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REPORT ON THE USE OF AID COUNTERPART FUNDS IN MADAGASCAR

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INTRODUCTION

The AID program in Madagascar consists mostly of non-project assistance that generates host government-owned counterpart funds. Since 1981, the principal sources of counterpart funds have been: PL480 Title I ($53 million), PL 480 Title II ($2.6 million), and the Agriculture Rehabilitation and Support project (MARS) ($11.4) million. At the present time, $17.8 million of these funds remain unprogrammed, i.e., the Government and AID have not yet formally agreed on how they are to be spent. In addition, two new programs are planned for USFY 1988: a Title II Section 206 program valued at $3.9 million, and the Agricultural Export Liberalization Program (MAELP) which will generate about $16 million of counterpart funds in the first year. The 1990 Annual Budget Submission and the recently completed AID/Madagascar Concept Paper indicate that the program will continue to be primarily non-project for the forseeable future. Counterpart fund generations are projected to average about $15 million per year.

In the past, AID and the GDRM have jointly programmed these funds mostly for small development projects outside the normal GDRM budgetary process. Recent evaluations of the use of counterpart funds have found that they have been well managed by AID and the GDRM and, for the most part, were used for sound development projects that would not have been funded if AID counterpart funds had not been available. However, the last evaluation (Hawes, 1987) as well as several outside observers have suggested that AID counterpart funds would have a larger development impact if they were used in support of large programs rather than small projects and allocated within rather that outside of the GDRM budget.

An additional consideration is that new AID guidelines from Washington require that missions monitor the design and implementation of individual counterpart-funded projects much more closely than they have in the past. This also argues for reducing the number of projects.

The purpose of this report is to analyze the budgetary and macro-economic impact of AID counterpart funds in Madagascar and recommend how they can be most effectively programmed to help achieve the objectives of AID's development program. The report is divided into four sections:

- AID policy regarding the use of counterpart funds
- Economic and fiscal issues related to counterpart funds
- An analysis of the use and impact of AID counterpart funds, including their value as a development resource in the Madagascar context
- Recommendations for the future programming of AID counterpart funds in Madagascar

AID POLICY REGARDING THE PROGRAMMING AND USE OF HOST COUNTRY-OWNED COUNTERPART FUNDS

The legal requirements regarding the programming of counterpart funds are quite general. The Foreign Assistance Act (DA and ESF) and PL 480 have specific language regarding how the funds can be used, but basically AID missions are only required to assure that the funds are used for any activity consistent with the objectives of the Foreign Assistance Act, with particular emphasis on agriculture, food production, rural development, nutrition, and health. AID policy is mainly concerned with how to carry out this legislative requirement in ways that have maximum development impact.

In general, AID policy encourages the involvement of Missions in the joint programming of host country-owned counterpart funds. The desired objective of joint programming is not the allocation of the counterpart funds per se but rather the use of counterpart fund programming to improve the allocation of host government resources for development purposes. This objective recognizes that the funds are in fact host government resources and joint programming can have an impact only when overall resource allocation is different than it would otherwise have been.

Given this objective, AID policy is to give the missions considerable leeway in how they program their