations, the need to accumulate foreign exchange over several months to finance bulk imports, and administrative delays in granting import licenses have made it a less than optimal mechanism, and the Government of Madagascar decided in December of 1987 to move forward the timetable for introducing an Open General License system (OGL). Under the OGL, importers have essentially unlimited access to foreign exchange at the prevailing exchange rate, and the procedures for obtaining it have been greatly simplified. Commercial banks handle all administrative formalities and import licenses are no longer needed. The Government is committed to adjusting the exchange rate if foreign exchange reserves fall below a predetermined target level. The OGL will be introduced in phases: in February 1988 imports of raw materials and spare parts will be put under the OGL; in May of 1988 equipment goods will be added; and on July 1 the OGL will be extended to all other imports. Until July 1988 the LIR will continue to operate for those goods outside the OGL.

The depreciation of the exchange rate was a significant measure to improve the competitiveness of Madagascar's exports. Other measures to stimulate exports have included: 1) the easing of administrative procedures, including easier access to exporters cards, the elimination of minimum export values, and the abolition of the system of trial periods for new exporters, all taken in 1987; 2) the extension of the maximum time limit within which foreign exchange earnings have to be repatriated from 30 to 90 days; 3) increases in official producer prices for the traditional export crops (coffee prices were increased by 52% in 1986 and again by 33% in 1987, and prices for vanilla and pepper were also increased); and 4) the elimination of government monopolies on the export of the traditional crops of pepper and cloves, which was announced on February 18, 1988. In addition, the government has removed export taxes on all but the four traditional export crops.

<u>Agriculture</u> - Although some progress has been made in reform of export crop production and marketing, as well as in the rehabilitation and maintenance of irrigation infrastructure, by far the most far-reaching and controversial of the reform measures taken to date has been the liberalization of the commercialization of rice. Reform began in 1982 with an increase of 82% in official retail rice prices which eliminated an explicit consumer subsidy and improved producer price . In 1983, the Government ended the monopoly on rice marketing in all but two

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geographic areas which accounted for 25 percent of marketed rice production. In the same year, it placed quantity restrictions on rice imports. In June 1985 the legally established ceiling price for rice was abolished. As a result of these measures, regional price differentials fell substantially, many new traders entered the rice market, state trading companies broadened their participation in wholesale trade, rice millers created new distribution networks, and many small private mills came into operation (90 in 1985 as compared with 11 in 1983).

However, the initial production response to these measures was disappointing. Consequently, as part of its 1986 Agricultural Sector Adjustment Operation (French acronym CASA) with the World Bank, the Government agreed to more far-reaching measures. In April 1986, the two remaining regional monopsonies were eliminated. The Government sharply curtailed below-market price official distributions and announced their elimination altogether in April 1987. To prevent unacceptably high price rises during annual periods of shortage, the Government with donor assistance established a "buffer stock" whose operation would be governed by a retail level trigger price. Higher rice prices led producers to expand the area planted and to greatly increase utilization of modern inputs, which together with good weather conditions resulted in an exceptional harvest in 1987.

The buffer stock succeeded in holding consumer prices within the agreed range in 1986-87. However, retail and farmgate prices fell dramatically in 1987 when the exceptional harvest came in on top of large holdover stocks from high imports in 1986 (the GDRM exceeded the limit on rice imports originally agreed with the World Bank for 1986). As rice storage costs mounted and imported stocks deteriorated, the donors proposed to the GDRM's Director of Food Security a swap arrangement in which paddy would be exchanged for the donated rice, which in turn would be sold in outlying regional markets at auction so as not to disrupt the normal functioning of the market. The paddy would consitute the buffer stock when the stock reopened. As the donors waited for a government response to this proposal, sacks of donated rice began to appear in the Antananarivo and Tamatave markets priced at FMG 360/kilo, below the prevailing market price of FMG 420-460 and substantially below the FMG 460/kilo price at which the buffer stock in those two cities was to operate. Signs indicated that this rice was "buffer stock" rice.

Members of the government gave donors contradictory explanations of what was happening. The President himself announced on two occasions that the buffer stock was open, and that he would not allow rice prices to rise above FMG 370/kilo. A spokesman from the Ministry of Agriculture reported that the buffer stock had not yet opened, and that the GDRM planned to keep to the previous agreement with donors on the operation of the buffer stock. What was clear, however, was that donated rice was being sold in late 1987 and in early 1988 at below market prices in various places both by parastatal trading companies and by a new private operator on the scene - PROCOOPS, a commercial organization associated with the ruling AREMA political party. PROCOOPS began its involvement with rice with the sale of a large shipment of rice donated by North Korea, and used the profits from this sale to purchase domestic rice and sell it on local markets for FMG 360 per kg. PROCOOPS' non-market driven operations threaten to seriously damage the private sector distribution system which has developed since 1983, and to depress farm-gate prices, thereby undermining farmer incentives to increase production.

A World Bank mission concluded in February 1988 that the GDRM had not, strictly speaking, violated the letter of its agreement on rice, although it had clearly violated its spirit. In discussions in Washington in mid-March, a new agreement was worked out between the World Bank and the Minister for Agriculture, which in effect salvages the rice reform program while taking account of the fact that in a pre-election year it will not be possible to prevent political parties from distributing free or cheap rice to supporters, no matter how adverse the effects on producers or the marketing system. Under this agreement, official 1988 imports will not exceed 60,000 MT; official stocks will be held until the next "soudure"(hungry period) when they will be sold to traders at weekly auctions in Tamatave at a minimum price of FMG 400/kg, in order to support a producer price of FMG 180/kg; and the GDRM has undertaken to ensure that private rice donations will not perturb the market and that the freedom of commercial operators will be maintained. This agreement allowed for the sale to peripheral markets on an exceptional basis of some 6,000 MT of donor rice (including the remainder of Food for Progress stocks) which would otherwise deteriorate.

This experience with rice reconfirms the fact that the availability and price of rice is the most politically sensitive issue in Madagascar, and that political imperatives can easily overtake economic objectives, especially in a pre-election year. It also serves as a reminder that the road to reform is seldom smooth, and that setbacks are to be expected. What is important is that overall forward progress be maintained, which means that donors should adopt a flexible approach that permits the Government of Madagascar to adjust the timing of reforms to political and social, as well as to economic, realities.

<u>Transport</u> - With its rugged topography and long distances both between principal cities and between agricultural areas and urban centers, Madagascar suffers from certain inherent transport difficulties which have been compounded in the past by extensive and ill-conceived government intervention. The national government has intervened extensively in transport by restricting routes, controlling entry, setting tariffs, and imposing selective controls on commodity movements. In addition, local authorities could and did tax road transport and impose both ad hoc and systematic restrictions on collection and interregional movement of commodities.

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The Government has now deregulated the road transport industry by liberalizing tariffs and eliminating restrictions on transport sector entry. A priority program for rehabilitating 10,000 km of roads has been undertaken and rehabilitation programs for the national airlines, the railway, and ports have been initiated.

Public Enterprises - The first steps to address the substantial problems of the public enterprises have been the rehabilitation of utilities (water supply and electricity, rail transport, airlines) and of certain productive enterprises in subsectors where Madagascar has actual or potential comparative advantage (cotton production and processing, sugar). In addition, a program to restructure 16 public enterprises which represent a substantial drain on the banking sector is underway and diagnostic studies of still others have been initiated. A.I.D. has provided the assistance of Coopers and Lybrand under the MARS project (687-0101) to identify the most promising candidates for divestiture among the parastatals in the agricultural sector, and to prepare divestiture plans for these firms. The Government has increased prices and service charges to reflect the devaluation of the currency.

3. Next Steps

This review shows that since 1982 the Government of Madagascar has moved forward rapidly with a wide-ranging program of reforms. What have these efforts achieved? The Policy Framework Paper(IBRD/GDRM, 1987, p.5) summarizes the situation well:

> Overall, the economy has been successfully stabilized and domestic and external imbalances have been reduced to manageable proportions. Nevertheless, after a cumulative decline in GDP of 11.3 percent in 1981 and 1982, growth has averaged only 1.6 percent per year since 1983. Real GDP per capita is now estimated at 20 percent below the level of 1980. Largely because of the heavy debt service burden and the stagnation of exports, import volumes have been severely constrained since 1980. Yields in agriculture are still well below potential, while industrial production remains 40 percent below levels reached at the end of the 1970's. Road and maritime transport bottlenecks persist, and most of the parastatal sector still faces numerous difficulties. Commercial bank portfolios contain a large amount of doubtful loans to public enterprises, compromising the financial sector's ability to meet the credit needs of the economy.

In short, despite seven years of bitter medicine, the patient has yet to get back on his feet. The most important constraints that impede realization of the country's productive potential are a vastly inadequate infrastructure, lack of credit, governmental overregulation, a high population growth rate, accelerated environmental degradation, and a deterioration in social services. Much more needs to be done to move the economy to the point where real growth can be sustained. Concerns have grown over the short term negative impact of structural adjustment measures on the less advantaged segments of the population, resulting in a call for special programs to meet their needs. The difficulties of proceeding with reforms that are often not well understood and that produce no immediate benefits become even larger as the national elections scheduled for 1989 approach. These difficulties are well illustrated by recent events in the rice sector.

Despite the inherent political difficulties of continuing with reforms, the Government of Madagascar has made it clear that it not only intends to proceed with the comprehensive program of reforms agreed to in the Policy Framework Paper (PFP) (see the matrix at the end of this Annex for a summary), but will accelerate the implementation of several key measures in 1988. Some planned measures will, in fact, go beyond the steps agreed to in the PFP. The next steps to be taken by the Government of Madagascar in 1988 and 1989, which follow a logical progression in the effort to put the country on the path of sustainable growth, are summarized below. These measures are the result of a careful analysis of the remaining constraints to growth, and will be undertaken with the assistance of the IMF and the IBRD as well as the bilateral donors.

<u>External Policies</u> - 1988 will be a year marked by major efforts to liberalize external trade and to stimulate export production. As previously discussed, the Open General License system will be introduced on an accelerated schedule with full implementation planned for July 1988. Initial experience with the OGL has been one of low demand for foreign exchange. This appears to reflect the transition from a system where exchange was applied for in advance of needs, to one in which foreign exchange is applied for only when needed since receipt of the full amount is assured and since full payment in local currency must be made at the time of application. Also, a large percentage of foreign exchange obtained under the LIR in 1987 is still unused. Thus, it is difficult for the Central Bank to anticipate actual demand for foreign exchange under the OGL, and concerns remain that a large sudden demand will push reserves below the target and force a large devaluation. The Central Bank is therefore increasing reserves, tightly controlling credit, and encouraging donors to disburse the balance of payments assistance promised at the January 1988 Consultative Group, which to date has been slow in coming. The GDRM remains committed to an active exchange rate policy, adjusting the rate as needed to maintain an appropriate level of foreign exchange reserves so as to assure the smooth functioning of the OGL system.

Liberalization of the export sector has also been accelerated. In mid-February 1988, the Government ended the state trading company monopoly on exports of pepper and cloves, and freed internal trade and prices in these products, leaving only coffee and vanilla subject to management by the Stabilization Funds. Taxes on pepper will be eliminated, although a flat tax on cloves will continue to be collected. Pending the planned April completion of a study commissioned by the World Bank, coffee exports will continue to be carried out by the state trading company. Under the terms of structural adjustment agreements, recommended changes in the marketing arrangement for coffee are to be made prior to the 1988/89 coffee season which beginns in May, while the producer price for coffee will again be raised substantially to bridge the gap that remains between producer price and f.o.b. export price. Coffee is the crop that holds the greatest potential for increasing export earnings in the short run, although non-traditional exports such as fruit and seafood also show promise.

Other steps will further lighten administrative export procedures. The Government will abolish requirements for cards, licenses, and prior authorizations for internal trade (collection, processing and storage) and export of all of the major export crops and will extend the maximum period for repatriation of foreign exchange earnings from 30 to 90 days. Full implementation of these measures at the local level is dependent on the outcome of the review now underway of the conclusions of a study on alternative sources of revenue for local governments, which until now have been heavily dependent on revenues from taxes on crop collection and commodity movement. Also, in 1988 the Government will publish an exporters' guide to support the export sector, and will activate plans for free trade zones to stimulate investment.

The success of these measures in achieving a viable balance of payments position will be dependent on favorable movement in the terms of trade (in particular a reversal of the sharp deterioration in coffee prices of 1987), and imaginative solutions to the debt problem. While Madagascar will continue to depend on exceptional sources of financing in the medium term to cover balance of payments deficits, if vigorously implemented, these trade promotion measures could prove to be a turning point in the country's economic performance.

Agricultural Production - As noted in the background section to this paper, Madagascar has enormous potential for agricultural production. Why then, has food production not kept pace with need and has production of the major export crops stagnated at levels below those reached in the 1970's? The answers are complex, and no doubt vary from crop to crop, yet a whole range of constraints can be identified: macroeconomic and sectoral constraints (shortage of foreign exchange, resulting in a shortage of inputs, vehicles, equipment and spare parts; deteriorating and inadequate infrastructure, including the transport network, storage and marketing facilities); external market constraints (slow growth or stagnating demand for some export crops such as coffee; strong and increasing competition from other producing countries for coffee and cloves, and from

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artificial substitutes for vanilla; inadequate skills to promote exportable crops in new markets); production constraints (low standards of on-farm technology in traditional agriculture, leading to generally low yields and deteriorating product quality; lack of incentive pricing, input supplies, and wage goods with associated lack of maintenance and investment; inadequate support from research and extension services); and marketing and processing constraints (inefficient collection operations and distorted pricing, weaknesses in public sector marketing and processing organizations; unproductive administrative controls on marketing). To these constraints are added those related to the governmental agencies that have responsibilities for production, pricing, and marketing of agricultural produce. A particular problem in the past on the export crop side has been the unofficial "reservation" of lucrative non-traditional export crop markets for such products as butter beans and lichees to only a few firms or individuals through discrimination in the issuance of export licenses.

The GDRM has already taken significant action to reverse the situation, particularly with respect to rice pricing and internal marketing. Major new actions are planned for 1988 and 1989 to remove pricing and marketing constraints on the agricultural export crop side, as discussed above. In addition to these needed policy and procedural changes, the Government will also initiate a number of major new projects intended to address production constraints. A national research plan is now being finalized which will assign priorities to overall research needs; a World Bank project will fill any significant gap in financing this research plan. Likewise on the extension side, a major new project will be funded by the World Bank to revitalize and redirect extension services. The rehabilitation of productive infrastructure will continue, including major work on irrigation infrastructure funded by a number of donors (FED, FAC, IBRD, Germans). Perhaps most importantly, a $200 million program to rehabilitate the road network focussed on agricultural areas and farm to market links will be inaugurated in 1988, while a French project to rehabilitate roads in the coffee producing area will be continued.

These efforts should bear fruit in the near to medium term. On the export crop side, the likely first response to proposed liberalization will be an improvement in the maintenance of existing investments (coffee, cloves and vanilla are all perennial crops whose production is very much a function of care). A renewed attention to export crop production will offer increased opportunities for employment for women, who have traditionally been employed for such tasks as pollination of vanilla plants, weeding, and harvesting. Coffee exports have some room for expansion since levels in past years have been below the agreed quota. Increases in exports of vanilla and cloves will require a much more aggressive marketing strategy and/or the development of processed products which might find new market opportunities. Export prospects for other non-traditional products such as seafood, peppers and some fruits are deemed to be very promising.

Financial Sector - Plans for 1988 include the opening in April of the financial sector to Malagasy private sector and foreign financial institutions, which will be able to operate independently or in participation with the three existing state-controlled banks. Needed revisions in the legislation to support this reform will be made. Central Bank supervision of banks will be strengthened, while banking system credit to high risk public enterprises was ended beginning in January 1988. These measures should improve the availability of credit to the private sector, which remains a critical constraint on economic activity at all levels in Madagascar. Monetary policy will aim to control inflation and ensure that deposit and lending rates remain positive.

Public Finance/Fiscal Policies - The GDRM will continue efforts to improve the efficiency of public sector resource use and to reduce the government budget deficit, both by controlling expenditures and by increasing tax revenues. If foreign assistance exceeds expectations, the Government will correspondingly reduce its indebtedness to the banking system, thus increasing the availability of banking system resources to the rest of the economy.

Expenditure control will focus on the categories of personnel, transfers and subsidies to cover the losses of public enterprises (these will appear in a transparent manner in the government budget), and capital spending. The GDRM will take strong action to address the problems of the public enterprise sector: it will select 5 enterprises for liquidation in early 1988, and by the end of June will reach agreement with the World Bank on those enterprises which will remain under state control, be partially or totally privatized, or be liquidated following a classification of all enterprises according to their viability. A timetable for actions will also be established.

In January 1988 a comprehensive tariff reform took effect. It significantly reduced the number of rates and established a maximum rate of 80 percent and minimum rate of 10 percent (although certain essential imports and all imports under the Investment Code will be subject to a 5 percent tariff rate). These revisions should support the efficiency gains resulting from the liberalized import regime. Efforts to improve the tax structure will also focus on broadening the base of the turnover tax(TUT) and the income tax, shortening the time lag between assessment and collection, and increasing the penalty rate for late payment in FY 1988.

Public budgetting reform will be extended in several important ways. First, program budgetting, which has been introduced in the Ministry of Agriculture and the Ministry of Public Works, will be extended to several new ministries to improve the formulation of expenditure priorities and to ensure that investment programs and recurrent expenditures are adequately funded. Second, work will

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begin on the integration of all revenues and expenditures into a consolidated budget which is expected to be introduced in 1989. (Currently, most donor assistance, the revenues of the Stabilization Funds, and many expenditures which account for a sizeable proportion of total revenues and expenditures, remain off-budget.) Third, a new regulation in 1988 will make the Public Investment Program (PIP) preparation cycle mandatory for all public administrations, thereby enforcing economic and financial selection criteria for the inclusion of projects in the program. To support public expenditure reforms, the Treasury will adopt a new more transparent public accounting system in 1988. This system will strengthen expenditure control and integrate extrabudgetary resources and expenditures into the accounts.

Population Policy - In January 1988, a detailed plan and timetable for the development of a national population policy was drawn up and approved under the leadership of the Population and Development Unit (PDU) in the General Planning Directorate. Activities are well underway and are expected to result in the presentation of a policy to the National Popular Assembly in the spring of 1989 for adoption in July of 1989. Meanwhile, in May 1988 during the upcoming session of the National Assembly the Parliamentary Group on Population and Development is expected to propose the repeal of a 1920 law prohibiting the sale and advertisement of contraceptives. Finally, plans are underway to expand the provision of family planning services in health clinics throughout Madagascar, for which NGO and donor assistance has been requested.

Environmental Policy - In December of 1987 a major effort was initiated to develop an Environmental Action Plan for Madagascar. With the support and participation of several bilateral donors and leadership by the World Bank, eight Malagasy working groups and their technical advisors are now drafting the Plan which should be ready for discussion at a national conference to be held in November of 1988. Pilot projects and studies in support of the plan will begin in mid-1988, and donor support will be sought to implement Plan recommendations.

Social Programs - The Government of Madagascar has become increasingly concerned about the impact of structural adjustment policies upon the poor, especially since several years of attempts to restructure the economy have thus far seen a deterioration in living standards, increases in infant mortality and malnutrition, and a growing number of abandoned children and homeless. The Government has attempted to lessen the impact of declining living standards by distributing inexpensive rice, and by maintaining the share of aggregate public expenditures on health at a reasonable level. The Government has also approached donors for assistance in the areas of low cost housing, essential drug supply, malarial eradication programs, and targeted feeding programs.

A UNICEF consultant is now working with the GDRM to develop targeted feeding programs, and the Swiss have promised assistance with the anti-malaria campaign. These measures and others will be included under the proposed program designed by the World Bank - PASAGE (Economic Management and Social Action Support Project) which will address several priority needs. PASAGE will become effective in US FY 1989 pending receipt of other donor support. This program will include a component intended to monitor closely the impact of adjustment measures on the population. The World Bank is also preparing major projects to support the health and education sectors which will begin in 1990.

Summary - The program of reform envisioned is ambitious. While it is necessary to move forward with new reforms, it is perhaps more important to consolidate the measures already announced or made in the past. It has become evident that translating the adoption of specific measures into meaningful structural changes calls for sustained implementation, which extends down from the center to local administrations, as well as to a deepening of policy at the sectoral level. The persistence of roadblocks and local interference in agricultural marketing is only one example of an inconsistency between announced reforms at the national level and actual results at the local level. As many commentators on Madagascar have noted, commitment to the reform program remains weak. For the spirit as well as the letter of the reforms to be adopted, an educational effort starting at the highest level of government is needed. Finally, the implementation of reforms must pay careful heed to political realities and to mitigating the possible adverse impacts on economically disadvantaged groups.

4. Institutional Constraints

The major question concerning the reform program in Madagascar is whether the present trend towards economic liberalization represents a real change in direction, or is only an opportunistic or forced response to the immediate economic crisis and donor demands. It is certainly true that there is a widespread perception that the reforms have been imposed by the IMF and the World Bank in return for much needed financial assistance. It is also true that understanding of the measures and popular support for them are notably lacking. During an assessment of the reform program conducted in June of 1987, an American economist Elliot Berg noted that he found little intellectual support for the free market idea outside the U.S. Embassy and the World Bank office ("Report on the Economic Reform Program in Madagascar", 1987). This raises the equally serious question as to what the outcome of the liberalization policies will be, regardless of government intentions, in the face of an uncommitted majority and well positioned groups that stand to lose from the changes that are occuring. Although there are many groups and institutions whose cross-cutting and changing interests enter into the equation, the answer to these questions is likely to depend on the response of the following three sets of socio-institutional structures: family/clan, regional, and government institutions.

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a. Family ("Fianakaviana"), Clan ("Foko") and Community ("Fokonolona").

Malagasy political organization officially begins at the level of the "Fokontany" (village) and moves up to the "Firaisana" (sub-district), the "Fivondronana" (region), and the "Faritany" (province) to the National Assembly and the President. This structure, developed by the King Andrianampoinimerina 175 years ago, grouped together a clan recognizing descent from a known ancestor into a geographic community called "Fokonolona". In offical political and ideological thinking the "Fokonolona" remains an idealized basis for building a united country. However, there is a critical contradiction between the political ideal and practical reality. With the geographical dispersal and intermixing of peoples, the offical community "Fokontany" no longer encompasses the "Fokonolona" or the extended family and it is in fact to the family that the Malagasy owe primary loyalty (known as "fihavanana"). This loyalty extends to the members of the clan or lineage that recognize common descent from a known ancestor. The importance of this family grouping explains in large part the extreme importance placed on ancestor worship and family tombs that exists today in Malagasy society.

The result is that behind the official facade of community unity lies an inherent factionalism that divides people into competing family groups through all levels of the society. This family partisanship is of direct relevance in the process of economic liberalization, because of the pronounced tendency for family groups to position themselves to the extent possible to benefit from the changes. Although certain ethnic groups are frequently accused of seeking monopolistic exploitation, in fact this strategy of family maneuvering is widely shared, especially among the families in the elite. This structure is in potential conflict with the notion of an open, competitive and administratively neutral system which is needed for the effective functioning of a market economy.

b. Regions

Madagascar's lack of regional economic integration is reflected in the continuing tension between peoples of the coast and peoples of the highlands. This lack of integration stems in large part from continuing isolation due to poor transportation and other communication links. Ethnic group separation is linked to this regional separation, since the main ethnic groups were originally named for the areas where they were located, e.g. Tanala - "people of the forest", Merina - "those from the country where one can see far".

Such regional/ethnic distinctions have been and will remain significant in the area of external trade, since Highland/Coastal competition has traditionally been between those located where the

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action is (on the coast) and those who administer the trade (in the Highlands). This distinction is of particular importance for agricultural exports since nearly all of Madagascar's main export corps are grown in the coastal areas. As Madagascar liberalizes its economy and revitalizes export trade, the groups who are perceived to have a disproportionate advantage in exploiting the opportunities are the Indians and Chinese who have existing overseas business connections, and the Merina, who are located in the capital where foreign business connections are centralized. In a government that is sensitive to equitable regional distribution of resources (the President is from the east coast), such inequities could influence the outcome of policy decisions.

c. Political/administrative institutions.

There are two major sources of opposition to economic liberalization in the official structures of the state. Within the political structure, several of the political parties within the National Front for the Defense of the Revolution espouse marxist/scientific socialist political ideologies that are opposed to the principle of a free market economy. Tt has been noted that disagreements over policy in this body and in the Supreme Revolutionary Council, which is the summit of the political structure, have increased since the reform program began in 1980. Representatives of political groups, including the President's own AREMA party, who are opposed to the change in direction away from the socialist path charted in 1972 and 1975 can be found throughout the government.

Another major source of opposition within the government are those state employees whose livelihood is directly threatened by liberalization, particularly employees of public enterprises which are likely to be closed and administrations whose functions have been abolished.

If those who stand to gain are more influential than potential losers, and the government can take effective action to financially or otherwise compensate those who are disadvantaged, the liberalization program has a better chance for success.

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Overview of Policy Reform and Conditionality in Madagascar

Policy Area	Paper Frame Work Paper	IMF Structural Adjustment Facility	IBRD Industry Credit	IBRD Agricultural Credit	IBRD Industry and Trade Credit	IBRD Structura Adjustmen Program (Ne
1. External trade and exchange policies	Maintain flex. exchange rates	*	Deval. Export retention scheme			
	Introd LIR-Improve LIR	*			Exp. LIR	
	Introduce OGL (Jul '88)	*			*	
	Reduce admin. barriers to exports.		Prep. & impl. exp. prom. licensing & reduce admin. obstacles	*	*	*
	Eliminate export monop. & licenses except those controlled by Caisse de Stablization	*		*	*	*
	Eliminate imports prohib	[illegible] of nomenc.	*		*	
	Reform Custom Tariff -reduce rates and spread				*	
2. Domestic trade lib.	Liberalize dom. prices	*	*		*	*
			Streamline procedures New invest. Code			
	Approve foreign exchange adjustments	*				
	Complete -lib. of ex-fact. prices	Except 5 prod.	*		*	
					*	
	-sharp red. in controls over profit margins at wholesale & retail level	Except 8 prod.			*	
	-phase out remaining controls				*	

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3. Public Finance: Revenues	Tax Reform:					
	-Introd. gen. tax reform					*
	-Reduce dependency on transfers from FNUP			Study		*
	-Shorten tax collection lags					
	Increase panalties for payments					
	Broaden Tax Base:					
	-Widen coverage of income and turnover tax					
	-Increase particip. of Regional Administrations					*
	-Restructure fees and charges					
4. Public Finances: Expenditures	Personnel:					
	-Review personnel exp. and redeploy/retrain civ servants					*
	-Maintain relative wage bill at 1987 level	*				*
	-Review pub. sector role, management, compensation manning levels, trg. req					*
	Social Services:					
	-Provide adequate budget alloc. for basic health and educ.					*
	Public Enterprises:					
	-Reduce transfers to PEs	*				*
	-Compensate cross debts	*				
	PIP Reform:		Agree on indust. PIP Adopt criteria for project selec. Strengthen MIEM			
	-Strengthen PIP formul:				*	
	-broaden coverage					
	-relate inv. to recur. costs					
	-clarify PIP prog. cycle inc. legal base, decision-making, prog authorizations, inv. selection criteria					

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	-Strenthen invest. prep and aid coord. within DG Plan.		proj. appraisal capac. Stop implement. Zeren & Mamisoa			
5. Public Finance: Management	Introduce new public accounting system					
	Modernize and computerize financial management					
	Establish timely and transparent financia information system					
	Evaluate program-budget system of MPAR.				*	
	Introduce program-budgets in other ministries				*	
6. Public Enterprises Reforms	Formulate and act upon programs to restructure 16 PEs				*	
	Initiate diagnostic of 20 additional PEs	13 PEs			7 PEs	
	Curtail bank credit to loss-making PEs	* Ceiling formal	PEs			*
	Develop comp. action program to restruct. PE sector, including rehab., closure, priv. of PEs according to study results				*	*
	Execute action program				7 PEs	20-30 PEs
	Create new capacity for addressing PE problem at national level					*
	Set off cross debts	*				
7. Money and Credit	Credit policy: Support	*				

	Growth while containing inflation, through:					
	-Introduction of reserve requirements	* 8% reserve req				
	-Determining interest rt through tendering of floating rate Treasury bills	*				
	-Strengthen CB superv. of national banks				*	
	-Seek to maintain real positive rates	*				
	Financial System reform					
	Formulate comp. national credit policy				*	
	Rebuild bank portfolios while addressing prob. of PE debts	*			*	*
	Establish new internal, operating policies and procedures				*	*
	Encourage creation of new fin. inst.				*	*
	Initiate studies of institutions, laws and regulations, export finance, housing fin., lessing, and saving mobilization mechanisms				*	
8. Agriculture	Expand crop production & intensify cropping techniques					
	-Pursue liberalization of commodity prices and markets begun in 1983			*		*
	-Eliminate export license of major commodities				*	
	-End input subsidies					
	-Announce ag. support			*		

	prices well in advance of planting season					
	-Inc. intern. competitiveness of food crop prod. leading to food self-sufficiency			*		*
	Achieve rice self-sufficiency.					
	-Use internv. stock to reduce seasonal price fluctuations			*		
	-Phase out rice imports by 1990			*		*
	-Maintain modest rice stock to meet emergency requirments arising from natural disasters.					*
	Increase volume of ag. exports					
	-Estab. min. prod. prices sufficient to encourage higher output	*		*		
	-Elim. 10% commission of state trading companies & allow priv. traders to compete on equal level			*		
	-Study & move to elim. admin. obstacles to ag. exports	*		*		*
	-Abolish state exporting monopolies except prod. managed by Caisse de Stab.			Study		Implement.
Industry	Promote efficient indust. within mixed economy					
	-Study and reduce admin.					*

	obstacles to adjustment (enter-exit branches, sale/resale enterp., technological choices, labor shedding, etc..)					
	-Lower dispersion of tariffs					
	-4 yr. prog. to reduce av. protection to 35%					
	-Study poss. use to debt-equity swaps & duty-free zone					
	-Study strateg. to prom. SSEs					
	-Ensure continued access of exporters to imported inputs					Service account
10. Transport	Remove existing bottle-necks & encourage comp.					
	-Estab./implement Transp. Plan, focussing inv. on rehab. & maint.					
	-Encourage entry of new firms & remove price controls affecting road transp. system					
	-Improve avail. funds for road maint. & adjust the fuel tax					
11. Energy	Improve efficiency in generation, dist., use electrical and fossil fuel energies, reduce cost of imported oil					
	-Raise and simplify elec. rates					
	-Rehab. JIRAMA					
	-Expand coverage of interconnected elec. network					
	-Divest petroleum dist.					

	-Rehab SOLIMA -Adjust pretroleum to to intern. parity prices -Devise improved purchasing arrangement for the import of fossil fuels					
	Reduce rate of deforestation -Study resources and markets -Encourage alternative cooking fuels					
12. Education	Improve cost-effectiveness of education system & links with employment markets -Complete higher educ. study and formulate action prog. for the sector. -Implement action prog. aimed at limiting access to trad. higher educ. -Restructure basic & tech education to improve quality & relevance					
13. Population/Health	Improve cost-effectivenes of health delivery syst. and expand coverage Establish high level multisectoral task force on population issues to formulate new pop.policy and seek, inter alia, to reduce birth rate					
14. Social adjustment	Initiate measures aimed alleviating social cost of adjustment on more					

	vulnerable groups, parti					
	cularly in regards to					
	food security & shelter					
	Initiate longer-term					
	on social adjustment					
	assistance of intern.					
	community					

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ANNEX C

LOGFRAME

Madagascar

FY88 Agricultural Export Liberalization Program

LOGFRAME

GOAL	MEASURES OF THE GOAL	MEANS OF VERIFICATION	ASSUMPTIONS AND LINKAGES
To increase rural incomes.	-Increased farmgate prices. -Increased availability and purchase of incentive consumer goods in rural areas. -Improved housing, nutrition and health status in rural areas. -Increased production of tradeable crops.	-National income statistics. -Rural household income and expenditure survey. -Health, nutrition and mortality statistics. -Agricultural production statistics.	-External markets for traditional and non-traditional agricultural exports remain stable or expand. -Transportation and infrastructure rehabilition programs continue. -No severe cyclones or droughts. -Known difficulties of the state banking system will not impede the activities of private operators in collection processing, transport and export of ag. crops. -Collusion among above private operators will not prevent the transmission of higher border prices to producers.

MAELP LOGFRAME

PURPOSE	END OF PROGRAM STATUS	MEANS OF VERIFICATION	ASSUMPTIONS AND LINKAGES
To reduce policy and procedural impediments to liberalized Malagasy external markets.	-Liberalized agricultural export markets for the principle export crops (coffee, cloves, pepper): 1) free entry for private operators. 2) differential between FOB export parity and farmgate prices reflect marginal cost of transport & processing. -Streamlined administrative procedures for all agricultural exports. -Continued operation of a market clearing foreign exchange allocation system. -Existence of a framework for continued discussions with the GDRM on the implementation of agricultural market liberalization.	-Evaluations conducted to measure progress on following indicators: (1) share of export volume of traditional crops marketed by private operators has increased. (2) No. of private operators involved in export marketing has increased. (3) export volume of non-traditional crops has increased. (4) time required to process an export shipment has decreased. (5) No. of administrative approvals, clearances and fees for export transactions has decreased. (6) export guide has been published which provides a complete and concise summary of all export regulations in effect. (7) non-discriminatory access to foreign exchange under the OGL. (8) OGL system operates as planned with respect to receipt of full amount of FX within the 6 day time period. -Central Bank reports. -Export and Customs Statistics. -Rural household and income expenditure survey.	-Sustained commitment to the policy reform program by the GDRM. -Sufficient foreign exchange is available from GDRM and other donor contributions to finance imports.

MAELP-- LOGFRAME

OUTPUTS	MAGNITUDE OF OUTPUTS	MEANS OF VERIFICATION	ASSUMPTIONS AND LINKAGES
-Policy and procedural changes which facilitate exports.	-Monopolies on export of at least two traditional crops ended. -Requirements for cards, licenses and/or prior authorizations for internal trade and export of agricultural products abolished. -Export guide published. -Free trade zones created.	-Official decrees. -Published reports. -Project evaluations.	-Malagasy Parliament approves decrees for policy changes.
-Increased business and marketing skills of Malagasy entrepreneurs.	-30 participants receive specialized business training in U.S. of academic or practical(on-the-job) nature. -15 businesses receive T.A. in developing export marketing programs. -Minimum of 75 private entrepreneurs participate in business seminars at INSCAE.	-Training completion reports. -Contractor's reports.	-Malagasy entrepreneurs willing and able to participate in training.
-Strengthened institution for business training - INSCAE.	-MBA and part-time evening business programs developed as well as business English program. -4 faculty members and language training coordinator trained. -INSCAE Director visit to U.S. graduate business schools. -Minimum of 3 business seminars organized for private entrepreneurs.	-INSCAE program brochure. -Training completion reports. -Seminar report.	

OUTPUTS	MAGNITUDE OF OUTPUTS	MEANS OF VERIFICATION	ASSUMPTIONS AND LINKAGES
-Recommendations for policy changes in rural input, financial and consumer goods markets needed to further the liberalization of rural agricultural market operations.	-Minimum of 3 technical studies and 3 policy studies completed.	-Written reports.	
	-3 study tours and follow-on seminars.	-Participants reports.	

INPUTS	LEVELS	MEANS OF VERIFICATION
-Cash transfer	$16.000 million	-Project Implementation Reports.
-Training	$ 1.200 million	-Contractors Reports.
-Technical Assistance	$ 0.800 million	-Study Documents.
-Studies	$ 0.435 million	
-Evaluation/Audit	$ 0.100 million	
-Other	$ 0.200 million	

ANNEX D

ECPR GUIDANCE CABLES

(MAELP)

ORIGIN AID-02

INFO LOG-00 AF-00 CIAE-00 EB-00 DODE-00 L-03 TRSE-00
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DRAFTED BY: AID/AFR/PD/EAP:CTERRY:HML
APPROVED BY: AID/AA/AFR:CLGLADSON
AID/AFR/PD:JGRAHAM (DRAFT) AID/AFR/PD/EAP:JSCHLESINGER (DRAFT)
AID/AFR/DP:JWOLGIN (DRAFT) AID/PPC/PB:RMAUSHAMMER (DRAFT)
AID/AFR/EA:DLUNDBERG (DRAFT) AID/AFR/EA:WNORTH (DRAFT)
AID/GC/AFR:AADAMS (DRAFT) AID/DAA/AFR:WBOLLINGER
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FM SECSTATE WASHDC
TO AMEMBASSY ANTANANARIVO IMMEDIATE

UNCLAS STATE 204394

AIDAC

E.O. 12356: N/A

SUBJECT: ECPR GUIDANCE CABLE - MADAGASCAR ECONOMIC POLICY REFORM PROGRAM (687-0102)

REF: (A) STATE 34024 (B) NAIROBI 15644

1. THE SUBJECT PAAD WAS CHAIRED AND APPROVED BY DAA LARRY SAIERS ON JUNE 15 AND ATTENDED BY AFR/PD, AFR/DP, AFR/EA, AFR/TR/ARD, PPC/PB, AFR/EPS, AFR/DP/PAR, STATE EB/IFO/OUF, GC/AFR AND DONNA STAUFFER OF OAR/MADAGASCAR. THE FOLLOWING ECPR GUIDANCE IS PROVIDED BELOW.

2. MULTI-YEAR AUTHORIZATION: ECPR RECOMMENDED THAT THE MISSION PLAN TO PROVIDE ADDITIONAL SUPPORT IN FY 89 TO CONSOLIDATE THE REFORMS INITIATED UNDER THIS PROGRAM IN FY 88. IN ACCORDANCE WITH ABOVE RECOMMENDATION, THE PAAD SHOULD CLEARLY REFLECT THE ON-GOING NATURE OF THE PROGRAM. ECPR NOTED THAT ADDITIONAL FUNDING FOR THE PROGRAM IN FY 89 WILL REQUIRE AN AMENDMENT TO THE PAAD. MISSION HOWEVER SHOULD NOT NEGOTIATE OR PROGRAM FY 89 PROGRAM FUNDS UNTIL SUCH TIME AS THE INTERIM EVALUATION

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(SCHEDULED FOR OCTOBER 1989) HAS BEEN CONDUCTED AND CAN CONFIRM THAT THE PROGRAM IS ACHIEVING POLICY REFORM OBJECTIVES. ASSUMING THAT AN FY 89 INCREASE IS AUTHORIZED, THE PAAD WILL PROBABLY REQUIRE NEW CONDITIONS PRECEDENT OR COVENANTS, OR FINE TUNING OF EXISTING CONDITIONS PRECEDENT AND COVENANTS. IN THIS REGARD, ECPR SUGGESTED THAT MISSION MIGHT WISH TO CONSIDER BROADENING OUT-YEAR CONDITIONALITY IN THE PAAD TO INCLUDE OTHER TRADITIONAL EXPORT CROPS.

3. CONDITIONS PRECEDENT: ECPR RECOMMENDED THAT CP TO DISBURSEMENT OF FIRST DOLS 8 MILLION TRANCHE (I), BE REVISED TO REQUIRE THAT THE GDRM PROVIDE EVIDENCE THAT IT HAS CARRIED OUT THE FOLLOWING:

I. ON THE BASIS OF PRIOR DISCUSSIONS AND AGREEMENT WITH A.I.D., OPENED EXPORT MARKETING OF THE TRADITIONAL EXPORT CROPS (COFFEE, CLOVES AND PEPPER) TO THE PRIVATE SECTOR AND CONTINUES TO PERMIT PRIVATE OPERATORS TO OPERATE ON AN EQUAL BASIS WITH PUBLIC SECTOR FIRMS;

II. INSTITUTED THE OGL OR AN AGREED ALTERNATIVE SYSTEM TO ALLOCATE FOREIGN EXCHANGE IN AN OPEN AND MARKET-CLEARING MANNER; AND

III. SUBMITTED A LETTER TO USAID WHICH OUTLINES THE GDRM'S PROPOSED SCHEDULE FOR MEETING THE CONDITIONS PRECEDENT TO THE SECOND DISBURSEMENT.

AS PROPOSED BY REDSO/ESA AND AGREED TO BY THE MISSION, CONDITION (III) HAS BEEN INCLUDED AS A CP TO INITIAL DISBURSEMENT.

4. DOLLAR TRACKING: THE ECPR DETERMINED THAT THE PROJECT NEED NOT TRACK THE DOLLARS; AND THEREFORE, A SEPARATE DOLLAR ACCOUNT IS NOT REQUIRED. FYI: UNDER CURRENT DRAFT BUREAU GUIDANCE, TRACKING OF DOLLARS IS NOT REQUIRED UNDER THE DEVELOPMENT FUND FOR AFRICA (DFA) PROGRAM AND, THEREFORE, SHOULD NOT BE TRACKED UNDER THIS PROJECT. THIS DETERMINATION, HOWEVER, IS SUBJECT TO CHANGE AS AGENCY POLICY IN THIS REGARD IS CURRENTLY UNDER REVIEW. ON THE OTHER HAND, THE USE OF LOCAL CURRENCY SHOULD BE TRACKED UNDER THE PROJECT. ECPR RECOMMENDS THAT FULL AMOUNT LOCAL CURRENCY BE GENERATED IMMEDIATELY FOLLOWING DOLLAR RELEASE IF THIS IS WITHIN THE CAPACITY OF GDRM AND CONSISTENT WITH GDRM REGULATIONS/LAWS. IF NOT, LOCAL GENERATION SHOULD BE TIED TO A PERCENTAGE OF THE OPEN GENERAL LICENSING (OGL) SYSTEM FOR IMPORTS. UNDER THIS LATTER SECOND-BEST

ARRANGEMENT, FULL AMOUNT OF LOCAL CURRENCY SHOULD BE GENERATED ON A PERIODIC BASIS WITH THE FIRST PAYMENT PROVIDED AFTER THREE MONTHS AND SUBSEQUENT PAYMENTS EACH MONTH THEREAFTER

5. MANAGEMENT: AS NOTED DURING THE PAIP REVIEW PER REF A, PARA 9, ECPR REMAINS CONCERNED ABOUT MISSION CAPACITY TO MANAGE THE PROPOSED ACTIVITY. IT WAS NOTED THAT THE PRIMARY RESPONSIBILITY FOR THE INITIAL TWO-YEAR MANAGEMENT OF THE PROGRAM WILL REST WITH A PERSONAL SERVICES CONTRACTOR/ECONOMIST WHO IS YET TO BE RECRUITED. ECPR RECOMMENDS THAT THE MISSION MONITOR CAREFULLY ITS CAPACITY TO MANAGE THIS PROGRAM. IF MANAGEMENT BURDEN INTENSIFIES BEYOND MISSION ABILITY TO SERVICE THE PROGRAM REQUIREMENTS AS CURRENTLY STRUCTURED, MISSION IS ENCOURAGED TO SEEK WAYS TO MODIFY IMPLEMENTATION ARRANGEMENTS.

6. PROJECT TITLE: ECPR RECOMMENDED THAT THE SUBJECT PROJECT TITLE BE CHANGED TO REFLECT THE SECTORAL NATURE OF THIS DFA PROGRAM RATHER THAN OF THE MACROECONOMIC FOCUS IMPLIED BY CURRENT TITLE.

7. NEXT STEPS:

A. THE ABOVE REVISIONS ARE BEING INCORPORATED INTO THE PAAD IN AID/W. REQUEST MISSION CONCURRENCE WITH ABOVE PROPOSED REVISIONS.

B. THE AUTHORIZATION PACKAGE AND CN WILL BE PREPARED IN AID/W.

C. AID/W WILL PROCEED TO AUTHORIZATION WHEN PAAD AND AUTHORIZATION PACKAGE COMPLETE. SHULTZ

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UNCLAS STATE 034024

AIDAC

E.O. 12356: N/A

SUBJECT: ECPR GUIDANCE CABLE - MADAGASCAR PAIP

REF: NAIROBI 40874

1. THE ECPR FOR THE SUBJECT PROGRAM WAS CHAIRED BY AA/AFR LARRY SAIERS ON JANUARY 14, 1988 AND ATTENDED BY AFR/PD, AFR/DP, AFR/EA, GC/AFR, AFR/TR, PPC/EA, STATE/A E AN DONNA STAUFFER OF AID/MADAGASCAR. THE FOLLOWIN GUIDANCE IS PROVIDED FOR THE PAAD DESIGN.

2. PROGRAM PURPOSE AND FOCUS: THE ECPR NOTED THE PROGRAM PURPOSE IS UNCLEAR AND NEEDS TO BE BETTER DEFINED AND FOCUSED. OF THE FOUR POTENTIAL REFORM AREAS DISCUSSED IN THE PAIP, ECPR RECOMMENDS MISSION FOCUS ON AGRICULTURAL LIBERALIZATION AND, PERHAPS, POPULATION POLICY TO BE CONSISTENT WITH THE CURRENT A.I.D. STRATEGY FOR MADAGASCAR. SINCE THIS PROGRAM WILL BE FUNDED FROM THE NEW DEVELOPMENT FUND FOR AFRICA (DFA) INCLUDED IN THE FY 1988 CONTINUING RESOLUTION, THE PAAD MUST CLEARLY

DEMONSTRATE HOW THE THIS PROGRAM AND ITS POLICY REFORM AGENDA WILL ACCOMPLISH DEVELOPMENT PURPOSES. THE ECPR EXPECTS THE PAAD PURPOSE TO BE CONSISTENT WITH THE MADAGASCAR PROGRAM STRATEGY AS APPROVED AFTER THE FEBRUARY 29, 1988 REVIEW.

3. OPEN GENERAL LICENSING SYSTEM (OGL): AS NOTED ABOVE, THE ECPR BELIEVES THAT THE PROGRAM SHOULD SUPPORT SPECIFIC SECTORAL REFORMS. THE OGL SHOULD BE VIEWED AS THE PROGRAM'S DISBURSING MECHANISM; AND NOT BE REGARDED AS THE PRIMARY REFORM SOUGHT BY THE PROGRAM (ALTHOUGH A.I.D'S ASSISTANCE WILL HAVE THE EFFECT OF SUPPORTING THE OGL AS WELL). THE PAAD SHOULD, HOWEVER, DESCRIBE HOW THE OGL'S SUPPORT FOR FOREIGN EXCHANGE AND IMPORT LIBERALIZATION ARE IMPORTANT TO THE SUCCESS OF THE PROGRAM'S PURPOSE AND SPECIFIC POLICY REFORM AGENDA.

4. ROLLING DESIGN : THE ECPR DOES NOT APPROVE THE OPEN ENDED ROLLING DESIGN PROCESS PROPOSED IN THE PAIP WHEREBY THE OLICY REFORM AGENDA WOULD BE MODIFIED (IN PAAD AMENDME TS) IN YEARS TWO AND THREE TO REFLECT PROGRESS MADE IN THE YEAR. IF THE MISSION WANTS APPROVAL OF A 3 YEAR PROGRAM, THE PAAD SHOULD SET FORTH A CLEAR STATEMENT OF POLICY REFORM OBJECTIVES AND YEARLY

BENCHMARKS TO MEASURE PROGRAM PERFORMANCE, AND PROVIDE A FIRM FUNDING LEVEL FOR ALL YEARS. SPECIFIC BENCHMARKS FOR POLICY REFORM MEASURES TO BE SUPPORTED IN YEARS 2 AND 3 COULD BE MODIFIED, AS LONG AS THE OVERALL OBJECTIVE OF THE PROGRAM REMAINED THE SAME. FUNDING FOR YEARS 2 AND 3 WOULD BE AUTHORIZED IN PAAD FACESHEET AMENDMENTS.

5. PROGRAM TRANCHING: IN VIEW OF THE UNCERTAINTY REGARDING THE GDRM'S CONTINUED COMMITMENT TO THE OVERALL LIBERALIZATION PROGRAM, ECPR CONCURS WITH REDSO SUGGESTION PER REFTEL THAT PERFORMANCE ON THE AEPRP BE CAREFULLY MONITORED. TRANCHING DISBURSEMENTS, INCLUDING FIRST YEAR LEVELS IF APPROPRIATE, WITH A PROGRAM REVIEW AT EACH STAGE, IS ONE WAY TO DO THIS. WE ARE OPEN TO OTHER APPROACHES. FYI: THE BUREAU SEES NO COMPELLING NEED FOR EARLY DISBURSEMENT IN ORDER TO SUPPLY THE OGL, GIVEN IBRD ASSURANCES ON INITIAL AVAILABILITY OF FUNDS. END FYI.

6. CONDITIONALITY: THE BUREAU WOULD LIKE YOU TO CONSIDER A SOMEWHAT MORE FLEXIBLE APPROACH THAN WE HAVE USED IN OTHER AEPRP'S IN THE PAST. THIS APPROACH WOULD AVOID TYING DISBURSEMENT IRREVOCABLY TO A SPECIFIED POLICY MEASURE WHICH MAY OR MAY NOT TURN OUT TO BE ACHIEVABLE, AND INSTEAD, EMPHASIZE REFORM OBJECTIVES. ECPR SUGGESTS YOU CONSIDER THE FOLLOWING:

A. DEFINE A SET OF REFORM OBJECTIVES (E.G., FOR AGRICULTURE LIBERALIZATION, TO INCREASE THE VOLUME OF DOMESTIC MARKETING BY THE PRIVATE SECTOR; TO IMPROVE AVAILABILITY OF INPUTS);

B. DEFINE POTENTIALLY ACHIEVABLE BUT ILLUSTRATIVE BENCHMARKS FOR EACH OBJECTIVE (E.G. REDUCTION IN NUMBER OF RURAL ROADBLOCKS; INCREASE IN REGIONAL CONSUMER PRICE DIFFERENTIALS; OVERALL REDUCTION IN COMMODITY PRICE LEVEL; INCREASE IN NUMBER OF PRIVATE TRADERS; PERCENTAGE INCREASE IN INPUT SALES);

C. BUILD INTO THE DESIGN A MONITORING SYSTEM TO ASSESS PROGRESS TOWARD THE OBJECTIVE AFTER A SPECIFIED TIME PERIOD (E.G. 6, 9, 12 MONTHS). IF THE BENCHMARKS ARE ACHIEVED, FINE. IF NOT, THE MONIORING PROCESS SHOULD ELUCIDATE WHY THROUGH A JOINT AID/GDRM REVIEW OF RELEVANT EVIDENCE AND DATA. THE PURPOSE OF ASSESSMENT IS TO DECIDE WHETHER SUFFICIENT PROGRESS HAS BEEN MADE TOWARD THE OBJECTIVE, OR WHETHER THERE IS REASON TO HOLD

UP THE NEXT PLANNED DISBURSEMENT. BENCHMARKS MAY BE MODIFIED, BUT THE OBJECTIVES THEMSELVES SHOULD BE HELD TO FIRMLY.

7. SPECIAL ACCOUNT: ALTHOUGH THE DFA DOES NOT REQUIRE THE ESTABLISHMENT OF A SPECIAL ACCOUNT FOR THE TRACKING OF DOLLARS, THE AFRICA BUREAU IS PREPARING GUIDANCE CONCERNING SPECIAL ACCOUNT AND TRACKING PROCEDURES TO BE FOLLOWED IN ONNECTION WITH DFAFUNDED ACTIVITIES. THE MISSION WILL BE ADVISED OF SUCH PROCEDURES BY SEPTEL.

8. SECTION 110 CONTRIBUTION REQUIREMENT: SINCE THE SUCCESSFUL OPERATION OF THE OGL IS ASSUMED TO BE IMPORTANT TO THE ATTAINMENT OF THE PROGRAM'S SPECIFIC SECTORAL REFORM GOALS, AND THUS PART OF THE OVERALL ACTIVITY SUPPORTED BY THE PROGRAM, GC/AFR BELIEVES THAT THE PROPOSED CONTRIBUTIONS BY THE GDRM TO THE OGL WOULD SATISFY THE HOST COUNTRY CONTRIBUTION REQUIREMENT OF FAA SECTION 110. THE PAAD SHOULD DEMONSTRATE THE LINKAGES BETWEEN THE OGL AND THE PROGRAM'S SPECIFIC SECTORAL REFORM GOALS AND A.I.D. MUST RECEIVE THE ASSURANCE OF THE GDRM THAT IT INTENDS TO CONTRIBUTE SUCH FUNDS BEFORE A.I.D. MAY OBLIGATE THE GRANT.

9. MISSION MANAGEMENT CAPACITY: ECPR EXPRESSED CONCERN THAT MISSION MANAGEMENT OF THIS PROJECT AT CURRENT STAFFING LEVEL WOULD NOT BE ADEQUATE FOR PROJECT IMPLEMENTATION. WHILE THE PAAD WOULD ALLOW FOR FLEXIBILITY IN THE POLICY DIALOGUE AND IN LOCAL CURRENCY PROGRAMMING, HIS VERY FLEXIBILITY WILL IMPOSE STRINGENT DEMANDS ON THE MISSION IN TERMS OF ANALYTICAL AND IMPLEMENTATION CAPACITY. AID/W WILL STRIVE TO INSURE THE EARLIEST ARRIVAL OF A PROGRAM ECONOMIST TO GUIDE AND IMPLEMENT THIS PROGRAM.

10. EFFECTS OF POLICY REFORM ON HUMAN WELFARE AND THE ENVIRONMENT: THERE IS GROWING DONOR CONCERN FOR THE SOCIAL IMPACT OF THE STRUCTURAL ADJUSTMENT PROCESS. THE WORLD BANK HAS EMPHASIZED THAT MADAGASCAR AND THE DONOR COMMUNITY SHOULD STEPUP EFFORTS TO SOFTEN THE IMPACT OF ECONOMIC ADJUSTMENT ON THE POOREST AND MOST VULNERABLE GROUPS OF SOCIETY. HE HOUSE APPROPRIATIONS COMMITTEE HAS RAISED SPECIFIC CONCERNS REGARDING THE NEED TO SAFEGUARD HUMAN WELFARE AND LONG TERM ENVIRONMENTAL INTERESTS AS PART OF ANY PROGRAM OF POLICY REFORM, AND A.I.D. HAS BEEN ASKED TO REPORT TO CONGRESS HOW WE HAVE RESPONDED TO THESE CONCERNS. THE PAAD SHOULD IDENTIFY POTENTIAL NEGATIVE EFFECTS OF THE EPRP ON HUMAN WELFARE AND THE ENVIRONMENT AND RECOMMEND STEPS WHICH CAN BE OR ARE BEING TAKEN TO MITIGATE THESE PROBLEMS.

11. EVALUATION: THE BUREAU IS PLACING INCREASED EMPHASIS ON EVALUATION OF POLICY REFORM EFFORTS. IT IS IMPORTANT THAT WE MEASURE PROGRESS AND IMPACT OF THESE REFORM EFFORTS. CONSEQUENTLY, MONITORING AND EVALUATION PLANS SHOULD BE INCORPORATED IN THE PAAD, INCLUDING A BUDGET TO PROVIDE SUFFICIENT FINANCIAL SUPPORT TO

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MONITORING AND EVALUATION DURING THE COURSE OF IMPLEMENTATION OF THE PROGRAM. GIVEN OUR RATHER FOCUSED OBJECTIVES IN MADAGASCAR ON INCREASING RICE PRODUCTION AND RURAL INCOME, THE MISSION MAY WANT TO EXPAND THIS EVALUATION EFFORT TO EXPLORE OVERALL COUNTRY PROGRAM IMPACT, NOT JUST IMPACT UNDER THIS AEPRP.

12. STUDIES: THE IMF AND WORLD BANK STUDIES WHICH ARE CURRENTLY UNDERWAY WOULD PROVIDE AN ADEQUATE BASIS FOR DESIGNING THE PAAD. HOWEVER, AS NOTED IN REF ABOVE, TO RELY ON THESE STUDIES COULD DELAY THE PAAD DESIGN IN THE EVENT THE GDRM DOES NOT ADHERE TO THE IMF/IBRD TIMETABLE FOR COMPLETING THEM.

13. LOCAL CURRENCY UTILIZATION: ECPR SUPPORTS THE PAIP RECOMMENDATIONS THAT EPRP LOCAL CURRENCY GENERATIONS BE PROGRAMMED AS BUDGET SUPPORT IN VIEW OF THE MANAGEMENT IMPLICATIONS OF CONTINUING TO PROJECTIZE GENERATIONS. SUCH PROGRAMMING SHOULD BE CONSISTENT WITH A MORE SPECIFIC PROGRAM FOCUS (PER PARA 2).

14. TECHNICAL ASSISTANCE/TRAINING COMPONENT: THE ECPR BELIEVES THAT THE PORTION OF THE PROGRAM INVOLVING TA, TRAINING AND STUDIES SHOULD BE DESIGNED AS A QUOTE PROJECT UNQUOTE IN ACCORDANCE WITH HANDBOOK 3. THE NECESSARY DOCUMENTATION MAY BE INCLUDED AS PART OF THE PAAD AND AUTHORIZATION OF THE NON-PROJECT AND PROJECT COMPONENTS OF THIS ACTIVITY MANY OCCUR AT THE SAME TIME.

15. INITIAL ENVIRONMENTAL EXAMINATION (IEE): THE IEE FOR THIS PROGRAM HAS BEEN APPROVED BY THE BUREAU ENVIRONMENTAL OFFICER. SHULTZ
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ANNEX E

HUMAN WELFARE AND THE ENVIRONMENT

HUMAN WELFARE AND ENVIRONMENT

A. HUMAN WELFARE

At a recent (March 88) United Nations conference on the "Human Dimensions of Africa's Economic Recovery and Development" the situation of Madagascar was presented as a case in point.

In fact, however, the situation in Madagascar is somewhat unique and filled with seeming contradictions. The island's productive potential is quite high, and under systems of intensive cultivation of rice and other crops it could easily support a significantly greater population. (In fact higher population densities are needed in some areas to provide the labor force that more intensive irrigated rice cultivation demands.)

Madagascar's problems on the human welfare dimension stem from the conjuncture of several adverse economic and social trends. First, are past economic and administrative policies that greatly reduced economic efficiencies and production incentives. Once self-sufficient in food production, Madagascar now imports its staple - rice. Exports of the crops that most effect small producer's incomes suffered large drops: from 1970 to 1985, exports of coffee dropped from 51,956 tons to 44,780 tons; of rice from 67,923 tons to 0 tons, of pepper from 2,227 tons to 2,610 tons, and of meat and conserves from 9,616 tons to 1,010 tons. In addition to production declines, Madagascar has been effected by falling prices for its commodity exports, and generally rising prices for its imports. Government expenditures for social services in the face of austerity measures could not be increased to match population growth, resulting in a decline in the quality and availability of services.

Evidence that the problem exists in the administration of the economy and not at the producer level is the fact that Madagascar is one of the few countries where more people leave urban areas than flow to them in times of economic difficulty (a generally

2:1 proportion). The reason is that there is subsistence potential in rural areas at times when there is neither employment nor alternative sources of support in urban areas. When to this is added the fact that on average it costs three times more for a family to live in an urban than in a rural area, the direction of migration is easily understandable.

However, although rural areas are productive, they, too, are now under pressure. The amount of land available per capita for producers decreases annually due to high population growth and loss to erosion. At the same time, the material and labor inputs and technical knowledge required for more intensive production are not in place and will take time to be effectively established.

To the above two problems one must add the periodic, though generally localized, natural disasters that have chronically placed the population at risk (e.g. drought, especially in the south, and cyclones in general). Urban migration generally seems to stem from such natural catastrophies as well as from personal catastrophies of which (for women and their children) divorce and widowhood are among the most prominent.

It is upon this reality that the effects of structural adjustment are imposed, including a substantial decrease in effective public spending per capita in critical areas of health, education, infrastructure etc., and devaluations that have reduced the effective non-agricultural minimal wage by 36% and civil servant wages by 60% over the last seven years. Since these two categories make up a majority of urban populations, their reduced purchasing power has not only decreased the goods and services at their disposal, but has in turn reduced internal markets for rural producers.

The above factors correlate with disturbing social statistics. Mortality in child birth has increased 400% from 1978-1984. While the number of students has increased with population, the number passing exams at all levels has fallen by 25% and more. Child malnutrition, depending on the season, seems to be on a steady increase of 5-10% a year. Not surprisingly, there has been a corresponding rise in mortality in all categories of disease - respiratory, intestinal, parasitic - due both to reduced care and to reduced resistance, although attribution of cause between these factors is difficult to assess.

It is almost a tautology to say that in hard times the most marginal suffer most since the very reason they are marginal is that they lack economic, social or political resources to mobilize to meet their needs. Logically, it follows that increasing the resources of these people is the key to any long term improvement in their situations. The sad fact is that structural adjustment programs to date have concentrated mainly on the macro-economic goal of getting the economy back in order rather than on the more complex and often more politically charged question (both nationally and between borrowers and lenders) of who is going to pay the price of reform and who is ultimately going to benefit most from it. In the case of Madagascar, for example, funding has been provided to increase the number of physicians, while funds for providing them with the minimally necessary supplies to work have gone down. Thus, macro-economic structural adjustments at the level of the public budget do not appear to have been accompanied by much if any strategic thinking as to exactly how to reorder public spending priorities and to distribute expenditure cuts.

It would be foolish to think that the MAELPby itself is going to be a major factor in reorienting the way structural adjustment and policy reform is carried out. However, it certainly can begin to demonstrate a concern for the social and human consequences of the policy reform process, not only in terms of what is presently happening but also in shaping how things will look after the economy is properly reconstituted. In two ways the MEPRP reflects such concerns. First, despite the ultimate importance of rice to the national economy, the program has decided to address the improvement in efficiency of agricultual export markets. Rapid rises in rice prices without specific actions to provide small and marginal farmers(who are often net buyers of rice, and thus are hurt by rice price increases) with the capability to respond, would almost certainly result in an appreciation of land value, and raise the prospect that these farmers would be forced off the land by landowners or more efficient farmers with access to modern inputs. To some extent this phenomenon is inevitable, but its effects can be mitigated if price rises are coordinated with the introduction of needed goods and services, as for example, through the creation of responsive rural financial institutions. (The MEPRP provides funds to examine the question of rural financial services.) For these reasons a "go slow on rice" strategy really does make sense.

The export crop sector, at least initially, offers a greater chance than does the rice sector for increasing production and rural incomes without negative consequences on marginal producers, while presenting a good opportunity for small producers to participate. This is due to the fact that marginal people are not net buyers of these crops. The history of colonial times demonstrates that the small plantation production that is likely to arise is not incompatible with small producer activities in the same domains. (An example, in fact, now exists in increasing grape production both on plantation style operations and neighboring small plots.)

B. ENVIRONMENT

The severe nature of environmental degradation in Madagascar has long been recognized, and in particular the massive deforestation due to slash and burn agriculture. In the 1914 French "Bulletin Economique de Madagascar", L. Caltie wrote:

"It is our opinion that the practice of "Tavy" (slash and burn agriculture) should be completely outlawed and suppressed by whatever means possible. It is incontestable that this practice, even when it provides two successive harvests is anti-economic".

In fact, it is not slash and burn agriculture per se that causes degradation, but the fact that increasing population pressure has over time resulted in shorter and shorter periods of rotation and decreasing land fertility, to the point that new forest land is burnt rather than recycling secondary growth areas. Regardless of the primary factor, however, the hard fact remains that despite desires and attempts to do so, even the colonial authorities were unable to suppress the practice, which provides the principal means of subsistence for a substantial portion of the population. While one can project that the system will eventually burn itself out, those who depend on tavy will continue to engage in it until they find alternative sources of revenue or subsistence .

Practically speaking, the only solution to environmental degradation resulting from slash and burn agriculture is to make the existing areas used for agricultural production more productive on a sustainable basis. This solution would almost certainly require the introduction of more permanent tree crops, such as coffee, cloves, and vanilla which are among Madagascar's major exports. Such crops give value to protection of the land, and even now one can find people who have given up "tavy" on land above tree crops precisely for fear of not being able to control the burn and possibly damaging their tree crops.

Theoretically speaking, therefore, increased export markets for such tree crops and a resulting expansion in agricultural areas under their production should be beneficial to environmental preservation or environmentally neutral. The same might not in fact be true for very rapid increases in rice or other annual crop production, especially if in response to a significant market boom. If increased prices encouraged an extension of non-tree crop production onto marginal lands, the impact in terms of environmental degradation could be highly negative. Those without basin land for rice production would be most likely driven to try to increase hill rice production through slash and burn for the sake of quick if unsustainable profit. The eventual creation of a labor intensive irrigated rice production system would present an attractive alternative to slash and burn; however, such a system is not quickly achievable, and the area of forest remaining is limited. An alternative solution would be for the government to introduce policies which raise the private costs of cultivating marginal lands to cover social costs, for example by introducing high land taxes or fines for forest clearing; however, the government's capacity to enforce such policies remains limited, and therefore such an approach is unlikely to achieve the desired effect in the near future.

Despite the attractiveness of increased export tree crop production environmentally, one strong cautionary note needs to be made. While lands planted with tree crops are protected, past experience in Madagascar has been that in areas where large export crop plantations were created, and in the process pushed people from the land, those displaced populations then turned to increased hill side cultivation. The possibility of such a reoccurrance is a strong argument why, in addition to the question of equity, it is environmentally important that a strategy to assist export crop production be particularly concerned that small and medium producers are given access to new technologies and markets. At present, almost all export crop production is in the hands of these producers, since the old plantation system was largely destroyed during the 1970's. However, donor and government action in the future will be critical determinants of what form a revitalized export crop production system takes. The donors should be prepared to assist the GDRM in preparing policies and plans for rational land use. The Environmental Action Plan, which will soon be completed with the assistance of USAID, the Swiss and the World Bank, is a major step in the direction of addressing environmental concerns in the development process in Madagascar.

ANNEX E

INITIAL ENVIRONMENTAL EXAMINATION

Project Country: Madagascar

Project Title: Madagascar Economic Policy Reform Program

Funding: $17 million FY: 1988

-**IEE Prepared by:** Donna Stauffer, Project Development Officer

Environmental Action Recommended: Categorical Exclusion

Discussion: The proposed Madagascar Economic Policy Reform Program meets the criteria for Categorical Exclusion under Section 216.2(c) of Regulation 16. A cash grant of $15.0 million will be provided to support the Government of Madagascar's reform of the foreign exchange allocation system and will be used to finance imports under an open general licensing system. The use of cash grant funds is not tied to either specific commodities or a specifically identifiable project and thus may be considered as an "Action which does not have an effect on the natural or physical environment". This, according to Section 216.2(c)(1)(i), is a criterion for categorical exclusion. The balance of program funding, $2.0 million, will be used to finance technical services, studies and training in support of policy reform measures. This portion of the grant meets the criteria for categorical exclusion provided in Section 216.2(c)(2)(xiv).

Bureau Environmental Officer's Decision:

B. Boyd AFR/TR/ARD

Approved: X

Disapproved: ______

Date: 1/11/88

Clearance: GC/AFR DWL

Date: 1/26/88

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ANNEX F

IMPLEMENTATION SCHEDULE

ANNEX F

Implementation Schedule

Activity	Timing	Responsible Party
REDSO/ESA PAAD Review	5/88	REDSO/ESA
Submission of PAAD to A.I.D./W	5/88	USAID
A.I.D/W PAAD approval	6/88	AID/W
Grant Agreement Signed	7/88	AA/AFR
Advertise PSC Economist Position	7/88	Contracting Off.
First Tranche Released	7/88	AID/W
Issue PIO/T for Baseline Survey Design	7/88	USAID
Issue PIO/T for Training Contractor	8/88	USAID
Advertise FRP for Training Contractor	8/88	Contracting Off.
IQC Work Order for Baseline Survey Design	8/88	Contracting Off.
Review applications for PSC Economist	8/88	Evaluation Comm.
Baseline Survey Design begins	9/88	IQC Contractor
Negotiate Economist PSC	9/88	Contracting Off.
Review Responses to Training RFP	9/88	Evaluation Comm.
Issue PIO/T & RFP for Baseline Survey	9/88	USAID
Negotiate Training Contract	10/88	Contracting Off.
Baseline Survey Begins	10/88	Contractor
PSC Economist Arrives	11/88	Contractor
Develop Training Plan	11/88	USAID/GDRM/Cont.
Develop Program of T.A. for Exporters	11-12/88	USAID
PIO/T and IQC Work order for Study Tour on Coffee Marketing	11/88	USAID
INSCAE Director to U.S.	12/88	Contractor
Issue PIO/T for macro-economist visit	12/88	USAID
Prepare Grant to IESC for T.A. for Exporters	12/88	USAID/Cont. Off.
Study Tour on Coffee Marketing	01/89	Contractor
Develop Studies Agenda	01/89	USAID/GDRM
Prepare SOW for Assessment of CPs	01/89	USAID
IQC Work Order for macro-economist visit	01/89	Contracting Off.
Finalize Plan for INSCAE strengthening	01/89	Contractor
Workshop on Coffee Marketing alternatives	02/89	Contractor/INSCAE
Macro-economist visit	02/89	IQC Contractor
Assessment of CPs for 2nd Tranche release	02/89	REDSO/Contractor
Prepare SOW for first policy study &	03/89	AID/W
first technical study	03/89	USAID/GDRM
Candidate Selection for first trainees	03/89	Contractor/INSCAE
Advertise RFP for first policy study	04/89	Contracting Off.
Issue IQC order for first technical study	04/89	Contracting Off.
Review Responses to RFP for policy study	05/89	Evaluation Comm.
First Technical Study begins	06/89	Contractor
First training participants to U.S.	06/89	Contractor
Negotiate contract for first policy study	06/89	Contracting Off.
First Policy Study begins	07/89	Contractor

Activity	Timing	Responsible Party
PIO/T for design of 2nd policy study	07/89	USAID
Disseminate results of technical study	08/89	USAID/GDRM
IQC order for 2nd policy study design	08/89	Contracting Off.
Plan second study tour	08/89	USAID/GDRM
Seminar on results of 1st policy study	08/89	Contractor/INSCAE
IQC work order for financial review	09/89	USAID/RFMC
Design of second policy study begins	09/89	Contractor
Financial Review	10/89	Contractor
Advertise RFP for second policy study	11/89	Contracting Off.
Candidate selection for 2nd group	11/89	Contractor/INSCAE
Review responses to RFP for 2nd policy study	12/89	Evaluation Comm.
Mid-Term Evaluation	11/89	USAID/REDSO
Negotiate Contract for 2nd policy study	12/89	Contracting Off.
Second study tour	12/89	Contractor/USAID
Second policy study initiated	01/90	Contractor
Second group of participants to U.S.	01/90	Contractor
Workshop on second study tour	02/90	Participants/INSCPIO/
T for macro-economist 2nd visit	02/90	USAID
Seminar on results of 2nd policy study	03/90	Contractor/INSCAEIQC
work order for macro-economist	03/90	Contracting Off.
Candidate Selection for 3rd group	03/90	Contractor
Macro-Economist 2nd visit	04/90	Contractor
PIO/T for design of 3rd policy study	04/90	USAID
PIO/T for 2nd technical study	05/90	USAID
IQC work order for design of 3rd policy study	05/90	Contracting Off.
IQC work order for 2nd technical study	06/90	Contracting Off.
Design of 3rd policy study	06/90	Contractor
3rd group of participants to U.S.	06/90	Contractor
2nd technical study initiated	07/90	Contractor
Advertise RFP for 3rd policy study	07/90	Contracting Off.
Plan third study tour	08/90	USAID/GDRM
Review responses to RFP for 3rd policy study	08/90	Evaluation Comm.
Negotiate contract for 3rd policy study	09/90	Contracting Off.
Candidate selection for final group	09/90	Contractor
Third study tour	10/90	Contractor
Initiate third policy study	10/90	Contractor
Workshop on third study tour	11/90	Participants/INSCAE
PSC Economist Departs	11/90	USAID
Seminar on results of 3rd policy study	12/90	Contractor
PIO/T for final macro-economist visit	12/90	USAID
Final participants to U.S.	01/91	Contractor
IQC work order for final macro-economist visit	01/91	Contracting Off.
Final macro-economist visit	02/91	Contractor
Prepare PIO/T for final evaluation	04/91	USAID/GDRM
PIO/T for final financial review	04/91	USAID
IQC work order for financial review	05/91	Contracting Off.
Advertise RFP for evaluation	05/91	Contracting Off.
Financial Review	06/91	Contractor
Review response to RFP/select PSCs	06/91	Evaluation Comm.
PACD	06/91	
Final Evaluation	08/91	Contractor/GDRM/USAID

ANNEX G

STATUTORY CHECKLISTS

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to: (A) FAA funds generally; (B)(1) Development Assistance funds only; or (B)(2) the Economic Support Fund only.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FY 1988 Continuing Resolution Sec. 526. Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully? No

2. FAA Sec. 481(h). (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government), has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without N.A.

Congressional enactment, within 30 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, and to prevent and punish drug profit laundering in the country, or that (b) the vital national interests of the United States require the provision of such assistance? N.A.

3. Drug Act Sec. 2013. (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to Congress listing such country as one (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country? N.A.

4. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government? No

5. FAA Sec. 620(e)(1). If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities? No

6. FAA Secs. 620(a), 620(f), 620D; FY 1988 Continuing Resolution Sec. 512. Is recipient country a Communist country? No
If so, has the President determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism? Will assistance be provided directly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, South Yemen, Iran or Syria? Will assistance be provided to Afghanistan without a certification?

7. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property? No

8. FAA Sec. 620(l). Has the country failed to enter into an investment guaranty agreement with OPIC? No

9. FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made? No

10. FAA Sec. 620(q); FY 1988 Continuing Resolution Sec. 518. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1988 Continuing Resolution appropriates funds? No No

11. FAA Sec. 620(s). If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.) N.A

12. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? No

13. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the Taking into Consideration memo.)

The A.I.D. Administrator has taken Madagascar's arrearages into account in determining the current O.Y.B. (see 2/1/88 Memo).

14. FAA Sec. 620A. Has the President determined that the recipient country grants sanctuary from prosecution to any individual or group which has committed an act of international terrorism or otherwise supports international terrorism?

No

15. FY 1988 Continuing Resolution Sec. 576. Has the country been placed on the list provided for in Section 6(j) of the Export Administration Act of 1979 (currently Libya, Iran, South Yemen, Syria, Cuba, or North Korea)?

No

16. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures?

No

17. FAA Sec. 666(b). Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

No

18. FAA Secs. 669, 670. Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

No

No

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19. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device? — No

20. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.) — Madagascar's participation's in the 36th UNGA meeting and subsequent communique has been taken into account by the President.

21. FY 1988 Continuing Resolution Sec. 528. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States? — No

22. FY 1988 Continuing Resolution Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree? — No
If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance? — No

23. FY 1988 Continuing Resolution Sec. 543. Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin? — Yes

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy? No

FY 1988 Continuing Resolution Sec. 538. Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performace of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? No

2. Economic Support Fund Country Criteria

FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest? No

FY 1988 Continuing Resolution Sec. 549. Has this country met its drug eradication targets or otherwise taken significant steps to halt illicit drug production or trafficking? N.A.

5C(2) - PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A includes criteria applicable to all projects. Part B applies to projects funded from specific sources only: B(1) applies to all projects funded with Development Assistance; B(2) applies to projects funded with Development Assistance loans; and B(3) applies to projects funded from ESF.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

Yes

Yes

A. GENERAL CRITERIA FOR PROJECT

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. If money is sought to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified?

2. FAA Sec. 611(a)(1). Prior to an obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance, and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

   No construction is planned. Other planning and cost estimates appear to be reasonably firm and are based on past experience with similar project element

3. FAA Sec. 611(a)(2). If legislative action is required within recipient country, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?

   No further legislative action is required.

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4. FAA Sec. 611(b); FY 1988 Continuing Resolution Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.)

N.A.

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?

N.A.

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

No. However, the project closely complement: and reinforces the efforts of other donors in the same field, and has been designed in full collaboration with them.

7. FAA Sec. 601(a). Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

Project is designed to support liberalization of external agricultural markets, including the ending of Government export monopolies, encouragement of an expanded private sector role, and increased exports.

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

U.S. private firms will be employed to provide technical services and training to Malagasy entrepreneurs.

9. FAA Secs. 612(b), 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

The Host Country will contribute in excess of $6,000,000 to finance imports in the context of this program. Local currencies will be provide through a Trust Fund to support local costs of th program.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No

11. FY 1988 Continuing Resolution Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

Although the program is intended to liberalize agricultural export markets it does not directly suppor the production of any commodity. Madagascar's major export crops - coffee cloves, and vanilla - do not compete with U.S. production.

12. FY 1988 Continuing Resolution Sec. 553. Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

No

13. FAA Sec. 119(g)(4)-(6). Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity;

No

(b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats;

No

(c) support efforts to identify and survey ecosystems in recipient countries worthy of protection;

No

or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?

No. Other AID programs in Madagascar are directly targetted on biodiversity preservation and conservation education.

14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)? N.A.

15. FY 1988 Continuing Resolution. If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government? N.A.

16. FY Continuing Resolution Sec. 541. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? N.A.

17. FY 1988 Continuing Resolution Sec. 514. If funds are being obligated under an appropriation account to which they were not appropriated, has prior approval of the Appropriations Committees of Congress been obtained? N.A.

18. FY Continuing Resolution Sec. 515. If deob/reob authority is sought to be exercised in the provision of assistance, are the funds being obligated for the same general purpose, and for countries within the same general region as originally obligated, and have the Appropriations Committees of both Houses of Congress been properly notified? N.A.

19. State Authorization Sec. 139 (as interpreted by conference report). Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).

Cabled confirmation of grant signature and a pouched copy of the full text will be sent to the appropriate offices within the time specified.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FY 1988 Continuing Resolution Sec. 552 (as interpreted by conference report). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (b) in support of research that is intended primarily to benefit U.S. producers?

Although the project is directed at improving agricultural export market operations, no funding is intended to promote exports of commodities that compete in third countries with U.S. products or crop research.

b. FAA Secs. 102(b), 111, 113, 281(a). Describe extent to which activity will (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and

The goal of the program is to increase rural incomes by removing policy and procedural impediments to liberalized external agricultural markets. Small producers dominate export crop production in Madagasca Technical studies will address the need for improved technologies in crop processing to expand markets for agricultural products, and should eventually stimulate investment in both production and processing.

insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

U.S. institutions will be used for training of Malagasy entrepreneurs.

Women will benefit from increased employment opportunities in the production and processing of agricultural products, and will be targetted for the training and technical assistance to be provided to entrepreneurs.

c. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Does the project fit the criteria for the source of funds (functional account) being used? Yes

d. FAA Sec. 107. Is emphasis placed on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)? Yes

e. FAA Secs. 110, 124(d). Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)? Yes

f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority? Yes

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

The program aims to benefit the rural producer in Madagascar, who represents 85% of the population, & will us country's intellectual resources to the extent possible, through hiring local consultants and firms to undertake studie and using a local institute for training.

h. FY 1988 Continuing Resolution Sec. 538. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions? No

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations? No

Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? No

i. FY 1988 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined to support or participate in the management of a program of coercive abortion or involuntary sterilization? No

If assistance is from the population functional account, are any of the funds to be made available to voluntary family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services? N.A.

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j. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes

k. FY 1988 Continuing Resolution. What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 20 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

Small and disadvantaged businesses, black universities, and PVOs will be encouraged to bid on any contracts to be awarded under this project.

l. FAA Sec. 118(c). Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (a) stress the importance of conserving and sustainably managing forest resources; (b) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (c) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (d) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (e) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared

Yes

Yes

The conservation of natural resources/forests is a high priority of the AID program in Madagascar. Other projects specifically address these concerns.

or degraded; (f) conserve forested watersheds and rehabilitate those which have been deforested; (g) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (h) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (i) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (j) seek to increase the awareness of U.S. government agencies and other donors of the immediate and long-term value of tropical forests; and (k)/utilize the resources and abilities of all relevant U.S. government agencies?

m. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project (a) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (b)/take full account of the environmental impacts of the proposed activities on biological diversity? N.A.

n. FAA Sec. 118(c)(14). Will assistance be used for (a) the procurement or use of logging equipment, unless an environmental assessment indicates tha. all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (b) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas?

No

o. FAA Sec. 118(c)(15). Will assistance be used for (a) activities which would result in the conversion of forest lands to the rearing of livestock; (b) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undegraded forest lands; (c) the colonization of forest lands; or (d) the construction of dams or other water control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

The local currencies to be generated by the cash grant will be used to support a major program for the rehabilitation and maintenance of roads in agricultural areas. USAID will verify that appropriate environmental impact assessment has been carried out for any roads passing through relatively undegraded forest lands.

p. FY 1988 Continuing Resolution If assistance will come from the Sub-Saharan Africa DA account, is it (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) being provided in

Yes

accordance with the policies contained in section 102 of the FAA; Yes
(c) being provided, when conistent with the objectives of such assistance, through African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; N.A.
(d) being used to help overcome shorter-term constraints to long-term development, to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy reforms, the need to protect vulnerable groups; Yes
(e) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the natural resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas? Yes

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED? — Yes / Yes

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No further legislative action is required.

3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

   No

4. FAA Sec. 601(a). Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

   Project is designed to support liberalization of external agricultural marke including the ending of Government monopolies on export of major commodities encouragement of an expande private sector role, and increased exports.

5. FAA Sec. 601(b). Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

   U.S. private firms will be employed to provide technical services and training to Malagasy entrepreneurs.

6. FAA Secs. 612(b), 636(h); FY 1988 Continuing Resolution Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

   N.A.

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

   No

8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

   Yes

9. FAA 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds?

   N.A.

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B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund — N.A.

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities?

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

e. FY 1988 Continuing Resolution. If assistance is in the form of a cash transfer: (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currences that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. governnent as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available)? (c) Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

f. FY 1988 Continuing Resolution. Have local currencies generated by the sale of imports or foreign exchange by the government of a country in Sub-Saharan Africa from funds appropriated under Sub-Saharan Africa, DA been deposited in a special account established by that government, and are these local currencies available only for use, in accordance with an agreement with the United States, for development activities which are consistent with the policy directions of Section 102 of the FAA and for necessary administrative requirements of the U. S. Government?

2. Nonproject Criteria for Development Assistance

a. FAA Secs. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

The goal of the program is to increase rural incomes by removing policy and procedural impediments to liberalized external agricultural markets. Small producers dominate export crop production in Madagascar. Technical studies will address the need for improved technologies in crop processing to expand markets for agricultural products, and should eventually stimulate investment in production and processing. U.S. institutions will be used for training of Malagasy entrepreneurs. Women will benefit from increased employment opportunities in the production and processing of agricultural products, and will be targetted for the training and T.A. to be provided by the project.

b. __FAA Secs. 103, 103A, 104, 105, 106, 120-21__. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

Activity is intended to liberalize external agricultural markets in the belief that the ending of government monopolies and regulation of trade will increase prices paid to producers and thus rural incomes.

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outrearch.

N.A

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

Assistance will be provided to strengthen a local institution in the provisi of business training, both for degree and non-degree programs, and part-time programs for private entrepreneurs. Some funding will also be provided for intensive short-term training (on-the-job as well as academi in business management and public policy for private sector development, in the U.S.

(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is:

(i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

N.A.

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(ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

(iii) research into, and evaluation of, economic development processes and techriques;

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness;

(v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

(vi) for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

(5) [120-21] for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multi-donor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?

c. FAA Sec. 107. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Technical studies will explore possibilities for improved, appropriate technologies for processing agricultural products in preparation for export.

d. FAA Sec. 281(b). Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

The program aims to benefit the rural producer in Madagascar, who represents more than 80 per cent of the population. The country's intellectual resources will be used to the extent possible in implementing studies and training activities.

e. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

ANNEX H

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(MEPRP)

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ABBREVIATIONS

AEPRP	African Economic Policy Reform Program
A.I.D.	Agency for International Development
CASA	Agricultural Sector Adjustment Credit
CASEP	Public Sector Adjustment Credit
CASPIC	Industry and Trade Credit Adjustment Program
FAA	Foreign Assistance Act
FED	European Development Fund
FMG	Malagasy Franc(currency unit)
FOB	Free on Board
GDP	Gross Domestic Product
GDRM	Government of the Democratic Republic of Madagascar
IBRD	International Bank for Reconstruction and Development (World Bank)
IEE	Initial Environmental Examination
IESC	International Executive Service Corps
IQC	Indefinite Quantity Contract
IMF	International Monetary Fund
INSCAE	National Institute for Accounting and Business Administration
IRRI	International Rice Research Institute
LIR	Liberalized Import Regime
MARS	Madagascar Agricultural Rehabilitation Support (AID Project)
MAELP	Madagascar Agricultural Export Liberalization Program
MPAEF	Ministry of Animal Production, Water and Forests
MPARA	Ministry of Agricultural Production and Agrarian Reform
MRSTD	Ministry of Scientific Research and Technology for Development
MTP	Ministry of Public Works
OAR	Office of the AID Representative
OGL	Open General Licensing System
OYB	Operational Year Budget
PAAD	Program Assistance Approval Document
PAIP	Program Assistance Identification Paper
PASAGE	Economic Management and Social Action Support Project
PFP	Policy Framework Paper
PIO	Project Implementation Order
PSC	Personal Services Contractor
REDSO	Regional Economic Development Services Office
RFMC	Regional Financial Management Center
SDR	Special Drawing Rights
TA	Technical Assistance
UNDP	United Nations Development Program

I. SUMMARY AND RECOMMENDATIONS

The proposed Madagascar Agricultural Export Liberalization Program grows out of a clear need to address policy impediments which limit the ability of Madagascar's small agricultural producers to respond to the pattern of improved incentives which they now face as a result of successful stabilization measures implemented by the government. The program is intended to stimulate the production of agricultural export goods so as to improve rural incomes and employment. This is expected to broaden the domestic market for mass consumption goods and provide a firmer basis for the expansion of output and employment for the economy as a whole.

After growing at an average annual rate of about 3 percent per year in the 1960s, based largely on strong agricultural performance, the economy of Madagascar underwent a drastic deterioration following the 1972 and 1975 revolutions. The socialist regime which came to power in 1972 emphasized state control of the economy, nationalized most large private firms, and established a government monopoly over the marketing of agricultural products and inputs. These policies resulted in stagnating agricultural output, steadily rising agricultural imports, and declining per capita output and consumption for the economy as a whole. By 1982, real GDP per capita had fallen by 28 percent from its 1973 level, external debt service obligations had reached 72 percent of exports of goods and non-factor services, and declining import capacity threatened still further declines in output, employment, and consumption.

Beginning in 1982, the government began moving aggressively to reduce the fiscal and balance of payments deficits. In all, the central government cash deficit was reduced from 14.9 percent of GDP in 1981 to an estimated 3.1 percent in 1988. The government was somewhat slower to adjust the exchange rate. Although adjustments of the nominal rate began as early as mid-1980, the initial adjustments were inadequate to offset accelerating inflationary pressures and the real effective exchange rate peaked in mid 1983. Subsequent adjustments including two large devaluations in the second half of 1986 and in June 1987 have left the real effective exchange rate at about half its 1978 value.

Although fiscal and exchange rate adjustments succeeded in restoring the balance of payments essentially to zero in the 1984-87 period (albeit with a great deal of debt rescheduling) while halting the decline in output, stabilization by itself has not been sufficient to restore an acceptable rate of growth. The reasons for this can be traced to a series of structural distortions, primarily introduced during the 1970s, which have prevented private sector producers, and producers of tradables in particular, from responding to an improved generalized pattern of price and market incentives. In some cases, these distortions were preventing an improved pattern of incentives from being reflected at the producer level, as in the case of price and markup controls at the retail level, price controls and regional marketing restrictions for agricultural products, especially rice, and public sector export monopolies (caisse de stabilization) for the country's principal export crops. In other cases, the structural obstacles prevented producers from responding effectively to the price signals that they received, as in the case of cumbersome export licensing procedures, rigid and somewhat arbitrarily administered exchange controls which blocked access to essential inputs and spare parts, and finally an inefficient public sector banking system burdened with a large volume of non-performing parastatal debt.

Since 1985, the Government of Madagascar has entered into a series of sectorally oriented structural adjustment credits with the World Bank to address this wide range ofstructural impediments to improved growth. The details of these programs are beyond the scope of this summary but they have attempted to deal in a systematic way with the structural impediments in each sector. As a result of these reforms, the exchange regime has been made more predictable and automatic, most price controls have been eliminated, regional transportation restrictions imposed at the national level have been eliminated (although regional government taxation and ad hoc restrictions remain a problem), and substantial progress has been made in the liberalization of the rice market.

Rice market liberalization has been by far the most controversial aspect of the reform program and the government's performance has been mixed. Prior to May 1983, the Government had an absolute monopoly of the purchase and sale of rice. Since that time, the government opened rice marketing to private sector participation except in two geographic areas which accounted for 25 percent of total production, abolished the legally established ceiling price for rice, and finally eliminated the remaining regional monopsonies. As a result of these measures, regional price differentials fell substantially, many new traders entered the market, and the number of private mills increased from 11 in 1983 to 90 by 1985.

Following a large increase in consumer rice prices in early 1986, the government established a "buffer stock" to limit upward movements in retail prices but the conditions for the release of buffer stock rice has been a major point of controversy between the government and donors in the period since 1986. Beginning in late 1987, PROCOOPS, an ostensibly private sector organization with strong political connections with the governing AREMA party, began below-market sales of rice donated by North Korea in Antananarivo and Tamatave. While not technically a violation of the agreement with the World Bank and other donors, its actions are certainly a violation of the spirit of those agreements.

The actions of the government and PROCOOPS are of considerable concern to AID. Yet they should be kept in perspective: the government has not reestablished price controls or restricted private sector milling or marketing of rice; and 1988 imports by the government and PROCOOPS are estimated at 110 to 120 thousand metric tons, approximately the same volume of imports which were undertaken in 1984 and 1985 and considerably less than the level of imports of 1986 or the period before 1984.

The GDRM has never explained its reasons for the backtracking but they clearly relate to concerns that the cumulative effect of exchange rate adjustment, government spending cuts, and price liberalization have had a disproportionate adverse impact on the living standards of the urban middle class. The toleration of this group for policy reform in general is critical to the success of the government's overall economic recovery efforts.

Because of the extreme political sensitivity of the rice pricing question, AID has chosen not to attempt to achieve further gains on that policy front at this time, but rather seeks to support further policy reforms in the area of small-farmer-produced export crops. This is a policy area which addresses the GDRM's immediate balance of payments concerns and furthers AID's objectives of improving small farmer income.

The Madagascar Agricultural Export Liberalization Program (MAELP) has two major components: (1) direct program assistance in support of policy reform in the agricultural export area, and (2) a project component made up of studies, technical assistance, and training which is designed to clarify and develop support for a broader policy reform agenda. In addition to the policy reforms to be immediately supported by the program, the policy studies will examine policy impediments to the efficient operation of the full range of markets in which small farmers transact, including rural financial markets, agricultural input and product markets, and the markets for consumer goods in rural areas. These are areas where needed changes are not yet clearly defined, despite widespread recognition that problems exist. The results of these studies and technical assistance will form the basis of future policy dialogue, whether or not supported by additional policy-based assistance.

Of the total planned $18.735 million in AID contribution to MAELP in FY 1988, $16 million will be disbursed in support of policy reform. Disbursements will be made in two tranches. The first is expected to be made shortly after signature of the grant agreement in July 1988, on the basis of the substantial dismantling which has already taken place - in part due to A.I.D.'s encouragement - of government monopolies for three of the chief traditional agricultural export crops. This action has already been announced by the GDRM. The second disbursement, which could be made as early as January 1989, will be based upon the performance of a small number of objectively verifiable indicators of the effective implementation of these same reforms. The performance of the GDRM, as reflected in these key indicators, will be examined by an external review team, which will make a recommendation to OAR/Madagascar concerning the release of the second tranche. This review team will also be tasked with recommending whether AID should obligate additional funds in FY 1989 under MAELP for agricultural market reform, and if so, what conditions should be attached to that support. OAR/Madagascar intends to continue to support the consolidation of the reforms identified in this document - or needed reforms identified by the studies to be undertaken under the MAELP - if such support is warranted.

The $2.735 million programmed for project assistance will support technical and policy studies, training, and technical assistance. The study activities will be designed both to clarify the remaining reforms needed in complementary areas (rural finance, input and product markets) to sustain the momentum generated by liberalization of agricultural export markets, and to build a constituency for the reform effort among a broad spectrum of academics, businessmen, and government officials. The most important of the studies to be undertaken early in the project is a baseline rural household income and expenditure survey. This survey will provide badly needed basic information on the components of small farmer real income and will guide future policy dialogue efforts. Beyond this, if the program is successful, the survey and subsequent follow-up surveys will demonstrate that success both to the Malagasy and to us. On the other hand, if there should be a breakdown between the program activities and the achievement of its goal and purpose, the follow-up surveys will provide us with both an early warning system to identify that breakdown and with suggestions for further study areas and corrective measures, either additional policy reforms or project interventions.

The MAELP comes at a time when the Government of Madagascar has shown its commitment to moving ahead with a far-reaching program of economic reform that extends to all key sectors so as to take advantage of the improved while known sources of coal, uranium and oil-bearing tar sands remain unexploited. Many years of exploration for oil in the south and west have recently resulted in the discovery by Petrocanada of a promising site near Morondava in the west. However, the most lucrative find to date is a deposit in the southeast of the strategic metal titanium, said to be one of the largest in the world. Plans for exploitation are underway despite the fact that the site is now a nature reserve harboring some of Madagascar's many unique plant and animal species. With extensive beaches along the coast and offshore islands, as well as its unique biological wealth, Madagascar also possesses strong potential for tourism.

B. Economic Analysis

The following discussion outlines Madagascar's recent social and economic history, from the revolutions of the early 1970s to the present, providing an understanding of what problems the country has faced, how it has responded, and what future actions need to be undertaken in order to further the country's development. In this discussion, the principal objectives are to describe the collapse of the economy in the early 1980s, the stabilization efforts and their successes, the need for structural adjustment, and the limits posed by social and institutional factors. The particular program intervention is derived from this analysis. The Mission Strategy concludes the discussion. A full discussion of the economic reform program and its social and institutional context can be found in Annex B.

1. Centralization and Economic Collapse

Madagascar is one of the world's poorest countries. With a population estimated at 10.6 million in 1987, the country's annual gross domestic product equals just $265 per person, a level which has been virtually stagnant for the last several years. Rapid population growth of nearly 3 percent per year compounds the problem, and has resulted in declining real per capita income. The situation has not always been quite this bleak.

In the 1960s, during the decade following independence, the Malagasy economy grew at approximately three percent per year. This was faster than the then rate of population growth, and produced small increases in real per capita incomes. Frustrated with the slowness of the growth, however, and disturbed by the unequal distribution of the proceeds of that growth, the country underwent socialist revolutions in 1972 and again in 1975. A principal concern of each revolution was reducing foreign, interpreted as French and western, interference in the country, increasing the role of indigenous Malagasy in the country's economy, and reducing individual control of and profit from the exploitation of the country's natural resource base. Specifically, the revolutions resulted in increasing state control over various aspects of the economy, including the institution of parastatal monopolies for marketing rice and other crops, banking, energy, insurance, imports, exports, and the expansion of public enterprises in several industries.

In addition, the centralized, post-independence Government structure was decentralized, allowing the fokontony, or local, government broad new rights to impose and collect taxes as well as to provide services. Regulatory intervention of the central and local governments also increased substantially, price controls were generalized, and import restrictions and exchange controls tightened. The net result of these actions was a general neglect of the productive, agricultural sector, and a promotion of inward looking production activities in a highly protected environment.

These changes did not produce the intended acceleration of growth which the Government desired. As a result, the government attempted to reverse the economic decline of 1972 to 1978 through a massive public investment program designed to hasten industrialization through capital intensive technologies while imposing further pricing and marketing policies which favored urban consumers. This industrial expansion effort began in 1978.

These attempts to stimulate the expansion of Madagascar's stagnating economy contributed to the economic crisis which began in 1980-81. The share of investment in GDP had averaged 13 percent from 1970 to 1978, but mushroomed to 25 percent for 1978-79. The financing of this massive expansion contributed to a large public sector deficit without adding to productive capacity. By 1980, the budget deficit equaled 18 percent of GDP, inflation grew at more than 30 percent per year in 1981 and 1982, and the debt service ratio exploded, from just four percent of export earnings in 1978 to 90 percent, before rescheduling, in 1985. This debt service burden has been responsible, in part, for the severe lack of foreign exchange in recent years, and has itself further stalled economic growth.

Exacerbating the foreign exchange shortage was the greatly overvalued Malagasy franc. This led to an unsustainable demand for imported goods while simultaneously undermining the profitability of exported Malagasy agricultural commodities and finished products. This, in turn, was translated back into declining real producer prices for agricultural commodities, and a sharp contraction of agricultural production for export.

By 1982, real GDP per capita had fallen by 28 percent from its 1973 level, external debt service obligations had reached 72 percent of exports of goods and non-factor services, and declining import capacity threatened still further declines in output, employment, and consumption.

2. Stabilization

Faced with a clearly unsustainable resource gap, the government undertook a series of strong and effective stabilization measures beginning in 1982. These measures included reducing capital expenditures from 11.6 percent of GDP in 1981 to 7.5 percent in 1982 (this level has been maintained in successive years). Secondly, the government limited central government recurrent expenditures, principally through a near freeze in the number of civil servants (their numbers increased by only 1.6 percent between 1983 and 1986), and a significant compromising of real public sector salaries. In all, the budget deficit was reduced from nearly 15 percent of GDP in 1981 to an estimated 3.1 percent in 1988. Concurrent with this contraction of the deficit, domestic bank borrowings by the central government have been substantially reduced from 7.4 percent of GDP in 1981 to a net repayment position in 1988.

The government was somewhat slower to correct the exchange rate. Although adjustments began as early as mid-1980, the initial adjustments were inadequate to offset accelerating inflationary pressures, and the real effective exchange rate peaked in mid-1983. Subsequent adjustments have been substantial, however, and have included two large devaluations in the second half of 1986 and another in June of 1987. Combined, these devaluations have left the real effective exchange rate for the Malagasy franc at just about one half its 1978 value.

Among other measures taken to reduce aggregate demand were reductions in consumer subsidies. The Government more than doubled the price of rice distributed through official channels, and consumer subsidies on imported rice were eliminated. In addition, tax measures were improved, price increases for public enterprise produced goods announced, and imports were sharply curtailed. Finally, tight bank credit ceilings were imposed to help reduce inflation. These efforts were successful and, during a time of devaluation, inflation was reduced from 30 percent in 1982 to just 11 percent by 1985.

3. Structural Reform - the need

Although fiscal and exchange rate adjustments succeeded in restoring the overall balance on the balance of payments essentially to zero by 1985, while halting the decline in output, stabilization by itself has not been sufficient to restore economic growth. There have been some responses that show that economic areas unencumbered by market distorting controls and regulations have indeed taken advantage of the stabilization efforts to date. Examples include shellfish exports, which have increased dramatically over the last several years to become the country's fourth largest foreign exchange earner. Domestically, there are many producers and exporters of this perishable commodity, and their volume of sales attests not only to their success but also to the incentives offered by undistorted stabilization efforts. In a second area, a look at the estimates of services receipts for 1988 compared to 1983 shows a projected increase of 76 percent over the earlier year, demonstrating a clear response to price incentives in a relatively unregulated field.

There are, unfortunately, more examples of how stabilization efforts themselves have been insufficient for growth. The reasons for this can be traced to a series of structural distortions, primarily introduced during the 1970s, which have prevented private sector producers, and producers of tradables in particular, from responding to an improved generalized pattern of price and market incentives. In some cases, these distortions have prevented an improved pattern of incentives from being reflected at the producer level, as in the case of price and mark-up controls at the retail level, price controls and regional marketing restrictions for agricultural products, especially rice, and public sector export monopolies (caisse de stabilization) for the country's principal export crops.

In other cases, the structural obstacles prevented producers from responding effectively to the price signals which they received, as in the case of cumbersome export licensing procedures, rigid and somewhat arbitrarily administered exchange controls which blocked access to essential inputs and spare parts, and finally an inefficient public sector banking system burdened with a large volume of non-performing parastatal debt.

The need for structural reform was discussed as early as the 1983 Consultative Group meeting on Madagascar. At that meeting, the Group developed the first phase of reform, which included the following main points (as reiterated by the World Bank, 1986):

(a) promotion of private, smallholder production, and de-emphasis of parastatals and collective production;

(b) concentration on investment in rehabilitation;

(c) reliance on market prices;

(d) withdrawal of the agricultural ministries and parastatals from direct-production and commercial activities; and,

(e) improvement of essential public sector services.

Some progress has been made in moving toward these goals, and substantial assistance for structural adjustment has come from the Bank itself.

Since 1985, the Government of Madagascar has entered into a series of sectorally oriented structural adjustment credits with the World Bank to address this wide range of structural impediments to improved growth. The details of these programs are discussed in detail in Annex B. In sum, the World Bank and the International Monetary Fund have attempted to deal in a systematic way with the structural impediments in each sector. As a result of these reforms, the exchange regime has been made more predictable and automatic, most price controls have been eliminated, regional transportation restrictions imposed at the national level have been eliminated (although regional government taxation and ad hoc restrictions remain a problem), and substantial progress has been made in the liberalization of the rice market.

Rice market liberalization has been by far the most controversial aspect of the reform program and the government's performance in this area has been mixed. Prior to May 1983, the Government had an absolute monopoly on the purchase and sale of rice. In 1982, the retail price of rice was raised 82 percent, eliminating an explicit consumer subsidy and improving producer prices. In 1983, the government opened rice marketing to private sector participation except in two geographic areas which accounted for 25 percent of total production. In June 1985, the legally established ceiling price for rice was abolished. Subsequently, the two remaining regional monopsonies were eliminated. As a result of these measures, regional price differentials fell substantially, many new traders entered the market and the number of private mills increased from 11 in 1983 to 90 by 1985.

Following a large increase in consumer rice prices in early 1986, the government established a "buffer stock" to limit upward movements in retail prices. AID and other donors contributed rice to establish that stock whose release price was set at 40 percent above the average market price during the previous post-harvest period. The conditions for the release of buffer stock rice have been a major point of controversy between the government and donors in the period since 1986. Beginning in late 1987, PROCOOPS, an ostensibly private sector organization with strong political connections with the governing AREMA party, began below-market sales of rice donated by North Korea in Antananarivo and Tamatave. While not technically a violation of the agreement with the World Bank and other donors, its actions are certainly a violation of the spirit of those agreements. Moreover, PROCOOPS actions have the potential for disrupting newly established private sector market channels, and thus may, although there is as yet no solid evidence that they have, reduce farm-gate prices.

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The actions of the government and PROCOOPS are of considerable concern to AID. Yet they should be kept in perspective. The government has not reestablished price controls or restricted private sector milling or marketing of rice. The volume of imports to be undertaken in 1988 by the government and PROCOOPS is unclear but seems to be in the range of 110 to 120 thousand metric tons. While this is higher than one would like to see, given that Madagascar has the potential to be an exporter of rice, it is approximately the same volume of imports which were undertaken in 1984 and 1985 and considerably less than the level of imports of 1986 or the period before 1984.

Not all reforms have been focussed on the rice sub-sector, however. The government also responded to recommendations for improving export crop marketing contained in major studies prepared by several international donors. Incentives to diversify exports were provided, with the elimination in 1984 of all taxes on agricultural exports, excluding the traditional crops. Real producer prices for coffee were increased at the time, and services to coffee growers strengthened. The government also removed market and price controls for groundnuts, previously an important export as well as edible oil source. Other reforms were undertaken with respect to edible oil production, livestock, and cotton.

Although many "correct" policy changes have been announced, the implementation of such reforms has been difficult for the government. An example of the difficulties arising from the implementation of the reforms comes from an AID financed study completed in October, 1987, by Elliot Berg. The report makes the following observation:

> Export marketing remains heavily controlled, with the traditional exports "reserved" for parastatal trading firms. Progress is being made in some non-traditional exports, where entry is easier; shrimp exporters are numerous, and volumes have grown rapidly in the last few years. According to some observers, a certain amount of informal privatization or decentralization is taking place in minor exports like lobsters and lychee nuts. But regulations remain endemic and monopolization typical in marketing of major agricultural exports.

This observation corroborates World Bank reflections at the time that the first phase of the adjustment process fell short of its goals due to a lack of coherence in the spectrum of government policies. "Incentives were not provided for all products, accentuating the preference of farmers for outputs with high returns. Controls on prices and markets gave room for crop retention, speculation, and black-marketing. At the same time, import policies were not tailored to overcoming shortages, and acted as a disincentive to production."

4. Structural Reform - the future

Despite the inherent political difficulties of continuing with reforms, the Government of Madagascar has made it clear that it not only intends to proceed with the comprehensive program of reforms agreed to in the Policy Framework Paper (PFP) (see Annex B for a summary), but will accelerate the implementation of several key measures in 1988. Some planned measures will, in fact, go beyond the steps agreed to in the PFP. The next steps to be taken by the Government of Madagascar in 1988 and 1989, which follow a logical progression in the effort to put the country on the path of sustainable growth, are summarized below. These measures are the result of a careful analysis of the remaining constraints to growth, and will be undertaken with the assistance of the IMF and the IBRD as well as the bilateral donors. This year, 1988, will be a year marked by major efforts to liberalize external trade and to stimulate export production. The Open General License system will be introduced on an accelerated schedule with full implementation planned for July 1988. Initial experience with the OGL has been one of low demand for foreign exchange. This appears to reflect the transition from a system where exchange was applied for in advance of needs, to one in which foreign exchange is applied for only when needed since receipt of the full amount is assured and since full payment in local currency must be made at the time of application. Also, a large percentage of foreign exchange obtained under the LIR in 1987 is still unused. Thus, it is difficult for the Central Bank to anticipate actual demand for foreign exchange under the OGL, and concerns remain that a large sudden demand will push reserves below the target and force a large devaluation. The Central Bank is therefore increasing reserves, tightly controlling credit, and encouraging donors to disburse the balance of payments assistance promised at the January 1988 Consultative Group, which to date has been slow in coming. The GDRM remains committed to an active exchange rate policy, adjusting the rate as needed to maintain an appropriate level of foreign exchange reserves so as to assure the smooth functioning of the OGL system.

Liberalization of the export sector has also been accelerated. In mid-February 1988, the Government ended the state trading company monopoly on exports of pepper and cloves, and freed internal trade and prices in these products, leaving only coffee and vanilla subject to management by the Stabilization Funds. Taxes on pepper will be eliminated, although a flat tax on cloves will continue to be collected. Pending the planned April completion of a study commissioned by the World Bank, coffee exports will continue to be carried out by the state trading company. Under the terms of structural adjustment agreements, recommended changes in the marketing arrangement for coffee are to be made prior to the 1988/89 coffee season which begins in May, while the producer price for coffee will again be raised substantially to bridge the gap that remains between producer price and f.o.b. export price. Coffee is the crop that holds the greatest potential for increasing export earnings in the short run, although non-traditional exports such as fruit and seafood also show promise.

Other steps will further lighten administrative export procedures. The Government will abolish requirements for cards, licenses, and prior authorizations for internal trade (collection, processing and storage) and export of all of the major export crops and will extend the maximum period for repatriation of foreign exchange earnings from 30 to 90 days. Also, in 1988 the Government will publish an exporters' guide to support the export sector, and will activate plans for free trade zones to stimulate investment.

In agriculture, the GDRM has already taken significant action to reverse poor policies, as noted above. Sustained and thorough implementation of the announced liberalization policies are now required. Major implementation actions are planned for 1988 and 1989 to remove pricing and marketing constraints on the agricultural export crop side. It is in this area where AID/Madagascar will provide support.

C. Social and Institutional Constraints

A major concern among all donors has been the problem of political opposition to the reform programs. It must be recognized that the various elements of the stabilization and structural reform efforts have had the effect of increasing the real incomes of rural smallholders at the expense of urban residents in general and the urban middle class in particular. The reduction in central government current expenditures has largely been accomplished through wage compression for civil servants and a substantial decline in employment on public infrastructure projects. The adjustments in the real exchange rate have disproportionately reduced the real incomes of the middle and upper class. (Imports, directly or indirectly make up 35 percent of the market basket of urban "modern households" but only 12.9 percent of the consumption of urban "traditional households" according to surveys underlying the consumer price index and almost certainly a still smaller proportion of rural consumption.) Similarly, the attempt to raise the farm-gate price of rice represented an income transfer from urban (and some rural) rice consumers to rural rice producers.

While it would be difficult to quantify the distributional impact of the reforms, the cumulative effect, although undoubtedly "favorable" in some abstract sense, has the potential for seriously, and perhaps irretrievably, undermining political acceptance of the reform effort among the urban population.

Asked in another way, the major question concerning the reform program in Madagascar is whether the present trend towards economic liberalization represents a real change in direction, or is only a forced response to the immediate economic crisis and donor demands. It is certainly true that there is a widespread perception that the reforms have been imposed by the IMF and the World Bank in return for much needed financial assistance. It is also true that understanding of the measures and popular support for them are notably lacking. During an assessment of the reform program conducted in June of 1987, an American economist Elliot Berg noted that he found little intellectual support for the free market idea outside the U.S. Embassy and the World Bank office ("Report on the Economic Reform Program in Madagascar", 1987). This raises the equally serious question as to what the outcome of the liberalization policies will be, regardless of government intentions, in the face of an uncommitted majority and well positioned groups that stand to lose from the changes that are occurring.

The implementation of the reforms needs to take into account not only the overall impact on the economy as a whole and the impact on AID's target group, the rural and urban poor, but also the impact on those identifiable groups whose opposition has the potential for blocking and even undoing the reforms. This has two implications for donor programming. First, it may require that we delay pressing the government to undertake reforms, such as complete rice price liberalization, which further aggravate the position of urban consumers, in favor of other reforms whose effect on those consumers is more neutral, such as export market liberalization. Second, it may require that we undertake assistance programs, such as the proposed Section 206 program, whose primary beneficiaries are urban middle class consumers.

D. Mission Strategy

The recently approved Concepts Paper for Madagascar states the goal of the A.I.D. strategy for the 1988-90 period to be "to assist Madagascar to increase rural incomes while improving nutritional levels and maintaining the country's natural resource base." This builds on the agricultural sector emphasis of the Mission's program to date.

The strategy outlined proposes an active role for A.I.D. in supporting the overall liberalization program, because without elimination of the constraints which presently depress their incomes, the welfare of smallholders, who form the backbone of the agricultural economy, cannot be improved in any sustainable way. U.S. support to the 1987-90 structural adjustment program entered into by the Government with assistance from the IBRD and the IMF will come in two principal forms: Balance of payments support will finance needed external resources; and local currency generated by BOP contributions will to support reform objectives through attribution to the GDRM budget. A.I.D. will be the first donor to take this approach, which is intended to reinforce the ongoing effort to reform budgeting procedures by bringing off-budget revenues into the budget. This approach will also guarantee adequate resources for the programs in the government budget which are central to the achievement of the objectives of the AID strategy, and to a sustainable growth path.

The U.S. will use food assistance to support the liberalization process by helping to stabilize prices and markets under conditions of scarcity while the GDRM implements agricultural policy reforms to stimulate domestic production. In particular, the Section 206 program will supply vegetable oil in order to assume as adequate supply of a commodity that is critical to the welfare of the urban population. A.I.D. remains prepared to support targeted feeding programs for nutritionally vulnerable groups, particularly women and children.

The major new activity, however, is the Madagascar Agricultural Export Liberalization Program (MAELP) which we present in detail in the next section. The policy reforms supported will be liberalizing external agricultural market operations. Given the current level of GDRM political sensitivity regarding the rice subsector (originally proposed as the focus of the MAELP), and in view of the need for time to allow recent reforms in the subsector to take hold, the focus of the proposed reform agenda on external agricultural markets offers the best opportunity for broadening the impact of the structural reform process. Such a focus will also enable OAR/Madagascar to maintain its dialogue with the GDRM on rural incomes. At the same time, reforms in agricultural export marketing, import liberalization, and the maintenance of a market determined foreign exchange rate will all directly contribute to the continued reform of the rice sub-sector by facilitating access by producers to imported inputs and by driving domestic producer prices upward toward world market levels.

Rural incomes are strongly affected by the production of export crops, and the importance of the export crop subsector, to the nations economy as well as to the livelihood of its rural producers, cannot be overlooked:

> Export crops are the main means of livelihood for almost one-third of Madagascar's population, and the country's principal source of foreign exchange. Coffee alone contributes an average 40 - 50 percent of annual export earnings. Cloves and vanilla are also critically important to the economy. Together, these three account for about 80 percent of export revenues. ... They are also important for the future expansion of employment opportunities in agriculture. Growth in this sector is, therefore, critical for social and economic development. (World Bank, 1984)

Experience everywhere demonstrates that the key to improving rural incomes is to raise producer prices. In Madagascar, the best way to achieve an increase in producer prices is through liberalizing agricultural export markets. Strict government control over prices and marketing margins along with a monopoly by public enterprises on the export of the traditional export crops have until now kept producer prices very low. For example, despite substantial price increases in 1986 and 1987, the producer price for coffee remains at 55% of the f.o.b. export price. The removal of price controls and restrictions on marketing will stimulate competition among a growing number of traders to the benefit of the producer. This in fact has already happened with cloves in the brief period since clove marketing was liberalized.

As previously discussed, there is scope for expansion of agricultural exports even in the short term. Increases in agricultural export earnings which already account for over 80% of total export earnings represent the most promising means for Madagascar to increase overall export earnings in order to finance the additional imports that are needed to fuel economic growth. Additional export earnings are essential for assuring the smooth functioning of the liberalized import system. A.I.D. balance of payments support for the implementation of a liberalized import system will strengthen Government of Madagascar resolve to proceed with another urgently needed reform at the same time - a market-determined exchange rate - since the adjustment of the exchange rate will depend upon the drawdown of foreign exchange reserves under the Open General License System.

In sum, the MAELP is intended to reinforce GDRM commitment to implement the substantial program of reforms already agreed to with the IBRD and the IMF and to extend and reenforce the implementation of these reforms in an area which will bring substantial benefits to the poor majority of Malagasy. The provision of MAELP resources will depend upon the Government's sustained implementation of these selected reform measures. At the same time, a primary purpose of training, studies, and technical assistance will be to build a public and private sector constituency in support of the structural adjustment program and to sustain commitment to the reform process.

III. PROPOSED PROGRAM

A. Goal and Purpose

Within the general framework of the Mission strategy the goal of the proposed program is:

to increase rural incomes.

In order to meet this goal, the purpose of the program is:

> to reduce policy and procedural impediments to liberalized Malagasy external agricultural markets.

Both the goal and purpose of the program are well grounded in the Mission's overall strategy. The concerns addressed remain focussed on the rural, agricultural sector and in particular on the livelihood of the smallholder who dominates in the production of export crops as well as food crops. It is these millions of small producers of export crops(one-third of Madagascar's population depends on export crop production for their main source of income) who are the intended beneficiaries of the MAELP, as well as the numerous private sector operators involved in the collection, processing, transport, and export of agricultural products.

The program recognizes the substantial progress which the GDRM has made in extending the liberalization effort throughout the agricultural sector, while also recognizing that reforms taken to date and those soon to be introduced need to be supported and consolidated before they can be regarded as a success. Since many of the reforms have recently been adopted, the areas of administrative and procedural resistance are just now becoming apparent. Therefore, the MAELP proposes support for the consolidation of the GDRM's reform agenda in the sector, while simultaneously exploring remaining problem areas through careful monitoring of the progress of reforms and continued policy dialogue based on a coordinated program of studies and technical assistance.

Principal among the concerns and risks facing the GDRM's reform program are political risks posed by segments of the population chiefly the urban middle class, who have been adversely affected by the reform program. The ways in which they are affected, and by which their conditions may be ameliorated, are discussed in Annex E.

B. Policy Dialogue Agenda

The policy dialogue agenda extends beyond the program purpose, which is to remove policy and procedural constraints which cause Madagascar's external agricultural markets to work inefficiently to encompass policy impediments which inhibit the efficient functioning of markets which rural producers transact in. It consists of four areas which, when taken together, address key constraints relevant to the Government's reform program in the agricultural sector. They are:

1. Liberalization of agricultural export markets;
2. Improving the efficiency of rural input markets;
3. Improving rural financial markets for both borrowers and savers;
4. Improving the availability and price of consumer goods in rural markets.

The first of these areas may be actively pursued at this time; the other three must be studied more closely to define interventions. For the first area, our objective is as follows:

> Export markets will be liberalized in order to improve market opportunities and producer prices for the agricultural producer and to increase private sector participation in agricultural exports.

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Liberalization will consist, first, in freeing the foreign exchange market through efforts which remove restrictions to the importation of commodities and which maintain a market clearing exchange rate. Second, liberalization will relax export controls on agricultural products, specifically the principal export crops. This twin approach to export market liberalization will ensure that the Malagasy franc provides an incentive to the current and potential exporter, while removing administrative barriers which are often a greater impediment to export growth than the exchange rate. Both aspects will be addressed concurrently.

For the other three areas of the reform agenda -- input and product markets, rural financial markets, and consumer good availability -- where there is general agreement regarding the existence of problems but for which precise interventions need to be defined, the Mission proposes a combined program of studies and technical assistance to further identify the nature of the problems and to outline policy or procedural reforms which would address them. The key issues in each of these reform areas are:

Rural input and product markets - inefficiencies which increase costs of commodities sold in rural areas and depress farmgate prices.

Rural finance - administrative and other barriers to rural financial market development, and the constraints imposed on rural production by the lack of credit and lack of opportunities to place savings in accounts which earn a reasonable rate of interest.

Availability and price of consumer goods in rural areas - the reduced supply of domestically produced consumer goods which result from monopoly and cartel production protected by tariff and non-tariff barriers and import controls.

These problems are explored in depth in section III.C.4. "Studies". The objective for the Mission which emerges from this segment of the program is:

> to establish, through studies and technical assistance, a framework within which the Mission can continue discussions with the GDRM regarding the implementation of agricultural market liberalization.

This approach does not commit the Mission to future policy based assistance in each area. Rather, the studies and technical assistance will provide the Mission with a series of options for appropriate next steps, with an agenda for sustained policy dialogue with the GDRM, and with a perspective on the nature of the evolving reform agenda within the agricultural sector.

C. Description of Program Activities

1. Introduction

The Madagascar Agricultural Export Liberalization Program has two major components: an agricultural sector grant conditioned on policy reform, and a project component made up of studies, technical assistance and training linked to the policy dialogue agenda which is intended to reinforce the implementation of announced policy and procedural changes. Of the total program funding of $18.735 million, $16 million has been targeted for policy reform support and $2.735 million for related project activities. Policy reform support will be provided through a sector grant, whereas studies, technical assistance, and training will be funded under a project grant. The PACD of the program is June 1991. Each component is discussed in detail below.

2. Policy Reform Conditioned Sector Grant

The first program component is a policy component, in which GDRM progress in meeting policy reform objectives will be used as the basis for making dollar disbursements which the GDRM is expected to use to finance imports under the Open General Licensing System. The policy reform objectives are focussed on the liberalization of agricultural export markets as the item on the policy dialogue agenda where needed interventions are well defined, and where progress can be expected to make a significant contribution to increasing rural incomes and stimulating economic growth over the next three years.

a. Reform Objectives and their Progress Indicators:

The objectives of the policy component are presented below along with the progress indicators that will be used to measure their achievement. The policy objectives are:

1) Agricultural export markets for the principal export crops (e.g. coffee, cloves, and pepper) will be liberalized.

2) Administrative requirements for the export of agricultural products will be streamlined.

3) The Open General Licensing system (OGL), or an agreed equivalent foreign exchange allocation mechanism, will continue operation, so that producers and those who produce for their needs will have adequate access to inputs and spare parts and so that a sufficient supply of incentive goods will be available for the rural producer.

As with any reform objective, the difficult task is identifying ways in which progress toward the objective can be measured. In the past, benchmarks have often been established in an inflexible way which has failed to recognize that objectives can be achieved by following more than one path. The emphasis in this program will be on measuring the overall achievement of objectives, and therefore performance will be assessed on a broad range of progress indicators. The following progress indicators proposed here should be viewed as illustrative rather than exhaustive, and are subject to modification during the monitoring process.

There are essentially two tiers of progress indicators that will be used to measure performance under the MAELP policy component. The first set of indicators concerns actions or announcements by the Government of Madagascar which indicate that policy or procedural reforms have been introduced. This set of indicators will be used to determine whether conditions for first tranche release have been satisfied. Examples of such indicators are:

- GDRM opens marketing of the traditional export crops: coffee, vanilla, cloves, and pepper, to the private sector. Actions might include the announcement that a government monopoly for export of a particular crop (cloves, coffee) has been abolished, or that restrictions on the number of operators who may purchase or export a particular crop have been lifted.

- A system for allocating foreign exchange in an open and competitive manner has been established.

However, fulfillment of these progress indicators alone will not ensure that the objectives outlined are met. As a recent World Bank report on Madagascar reminds us, "Administrative procedures are used to conceal a variety of discriminatory practices with negative impacts on export performance." ("Administrative Constraints to Agricultural Exports", IBRD, January 1987). Additional progress indicators which define the ways that implementation of the liberalization effort can be assessed are required. Such "second tier" progress indicators might include,

For agricultural export market liberalization:

-share of export volume of traditional crops marketed by private operators has increased.
-number of private operators involved in export marketing has increased.
-export volume of non-traditional crops, particularly those formerly subject to informally reserved markets, has increased.
-export of new products or processed versions of traditional products has been initiated.
-time required to process an export shipment has decreased.
-number of administrative approvals, clearances or fees for export transactions has decreased.
-an export guide has been published which provides a complete and concise summary of all regulations in effect for export operators.
-no new formal or informal disincentives or discriminatory procedures are introduced at the level of production, purchase, transport, processing or export sale.
-local government taxes on movement of agricultural commodities are replaced with alternative revenue-generating measures.

For foreign exchange allocation:

-do people all over Madagascar have equal access to foreign exchange under the OGL (i.e., do all existing bank branches including those in outlying provinces, provide services to clients who have need of foreign exchange)?
-are applicants receiving the total amount of foreign exchange requested within the six day period decreed for the OGL?
-are any hidden or excessive charges being imposed which discriminate against certain categories of applicants, or certain types of imports?

The reference points for these indicators will be established by a baseline survey. These indicators will be used to measure whether the implementation of announced reforms is proceeding, and it is upon the basis of sustained implementation that the second tranche of the sector grant will be disbursed.

The concept of progress indicators is not appropriate for the objective of the second segment of the reform agenda namely, to establish a framework within which the Mission can continue discussions with the GDRM regarding the

i. On the basis of prior discussions and agreement with A.I.D., opened export marketing of the traditional export crops (coffee, cloves, pepper) to the private sector and continues to permit private operators to operate on an equal basis with public sector firms.

ii. Instituted the OGL or an agreed alternative system to allocate foreign exchange in an open and market-clearing manner; and

iii. Submitted a letter to USAID which outlines the GDRM's proposed schedule for meeting the conditions precedent to the second disbursement.

2. Prior to the disbursement of the second tranche of $8.0 million under this Agreement, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish, in form and substance satisfactory to A.I.D. evidence that (a) it has met all the conditions set forth hereunder for the release of the second tranche of $8.0 million, and (b) has successfully implemented policies and procedures to promote liberalized agricultural export market operations, and continued to allocate foreign exchange in an open and market clearing manner through the OGL or an agreed alternative mechanism, as determined by measurement of the following progress indicators:

i. The share of traditional crops marketed by private operators has increased to at least 50% of total value for at least two of those crops.

ii. There is free access to export markets for all non-traditional export crops.

iii. The OGL system or an agreed equivalent mechanism operates as planned with respect to receipt of the full amount of foreign exchange applied for within the six working day time period specified in the implementing regulations for the OGL.

iv. The number of administrative approvals, clearances and fees for export transactions has decreased and the time required to process an export shipment has been reduced to less than three days.

v. The Government will have published an export guide providing a complete and concise summary of all export regulations in effect.

These progress indicators will be the subject of an Implementation Letter (IL) to be issued following the signature of the Grant Agreement. The IL will establish the baseline against which the progress indicators will be measured as well as the performance targets to be met. Upon notification that the conditions precedent to disbursement of the second tranche have been met, A.I.D. will designate an external review team to assess the progress made and to determine whether performance satisfies the conditions for second tranche release. This assessment will be held as soon as feasible after notification is received, except that it shall be held no earlier than December 31, 1988.

3. Covenants

The Program Grant Agreement will contain the following covenants:

The Grantee shall covenant that unless A.I.D. otherwise agrees in writing:

i. It will not in any way discontinue, reverse or otherwise impeda any action it has taken under this Agreement in satisfaction of any condition precedent to initial or subsequent disbursements except as the parties may otherwise agree in writing.

ii. It will: (a) establish a Special Account and have deposited therein local currency of the Democratic Republic of Madagascar in a sum equivalent to the dollars disbursed to the Grantee under this Agreement. The amount of the local currency to be deposited in the Special Account shall equal each dollar disbursement, and will be determined by using the highest exchange rate per US dollar which is not unlawful in Madagascar on the date of disbursement of the corresponding dollar amount. Funds will be deposited in three equal installments in the fourth, fifth, and sixth months following disbursement of the dollars.

(b) Except as provided in subsection (c) below, or except as A.I.D. may otherwise agree in writing, funds in the Special Account shall be used to finance the local costs of the Seventh Highway Project and for such other purposes as may be mutually agreed upon by A.I.D. and the Grantee.

(c) Not less than US$ 600,000 from the Special Account over three years shall be made available to the United States Government for the requirements of operating the USAID program in Madagascar.

(d) The Grantee agrees to furnish A.I.D. with such reports and information relating to activities financed with funds from the Special Account and the performance of the Grantee's obligations with respect thereto as A.I.D. may reasonably request. The Grantee will maintain, or cause to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, such books and records relating to the Special Account as are necessary to adequately show, without limitation, the receipt and use of funds from the account by the Grantee for agreed purposes. Such books and records will be audited regularly and in accordance with generally accepted auditing standards, and maintained for at least three years after the date of the last deposit into the Special Account required under this Agreement.

(e) A.I.D. or any of its authorized representatives shall have the right to inspect, at all reasonable times, the books and records maintained by the Grantee as required under this Agreement and to inspect the activities financed from the Special Account.

The Project Grant Agreement will contain the following additional covenant:

The Government of Madagascar agrees to abide by the criteria and procedures outlined in the Amplified Project Description for the selection of participants under the training programs funded by this project, and for the provision of technical assistance, which are intended to benefit operators in both the public and private sectors in Madagascar.

c. Monitoring and Assessment

Finally, the question of monitoring and progress assessment needs to be addressed. Since the reform program will be undertaken within the framework of an evolving reform environment, and not incidentally during political elections, a program of constant monitoring of the progress made toward achieving the program objectives will be required. This regular monitoring will be assured by the economist who will serve as project manager for the MAELP.

In addition to ongoing monitoring, a system of external review will be established to assess whether sufficient progress has been made under the program to fulfill the conditions for second tranche release. The review will be external to ensure objectivity in the assessment. AID/Washington, REDSO/ESA, or a private consultant in conjunction with one of the above offices, will be utilized as the external reviewer. Progress will be assessed on the basis of the illustrative indicators presented above, to be supplemented by additional indicators if deemed appropriate by the external review team, using as a baseline the situation at the end of 1987 as established by a baseline survey to be completed within the first four months of the project. After assessing reform progress, the reviewer will prepare a report with findings, conclusions, and recommendations to the OAR/Madagascar regarding progress, compliance, and the appropriateness of disbursement. The Mission will then prepare an action memorandum for the AID Representative, on the basis of the review report, which will outline the reasons for recommending release, or refusal of release, of the funding tranche. The AID Representative will approve or disapprove the recommended action with the concurrence of the Director of REDSO/ESA in Nairobi. Only on the basis of the approved memorandum will funds be released. Progress under the program will also be measured by the program evaluations scheduled for October 1989 and August 1991.

3. Policy Dialogue Linked Project Activities

The studies, training, and technical assistance activities presented below are closely inter-related, and are intended both to consolidate the implementation of reforms already undertaken, as well as to develop an understanding of the reforms which are needed to overcome remaining constraints to efficient agricultural market operations.

a. Studies

Given the evolving nature of Madagascar's overall liberalization program, this component will be instrumental in shaping and refining the Mission's policy agenda outlined in section B. Study activities and follow-on workshops will be designed to analyze remaining constraints to the liberalization of agricultural markets, and to recommend policy or procedural changes to address them. A secondary objective will be to involve as broad a spectrum of individuals as possible - academics, business, and local government leaders as well as central government representatives - to permit these people to feel a sense of participation in shaping parts of the reform program and thereby, hopefully to develop a commitment to seeing it implemented.

Sensitivity and a low key approach will be used in developing this component: although Malagasy recognize the issues and feel a need to understand them better, they are also wary of outsiders' interference. This wariness stems from two sources:

First, the government is moving from a socialist, very centralized stance, to a more market-oriented one, without changing leadership. Thus, political figures who were used to preaching one kind of market behavior, are finding that this is suddenly inappropriate, but are unclear as to what is acceptable. Political leaders feel it is their responsibility, and not that of outsiders, to clarify new policies. For this reason, high donor visibility in terms of technical assistance for economic policy related studies and seminars is at this time particularly delicate.

Second, as mentioned elsewhere, the country is approaching presidential elections in 1989, and the political leadership is reluctant to involve itself with any controversial reform-related study or seminar which might lead to loss of votes.

Three types of studies are envisaged:

--a rural household income and expenditure survey, which will first establish the baseline and later be used to measure performance in achieving policy reform objectives, as well as the project goal and purpose;

--technical studies to pursue issues directly associated with export development and diversification; and

--policy studies, to look at issues more broadly related to the MAELP program goal and policy dialogue priorities. It is this set of studies in particular where an effort will be made to involve a broad spectrum of Malagasy representatives, some through direct participation in formulating terms of reference, conducting research, reviewing drafts, etc., and others through participation in workshops or seminars to discuss study results.

Both technical and policy studies will contribute to exploring ideas and raising questions relevant to the development of the Mission's next CDSS, scheduled for submission in 1990, as well as to refining the Mission's strategic approach in the near term. The studies will build on the considerable amount of work already done by the government and/or other donors. They will synthesize available information before exploring questions of interest in more detail. Both sets of studies will include attention as appropriate to important environmental issues, and be concerned with identifying the social impact of alternative reform options that might be proposed, including possible adverse effects on women.

<u>Rural household income and expenditure survey</u>. A baseline survey will be initiated as soon as possible after the signing of the Grant Agreement. This baseline survey will establish the status of the key indicators at the end of 1987 as the point of reference upon which progress under the policy reform program will be measured. Given the importance of the baseline survey in measuring the achievement of project objectives, special expertise will be brought to bear on the design the baseline survey questionnaries and the sampling framework. The services of a U.S. firm under an IQC will be sought

for this task. This firm would then be responsible for supervising the work of a local firm to be competitively selected to undertake the baseline survey. This local firm will then be retained to do follow-up surveys prior to project evaluations in order to monitor progress on the key indicators ove. the life of the project.

<u>Technical studies</u>. These studies will be concerned with finding solutions to issues that affect the export marketing process in the "here and now" -- i.e. in the context of the given policy framework. They will be conducted in close cooperation with the Office of Exports of the Ministry of Commerce and the Ministry of Industry, Energy and Mines. Insofar as possible, local consulting firms will be used. The Chamber of Commerce and various business associations will disseminate findings. There will be close linkages with the technical assistance part of the program, in that technical specialists will be made available to work directly with individual firms that might be interested in exploring some of the possibilities suggested by the studies.

The studies will look into such issues as the export prospects for specific product lines (similar to the onion and garlic study undertaken to develop information for the Niger AEPRP). They may also address questions of processing and packaging technology. One of the coffee studies recently completed identified a simple conveyor belt mechanism as a way of speeding up and improving the sorting process without reducing the labor intensity of the operation. It also suggested that sisal from the newly revitalized private plantations in the South could be used to produce bags for shipping, substituting for imports of jute from Asia. A final area in need of study is alternative arrangements for marketing agricultural products to replace the Stabilization Funds. The Kenyan auction model is an example of a system which permits the free market to function while allowing the government to closely monitor prices and sales of commodities.

<u>Policy studies</u>. By contrast with the former studies, this set of studies is intended to identify specific policy constraints to improvements in agricultural market dynamics that have implications for the liberalization of external markets. Three study areas have been identified which address the major constraints to medium and long term development of the agricultural sector, without which export marketing of agricultural products will quickly reach its limit. The studies will aim to help the GDRM understand the constraints that are operating in each of these markets and to identify the conditions necessary for their removal. Recommendations will serve as the basis for future reform efforts.

--<u>Rural input and product markets.</u>

This study area is intended to identify constraints in the production and marketing processes. It will also explore the social impact and environmental implications of reform-induced changes in these processes.

Inefficiencies exist in internal input and product markets which increase costs of commodities sold in rural areas and depress farmgate prices. The task identified here is to analyze the nature of these distortions and develop an agenda for their removal. Efforts in this regard will be greatly assisted by the nearly completed World Bank financed study of local governments and their revenue situations, a study which is expected to recommend alternative sources of revenue to the currently predominant tax on agricultural commodities and commodity transport.

The concern with distortions, however, goes beyond the revenue requirements of local governments to include such issues as problems of vehicular registration and licensing, administrative responsibility and availability of financing for road maintenance and construction, availability of and demand for agricultural inputs, distortions imposed by parastatals, and opportunities for the sale of potential surplus production. Furthermore, in the case of agricultural inputs, the terms under which donated inputs are disposed of is an important concern. Finally, distortions exist between the social and private costs and benefits of exploiting Madagascar's natural resource base, which are resulting in the rapid degradation of the resource base for short-term private gain at the expense of long-term public benefits. The Mission recognizes that distortions exist in this sector which reduce the efficiency of domestic markets, but also accepts that it is not now in a position to identify specific interventions.

--Rural financial markets.

Upcoming plans to reform the banking system are expressed in general terms and remain limited, at this point, to questions of parastatal debt and the introduction of private sector participation primarily in commercial banking. While important, these questions do not touch on the constraints imposed on rural production by the lack of credit and lack of opportunity for farmers to place their savings in accounts which earn a reasonable rate of interest. Consequently, the Government's reform agenda, as it is currently evolving, does not directly consider removal of administrative and other barriers to rural financial market development.

Another critical question is the availability of credit for purchases of agricultural crops. A shortage of credit during the 1987 rice harvest reduced the number of buyers substantially, and thus drove down the producer price. The elimination of the Stabilization Fund role in the marketing and export of cloves and pepper has removed the vehicle by which traders, processors and warehousers of these crops had traditionally obtained credit, and generated fears about future access to credit. These questions should be addressed as part of the reform agenda to ensure that proposed reforms take into account the particular problems of rural finance in Madagascar. Any studies undertaken should take as a starting point the work that has already been done on rural credit in Madagascar and the lessons learned in credit projects, including the ongoing World Bank project in agro-industry credit with the Agricultural Development Bank (BTM), and the experimental program in farmer credit in the Lac Alaotra area.

--Availability of consumer goods in rural areas

Basic consumer goods provide an incentive for the rural farmer to produce a marketable surplus. Thus, the adequate supply of consumer goods, and their prices, are important considerations in sustaining the impetus to produce marketable surpluses provided by the initial price and marketing liberalization measures. Many of the impediments to the supply of consumer goods to rural areas are addressed in the discussion of internal markets, above. However, there are certain additional impediments to supply which confront consumer goods.

One example of an additional constraint is the reduced supply of domestically produced consumer goods resulting from monopoly and cartel production which characterizes much of the Malagasy economy. Protection offered by tariff and non-tariff barriers assists in the establishment and maintenance of these monopolies and cartels, and has the added negative effect of imposing higher prices for consumer goods on one of Africa's poorest populations. Administrative restrictions on imports, production, and distribution, are additional factors that could result in further distortions to the supply of domestically produced and imported consumer goods. The role of an open and market determined foreign exchange system is clearly instrumental to eliminating distortions in the supply of consumer goods.

This study will utilize domestic cost methodology to highlight the impact of the tariff regime on the domestic production of manufactured goods and to identify corrective policies. This study is important because it will lead to a discussion of opportunities for efficient domestic transformation of agricultural products for both internal and external markets, an issue likely to be of central concern for growth prospects over the medium to long term.

b. Training and Technical Assistance

1) Introduction:

There are several important constraints now preventing announced policy reforms intended to encourage a larger role for the private sector in economic development from achieving their desired results which the training and related technical assistance activities under MAELP are designed to address. The first is a widely recognized lack of business skills which inhibits the Malagasy from taking advantage of opportunities arising from economic liberalization, particularly in export markets. A related constraint is the inability of most Malagasy businesspeople to work in English, which limits the number of countries to which Malagasy desiring to export can market their products, and also the number of countries from which the Malagasy can obtain needed imports of goods and services. Taken together, this language barrier results in a less than optimal trade pattern and loss of potential revenue. A final constraint is a lack of understanding of the policy changes needed to remove remaining obstacles to the efficient operation of agricultural markets and a corresponding lack of commitment to the economic liberalization process. Training in all three areas is considered critical to the success of the reform process. While the resources provided under the MAELP will not address all the identified needs in these areas, they will make a substantial contribution toward achieving this goal.

Business Know-How - is an area repeatedly mentioned by the Malagasy when discussing what is needed in Madagascar for economic liberalization to succeed.

To address the lack of in-country business training programs, the World Bank in 1983 established an accounting and business administration school, the Institut National des Sciences Comptables et de l'Administration d'Entreprises (I.N.S.C.A.E.). This school was established on the North American model, with Canadian faculty and technical assistance from an American professor. Independent of the university system, the school is free to adopt innovative programs. It has wide-ranging support through its board of directors, which includes high level representatives from the public and private sectors, as well as from political parties. INSCAE is under the supervision of the Ministry of Finance.

Today INSCAE offers degree and non-degree, part-time and full-time courses. In September 1988 a two year MBA program will be added with funding provided by the World Bank and new French and Canadian faculty. In addition, to reach private sector and professional people who cannot leave their jobs for full-time training, INSCAE in 1989 plans to develop part-time, non-degree MBA type courses.

MAELP will strengthen this new program in several ways: 1) by first sending the INSCAE Director to the U.S. to visit schools with business programs that could serve as models in developing INSCAE programs, and to investigate resources for both the training of INSCAE faculty and for technical assistance in program development; 2) by providing short-term specialized business training for four members of INSCAE's faculty; 3) by assisting the establishment of a business English training program by training the future director of this program; and 4) by providing technical assistance for program development and possible in-country seminars. Likely program areas for assistance to INSCAE include: marketing, particularly for agricultural export; management information systems; and policies and strategies for enterprise development, particularly within free trade zones. INSCAE's facilities will be used as the site for in-country workshops and seminars sponsored by MAELP, since its high-level backing and contacts with the private sector will guarantee the desired broad spectrum of participation. INSCAE will thus be the primary vehicle for in-country business skill development and policy reform dialogue under MAELP.

A.I.D. under MAELP will contract with an American organization skilled in both business skill training and in developing business training programs in francophone third world countries. This contractor will work with INSCAE's Director to strengthen the INSCAE program by arranging the Director's visit to the U.S., by arranging the training programs for INSCAE faculty and business English director, and by identifying and coordinating technical assistance for program development. This contractor will also have primary responsibility for organizing approximately thirty 3-6 month specialized business courses and on-the-job training experiences in the U.S. for Malagasy, which is the second means by which MAELP proposes to strengthen business skills and economic policy formulation for private sector development. (Although the MAELP PAIP recommended one year MBA degree training, the Ministry of Finance has argued against this training because in the past, year long separations from work and internationally marketable U.S. degrees have induced Malagasy participants to remain indefinitely in the U.S.) INSCAE will work with the U.S. contractor in the selection of candidates and in the identification of training needs. Although some candidates for this training in the U.S. will hail from administrative offices and government parastatals, more than two-thirds will come from the private sector, and to the extent possible, will be women.

As noted earlier, a key impediment to the development of Madagascar's export trade is the inability of Malagasy businessmen to negotiate in English. Although the World Bank is in the process of setting up a language laboratory for INSCAE, it will not provide assistance for the design and management of language programs. MAELP will fund the training of a person to design and manage the English language program at INSCAE and will use INSCAE for English language training of participants to be sent to the U.S.

Intellectual understanding of the policy reform program and support for economic liberalization - were found to be notably lacking in a "Report on the Economic Reform Program in Madagascar" prepared by Elliot Berg in October 1987. Although high government officials, particularly the Minister of Finance, have begun the process of educating the population on the need for reform and the reasons for the policies selected, much more needs to be done.

The obvious institution to transmit understanding of and leadership for economic reform, as well as to provide training in business skills, is the University of Madagascar, in particular the Faculty of Law, Economics, Business and Sociology (E.E.S.D.E.G.S.). However, key ministers and presidential advisors have cautioned that the GDRM is still deliberating over major reforms of the university which must be in place before the university will be in a position to benefit from donor assistance. They estimate that these reforms will take effect around 1990.

While it is too early for the MAELP project to provide direct technical or other assistance to strengthen the business program in the E.E.S.D.E.G.S., it is timely to send the Dean of the faculty and a senior staff member to the United States to visit public policy and business education programs such as those at Harvard's Kennedy School and at the University of Michigan which could serve as models when plans to restructure the university with World Bank assistance go forward. In addition, professors from this faculty will be used to work on MAELP studies, as appropriate, and will be encouraged to participate in seminars and workshops sponsored by the project. This collaboration will enable USAID to explore where future training and TA to strengthen economic and public policy programs can be most effective once the working environment at the university improves.

In the interim, the project's studies, study tours and workshops will be the primary vehicles for increasing understanding of the policy changes now underway and those still needed to remove remaining impediments to medium and long-term development of the agricultural sector(in input supply, product, financial and consumer goods supply markets in rural areas), without which real growth cannot be sustained.

To summarize, MAELP training activities will include the following:

1 Strengthening in-country institutions to carry out training of Malagasy entrepreneurs, particularly in marketing and other skills needed to expand operations in export markets. This strengthening will be targetted primarily to INSCAE and will include: U.S. visits for the E.E.S.D.E.E.G.S. Dean and colleague, and the INSCAE Director to investigate resources available to strengthen economic, public policy, and business programs in Malagasy training institutions; U.S. business training for INSCAE teachers, who will receive short-term training in preparation for launching the part-time MBA type courses in 1989; and business English training, and other relevant skills, in the U.S. for the Malagasy trainer hired to set up and manage the business English language program at INSCAE.

2. U.S. classroom and on the job business programs: for an estimated thirty Malagasy businessmen from the private and parastatal sectors. Training programs will include business English(to be started at INSCAE prior to departure for the U.S.), macro-economic planning, management, and on-the-job training, as well as strictly business courses.

Participants will hail primarily from private businesses, but some will be selected from parastatals as well, for it is here that many Malagasy private sector operators begin their careers. In addition, participants may include the top graduates from INSCAE's accounting and business programs. Criteria for participant selection will include academic background, English proficiency, work experience and areas of interest for training.

3. Study tours, studies and workshops in support of external agricultural market liberalization: The purpose of these activities is to let key Malagasy policy-makers see for themselves how policies adopted in other countries have contributed to economic development, and to discuss with colleagues from the business and university communities as well as other government agencies in an open forum the relevance of those experiences for Madagascar.

For example, one planned study tour will take Malagasy in various political, technical and administrative roles to visit other coffee exporting countries to learn about alternatives to a state monopoly marketing agency for handling exports. Such a visit will be organized to Kenya, to observe the functioning of its auction process. All of the MAELP studies outlined in the preceding sections of this PAAD would benefit from the above study tour/workshop formula, namely: rural input and product markets, rural financial markets, availability of consumer goods in rural areas, and improved techniques for transforming and marketing agricultural exports.

Participants in study tours will be expected to prepare reports that will serve as discussion papers for the seminars, and to take an active role in the discussions. A U.S. economist or technical expert will travel with study tour participants, will assist them in report preparation, and will participate in the seminars. The workshops will aim to inform, and not to produce decisions. It will allow Malagasy to assimilate what they do understand, and to identify what they need to learn, in order to formulate and implement policies and programs conducive to Madagascar's economic development.

4. In-country seminars on such subjects as marketing, business start-up, preparation of proposals for bank financing, and negotiation of export contracts with foreign firms, for Malagasy businessmen. These seminars will be held at INSCAE and be led primarily by the technical advisors who travel to Madagascar to work on INSCAE program development.

5. USAID will contract with a U.S. institution experienced in business training, either a business school association such as the American Assembly of Collegiate Schools of Business (AACSB) or a firm/consortium to manage the training component of the project. This contractor will work in collaboration with INSCAE on participant profile development, selection in Madagascar, and placement and monitoring in the U.S. This contractor will also arrange the visits to the U.S. of the INSCAE Director and university business school dean, and the placement and monitoring of INSCAE faculty who will receive training in the U.S. Finally, this contractor will have responsibility for assessing with INSCAE its needs for program development, and for identifying and coordinating technical assistance to meet those needs. The Entrepreneurs International (EI) may prove helpful in assisting the contractor in planning on the job training.

Technical Assistance:

Some of the technical assistance activities under the MAELP are linked to the training, studies and study tours discussed in preceding sections. This technical assistance includes:

1) Technical assistance to INSCAE for developing its part-time business management courses. This assistance is expected to pave the way for short-term training in the U.S. for INSCAE faculty, and may well lead to longer term exchanges of faculty and students between INSCAE and U.S. institutions. Technical advisors who travel to Madagascar to work on program development may also be utilized to lead short-term intensive seminars on such subjects as marketing and setting up a business.

2) Economic reform related study tours, studies, and workshops: The MAELP will assure technical assistance for combinations of study tour, studies, and workshop activities focussed on economic liberalization policy and technical issues, especially those related to export markets.

Other technical assistance is targetted to meeting specific needs of entrepreneurs in expanding export operations, and in assessing the overall progress of the economic reform program.

3) Business consultancies for the Malagasy private sector: Malagasy businessmen have repeatedly emphasized to A.I.D./Madagascar staff the difficulties they face in entering export markets simply because they don't know where to start in identifying potential markets or buyers. Marketing thus appears to be a major constraint to increased exports by private sector operators. Under the MAELP, a variety of types of short-term technical assistance will be provided to primarily small Malagasy businesses interested in entering or expanding export trade.

One possible source of technical expertise for this program is the International Executive Service Corps(IESC), which provides the services of retired businessmen at no salary cost to private sector operators in developing countries. The director of IESC's regional office in Nairobi visited Madagascar in January of 1988 and informed A.I.D. that he saw many opportunities for IESC to work with the Malagasy.

4) Assessment of economic reform progress: Also included under technical assistance will be annual assessments of economic reform progress (or lack thereof) by a senior macro economist whose conclusions will be shared with both the GDRM and the other donors. Professor Elliot Berg has performed this function twice for A.I.D./Madagascar in the past.

5) Technical assistance for program management: An economist will be hired under a personal services contract(PSC) to manage the MAELP program over a two-year period. The scope of work for this manager is discussed in Section V below. This individual will be replaced at the end of his/her term by a U.S. Direct Hire economist.

4. Social, Political and Environmental Implications

Perceptions

In assessing change in Madagascar's political economy, it is important to keep in mind both the historical context (discussed in Section II B above and in Annex B), and the fact that societies and institutions can both maintain their continuity and change at the same time. In both personal and social behavior in Madagascar, there is a historical pattern of accepting change until it becomes too oppressive, when suddenly there is an explosive reaction that requires compensatory action on the part of the political authorities. This pattern has been evidenced in the country's historic swings between introverted nationalism and extraverted acceptance of foreign ways; in the explosive rebellion against the French in 1947; and in the rather unusual phenomenon in late 1984 of the Antananarivo kung-fu clubs which beheaded several members of a special youth organization (the TTS) of the ruling party. This phenomenon of action and compensatory reaction can make assessment of progress on the basis of a specific set of actions at any given moment an inappropriate representation of long term processes. On the other hand, tracking of processes can be a useful way of determining the direction of current change.

At the moment, Madagascar is clearly swinging towards an open free market economy; yet it is unclear where the extremes lie that would cause an opposing reaction. There is a significant lack of understanding of, dialogue on, and commitment to the new policies that are being advocated by, and blamed on, the major donors, particularly the World Bank and the IMF. There is little question that donor presence, behavior and involvement are not only important elements in the ongoing process but are also critical factors in how it will progress in the years to come. The perception of donor modus operandi is likely to be particularly important. If strict and almost dictatorial conditionality becomes too obvious for too long it might well prove the undoing of the policies. The Malagasy have repeatedly demonstrated throughout their history their respect for, and capability in, exercising power through negotiation and controlled resource distribution, but they have also demonstrated a strong resentment of foreign domination, particularly when it usurps the Malagasy role in decision-making.

The present period can be characterized as one of socio-economic disequilibrium, as the new policies that have been introduced, particularly a larger role for the private sector, require a major readjustment in the way resources are accessed and distributed. The population seems more divided between those taking a wait-and-see attitude and those trying to position themselves to take advantage of the changes, than between proponents and adversaries of the announced liberalization policies. A pronounced fear is that a small group of individuals or families now advantageously placed in the public or private sector will use their positions to gain new and anticompetitive positions in the evolving private sector. (A model of this outcome is the Philippines, where opportunism and greed on the part of a few strangled off the advancement of the majority.) There are bound to be winners and losers in the liberalization process. However, a critical determinant of a positive outcome to the policy changes will be the extent of participation by all elements of the population. It is essential that the number of winners is expanded and far exceeds the number of losers. For this reason it will be important - as this program advocates - to monitor not just the macro-economic indicators that often hide the distribution curve of benefits, but also the actual on-the-ground implementation of the policy changes, and to expand the scope of this monitoring beyond the capital to the outlying regions. Also, the Government and the World Bank should be encouraged to assess the social impact of proposed structural adjustment measures, and, to the extent possible, both to tailor the phasing of measures and to initiate compensatory programs so as to mitigate adverse consequences for the least advantaged segments of the population.

Realities

The two realities of the current situation that are of particular relevance to the reform agenda proposed in this program are rural insecurity and the ability of participants in the agricultural export sector to benefit from the new opportunities presented. These issues are discussed separately below.

a. Increasing rural insecurity is one of the most puzzling dimensions of socio-economic change in Madagascar. Very high and growing losses of crops, but particularly cattle, to theft and banditry are being reported throughout an increasing area of the country. To some extent this phenomenon, which began in the 1970's, and has gathered momentum in recent years, can be attributed to increased impoverishment and a lack of legitimate economic opportunities. However, the fact that official exports of cattle are extremely low in the face of a known and expanding clandestine export of cattle to Reunion indicates the collusion of at least some local authorities. This phenomenon represents a perverted form of a growing private sector economy.

One oft-heard criticism of the economic liberalization is that it is really a way of legalizing the black market. In fact, this may in a very positive sense be the ultimate test of its success; i.e., will the government be willing and able through policy and administrative reforms to convert clandestine economic activities into legitimate competitive market operations? The regulation of foreign currency will be a major factor in determining such an outcome, since it is the lack of readily available foreign exchange and fears of continued devaluations that encourage illegal export and the retention of profits overseas. An assurance that profits can be legitimately made and that repatriated earnings will retain their value is a prerequisite for the successful operation of an open market system.

b. Agricultural Export Sector

Due to its potential, the agricultural export crop sector has a critical role to play in revitalizing Madagascar's economy. Numerous rural producers and intermediaries are poised to respond to increased export opportunities, but have been held back not only by lack of inputs and technology and poor transport infrastructure, but also by rural insecurity and uncertainty over government policy. Although progress will be difficult to measure over the short term, the best indicators of progress toward or away from effective liberalization are likely to be qualitative assessments of changing behavior, strategies, and the spectrum of actors in the intermediary roles between producers and exporters/importers (buyers, transporters, processors, and local distributors of inputs and consumer goods).

Another measure of the progress of liberalization will be the flow of benefits. During more prosperous times before the socialist revolution, the traditional movement of export goods was from the regions either directly to external markets or via the capital, while the flow of benefits (primarily in the form of imported goods) was predominantly to the capital, with extremely low inter-regional exchange. If this pattern repeats itself or becomes even more pronounced in a revised export-oriented economy the benefits will be restricted and regional discontent and disparities may actually increase. Efficient, prosperous and expanded internal markets may be a pre-condition for increased general prosperity.

c. Environment

A categorical exlusion has been approved by the Africa Bureau Environmental Officer. A discussion of the environmental implications of the policy reform program supported by MAELP funds is presented in Annex E, which also contains the Initial Environmental Examination. The environmental impacts of the policy reform program will be monitored by the Natural Resources Advisor expected to join the AID/Madagascar staff by the end of CY 1988.

5. Relationship with Other Donor Activities and Relevant USAID Projects

Madagascar's structural reform program outlined in Section II and Annex B has evolved since 1983 in close coordination with the World Bank and the IMF. Without the Government's commitment to this program, A.I.D. would not have decided to re-engage in Madagascar as it did in 1984. Since that time, A.I.D. activities have been designed and conducted in direct support of the reform program, and consequently, in close coordination with the World Bank. Evidence of the unusually close working relationship between A.I.D. and the World Bank in Madagascar abounds, but is most evident in the rice liberalization and environmental action plan programs.

The MAELP builds upon lessons learned in the rice market liberalization through the PL 480 Food for Progress program, lessons which have also been applied in the development of a complementary PL 480 Section 206 reform program intended to extend agricultural market liberalization to the edible oils sector. The MAELP has also been designed to specifically complement the ongoing World Bank Structural Adjustment operations in agriculture (CASA), and Industry and Trade (CASPIC), as well as the proposed 1988 Public Sector Structural Adjustment Credit (CASEP). Coordination will be continued when the World Bank moves forward with a planned CASA II in 1989 or 1990 which will focus exclusively on agricultural exports.

Support for the liberalization of the import (and foreign exchange rate) systems in 1988 is expected to be provided by all of the major donors. To date, pledges have been made by the World Bank ($65 million remaining from CASA, and $60 million from CASEP), the African Development Bank ($20-30 million as part of CASEP), and the French (FF 230 million, or $45 million). France has been providing program type assistance since 1982. However, the French assistance for 1988 has been held up pending a review of GDRM credit policy. The U.S. contribution of $16 million will cover about two weeks of imports. Additional assistance may be provided by Germany, Switzerland and the EEC. Total donor commitments to date cover $206 million, compared with anticipated total requirements for imports of SDR 400 million per annum.

A number of donors provide assistance in support of the agricultural export sector. World Bank structural adjustment programs have promoted policy and procedural improvements in export administration, export crop pricing, tax structures, credit systems and the role of public enterprises, while projects support the rehabilitation of critical road and port infrastructure and the lending program of the Agricultural Development Bank. France has provided significant assistance for the rehabilitation of the coffee sector in the South East (with some attention to cloves and pepper) as well as for cotton and sugar production and processing. Other projects are directed at livestock, maize and rice, all products with potential for increased export. Both UNDP and the European Development Fund gave supported initiatives in fisheries development, as have the Japanese. The African Development Bank provides project assistance for infrastructure improvement, while the German aid agency has been working with livestock development.

A.I.D.'s proposed activities in technical assistance, studies and training in the areas of rural credit, input and product distribution systems, export market development, and export policies will build on earlier work done by other donors (the French in coffee technology and input supplies, the World Bank in rural credit and free trade zones) and complement planned initiatives, particularly the development of in-country business training by the Canadians, French and the IBRD. It will also build upon A.I.D.'s experience in Madagascar under the centrally funded AFGRAD and AMDP training projects, as well as the Madagascar Agriculture Rehabilitation Support Project (MARS). Several successful MARS activities will be continued under MAELP, including: visits and reports on policy reform progress by a senior and widely-respected U.S. macro-economist, the study tour/workshop formula, and in-country seminars organized by a local training institution.

Bank. The GDRM has indicated its intention to use these dollars in support of the Open General Licensing (OGL) system for imports. Grant funds for project activities will be disbursed directly by A.I.D. primarily through the Regional Financial Management Center in Nairobi, Kenya.

E. Local currency

1. Mechanics.

The mechanisms for generating and depositing local currency counterpart are described in Section III.C.2.b. above.

2. Use.

A small proportion of this counterpart will be reserved for the Mission's Trust Fund. The bulk of the funds, however, will be allocated within the government budget to support the rehabilitation of roads in key agricultural areas under the Seventh Highway Project. A key consideration in the choice of use of counterpart funds has been the Mission's limited management capacity in the face of new local currency guidelines, which has necessitated the selection of an option which will be the least management intensive, while meeting a priority objective of the USAID development strategy.

a) Trust Fund

Local currency counterpart in the equivalent of $600,000 will be made available to USAID to cover local currency costs of operating the A.I.D. program in Madagascar over a period of three years. Disbursements of funds to the Trust Fund will be made quarterly in accordance with existing procedures.

b) Budget Attribution

The Ministry which A.I.D. has selected to receive counterpart generations from the MAELP is the Ministry of Public Works, MTP. It has become evident in preparing the MAELP that one of the principal constraints to agricultural marketing and exports, and thus an improvement in rural incomes, is the abysmal state of road infrastructure. This hampers input delivery, the collection and processing of crops, as well as transport to export centers. The French-financed coffee rehabilitation project (ODASE) has found it essential to give priority attention and resources to the repair and maintenance of key rural and trunk roads in the coffee-growing areas. The GDRM recognizes the magnitude of the problem and has sought donor assistance for a well-thought out program to address the problem. The 7th Highway Project is now being negotiated with the World Bank for $200 million of multi-donor financing and is expected to come onstream in 1988. This project will address road rehabilitation and maintenance in key agricultural areas. The local currency requirements of this project are estimated to be the equivalent of $50.2 million. The GDRM's difficulty in meeting road repair needs is illustrated by the fact that in 1988 only FMG 13.5 billion($11 million) was allocated to MTP for all its activities. An A.I.D. allocation of $16 million in counterpart funds will thus make a substantial contribution to the realization of this key program.

Channeling counterpart funds through the budget will be a new undertaking for the GDRM. This effort is being undertaken upon the recommendation of the IBRD and the IMF in order to improve the efficiency of resource use by the GDRM and the transparency of Treasury operations. Until now, counterpart funds arising from donor balance of payments assistance have been used off-budget.

One of the objectives of the budget reform program now being carried out with the IMF and the IBRD is to bring all items now off-budget into the budget, so as to achieve a consolidated budget presentation by 1990. Using counterpart funds for budget attribution will also reinforce the new program-based budgeting approach which has already been introduced in MPARA (Agricultural Production) and MTP (Public Works), and is scheduled for introduction in the Ministries of Health and Education in 1988, and the assessment of competing priorities for Government resources which the new Public Investment Program guidelines are intended to strengthen. Finally, the allocation of counterpart funds will guarantee that funds will be available for identified priority activities.

These MAELP resources will be integrated into the GDRM budget beginning in FY 1989(which starts in January).

c. Reporting and monitoring

Section III.C., Conditions Precedent and Covenants, specifies certain reporting requirements. On a quarterly basis, the Treasury will inform USAID of deposits into the Special Account and of attributions of these receipts to the agreed program in the budget. On a yearly basis, the recipient ministry will certify that an amount at least equivalent to the U.S. counterpart allocation has been attributed to the agreed program. The Treasury has agreed to coordinate these responses.

Monitoring will take place through the program review which is due to take place before the disbursement of the second dollar tranche; through periodic reviews or audits (as stated in the Covenant, USAID will have access to books and records as appropriate); and through regular meetings with the World Bank and MTP to review the progress of work and the use of funds under the Seventh Highway Project. While relying on the World Bank as the principal implementing agency, AID/Madagascar, with assistance from REDSO/ESA Engineers, will also monitor the project through the review of all project reports and periodic site visits.

V. MANAGEMENT ARRANGEMENTS AND EVALUATION PLAN

A. Management

The MAELP will be managed jointly by the Office of the A.I.D. Representative to Madagascar and the Government of Madagascar. GDRM counterpart agencies will be the Central Bank as the recipient of cash disbursements under the agricultural sector grant, and the Ministry of Finance and Economy for review of policy performance and for the implementation of training, technical assistance and studies. The Ministries of Commerce and Industry will be key participants in the planned technical studies and seminars, while the policy dialogue under MAELP will be carried out with the Ministries of Agriculture and Commerce as the two ministries having primary responsibility for

AID/Madagascar also proposes to obtain the services of the International Executive Service Corps to handle the provision of technical assistance to Malagasy entrepreneurs.

AID/Madagascar will use the services of IQC firms to develop the scopes of work for studies, to recruit a senior macro-economist to undertake annual reviews of policy performance, to organize and lead study tours and workshops, to undertake project reviews or audits, and to participate in project evaluations as needed.

3. REDSO/ESA and RFMC

REDSO/ESA assistance will be needed in several areas: 1) the services of a Contracting Officer to contract for the PSC economist and the U.S. institutions/firms which will manage training and technical assistance activities; 2) the services of an Engineer to review progress on the implementation of the 7th Highway project, for which local currency counterpart generated by dollar disbursements will be programmed; 3) the services of an economist, an agriculturalist and a social scientist for the planned project evaluations; and 4) the assistance of the RLA, RCO and the Director in providing concurrence for certain implementation actions as required by DOA 551.

RFMC or RIG/A/N assistance will be needed as described below for financial reviews or project audits.

4. Government of Madagascar

The Government of Madagascar entities to be involved in this project include the Central Bank, the Ministry of Finance and Economy, the Ministries of Commerce and Industry and INSCAE.

The Central Bank will receive disbursements of dollars from the sector grant, will establish a special project account, and will have primary responsibility for assuring the timely deposit of local currency into the special account.

The Ministry of Finance and Economy will be the counterpart ministry for the implementation of project funded training, studies, and technical assistance, as well as for the management of local currency generations. It will review performance on policy reform with A.I.D., and will participate in the development of scopes of work for studies and technical assistance, and in the selection of in-country contractors to implement studies. It will co-sponsor seminars on the results of policy studies and study tours, and will participate in project evaluations. The Treasury Department within the Ministry will have primary responsibility for managing local currency generations as discussed above, and will prepare periodic reports on the status of the special account. A Project Manager will be hired to manage the project within the Ministry of Finance and Economy, who will provide all necessary coordination with other government ministries involved in studies and training. The other government ministries expected to be involved in project activities are the Ministries of Commerce and Agriculture, with whom the policy dialogue on agricultural export market liberalization will be continued, and the Ministries of Commerce and of Industry which will be key partners for technical studies and seminars.

AID/Madagascar has worked with the Treasury Department in the past on the disbursement of local currencies from special accounts, and believes that the staff of the Department are fully competent to carry out this role in the future. AID/Madagascar has not worked with the Ministry of Finance and Economy for project activities such as those proposed under MAELP. However, an initial assessment indicates that with close collaboration on implementation, the Division of Programming should be an excellent counterpart for A.I.D. in Madagascar. This choice of a counterpart was recommended by high-ranking officials within the Government because of its position of coordination with all line ministries involved in the reform process, its receptivity to and lead within the GDRM in promoting the private sector, and its ongoing role in managing counterpart funds. The Ministry of Finance has also been instrumental in establishing the business institute INSCAE, and is particularly interested in developing in-country business skill training.

INSCAE will work with the U.S. institution in the selection of participants for training in the U.S. and in the organization of in-country seminars and workshops which will be held at INSCAE facilities.

An implementation schedule is presented in Annex F.

B. Contracting Mechanisms

The key factors considered in determining the most appropriate mechanisms for procuring services required by MAELP were: 1) AID/Madagascar's small staff and resulting limited administrative capability, 2) the relative inexperience and limited capacity of the host country institutions in contracting, and 3) a desire to use local institutions and resources to implement project activities wherever possible. Thus, the services of contractors to manage the activities discussed above will be obtained through competitively-selected direct AID contracts and IQCs. The Design Team considered the feasibility of setting aside any project activities for firms or institutions which qualify for special consideration under the Gray Amendment(small, disadvantaged or women-owned firms). The team was unaware of any small or minority owned firm with experience in the implementation of a combined business training/business training institution strengthening program, or that offered business consultants to private entrepreneurs at no salary fee as provided by the IESC. However, the RFP for the training component technical services requirements will be sent to the AID small business office with a request that the contract requirements be brought to the attention of small businesses with experience and expertise in the required areas.

C. Methods of Implementation and Financing

The chart below shows the proposed methods to be used to implement and finance MAELP project components.

Activity	Method of Implementation	Method of Financing	Amount
Policy Support	Cash Transfer	Electronic Funds Transfer	$16,000,000
T.A.			
-Program Mng'r.	AID Direct Contract	Direct Payment	$240,000
-Business Cons.	AID Grant to IESC	Direct Payment	$225,000
-Macro-Econ.	AID Direct Contract	Direct Payment	$ 60,000
-Study Tours	AID Direct Contract	Direct Payment	$231,000
Training			
-Institution-building/business courses in U.S./ INSCAE program development	AID Direct Contract	Direct Payment	$1,124,000
-Workshops and seminars	AID Direct Contract	Direct Payment	$120,000
Studies	AID Direct Contract	Direct Payment	$435,000
Evaluation/ Audit	AID Direct Contract	Direct Payment	$100,000
Contingency	AID Implementation	Direct Payment	$200,000

The review of alternative methods of implementation and financing from the standpoint of project needs and funds accountability has led the design team to select direct AID contracting using direct payment or direct reimbursement procedures for project costs. This method is consistent with AID/Madagascar's current policies on program financing and implementation.

D. Logistics

AID/Madagascar will provide full support in the way of housing, office, secretarial and official transportation for the PSC Economist Program Manager. This support will be funded through the Mission's Trust Fund. Some support in the form of office space and secretarial support will be provided to IQC contractors for study scopes of work and evaluations/audits and, as available, to the training and technical assistance contractors. However, the latter two contractors will receive their primary in-country support from, respectively, INSCAE and the private entrepreneurs who will benefit from IESC consultancies. Funds will be provided under the contracts for other logistical support as may be needed.

E. Evaluation and Audit Plan

In addition to the ongoing monitoring of the project that will be carried out by the economist program manager, two special types of evaluation will be used

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to track project progress. The first type of evaluation is linked to performance under the policy reform component of the project and will be used as the basis for cash disbursements. The first such assessment will be conducted following the notification by the GDRM that conditions for second tranche of policy support assistance have been satisfied. The progress indicators upon which performance will be measured during this assessment and the composition of the external review team are described in Section III.C. above. In addition to making a recommendation on the release of the second tranche of the cash disbursement, the review team will be tasked with reviewing Government of Madagascar performance on the overall policy reform agenda and recommending whether or not A.I.D. should provide additional balance of payments support during FY 1989. If so, the team will advise what changes if any should be made in the policy reform agenda of the program. These recommendations will serve as the basis for designing a PAAD amendment in FY 1989.

The second type of evaluation will be for overall project performance. One interim project evaluation is planned for October of 1989. The scope of work for this evaluation will be as follows:

- to assess whether project activities are proceeding as planned, and whether the project environment has changed in any substantial way;

- to review disbursement of project funds as well as the disbursement of local currency counterpart to the GDRM budget;

- to assess the degree to which project activities are contributing to the achievement of the project purpose;

- to determine whether the policy reform agenda remains valid, and if so, whether additional A.I.D. resources for balance of payments support should be made available to the GDRM during fiscal year 1990;

- and finally, to make recommendations for any changes in the policy reform agenda, project activities, or implementation arrangements needed to assure achievement of the project goal and purpose.

A team consisting of an economist, an agricultural officer and a sociologist from REDSO/ESA if possible, or on contract as needed, will conduct this evaluation. A training expert with experience in business and management will form the final members of this team.

A final evaluation will occur after the expiration of the PACD in June 1991 to assess the degree to which project activities resulted in the achievement of the project purpose and goals, and to make recommendations on the basis of lessons learned for future A.I.D./Madagascar involvement in similar types of activities.

Twice during the project life, AID/Madagascar will arrange for REDSO/RFMC to issue work orders to a certified public accounting firm to be selected through an indefinite quantity contract (IQC) to carry out a financial review of the dollar and local currency accounts under the project. The scope of work for the accounting firm is limited to financial and compliance matters and will be prepared by AID/Madagascar's PDO with assistance from REDSO/RFMC.

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Project funds have been budgeted for the planned evaluations and financial reviews/audits.

VI. NEGOTIATING STATUS

All the elements of the project have been discussed at length with Government of Madagascar ministries which will have responsibility for approving or implementing project activities. These discussions have included AID requirements for GDRM reporting and management of special accounts, and the substance of proposed conditions. To date, full concurrence has been given and the GDRM has indicated its eagerness to sign an agreement at the earliest possible date. When RLA clearance has been obtained for proposed conditions and covenants, AID/Madagascar will review them with the GDRM prior to the finalization of grant agreements.

USAID MADAGASCAR, 1988

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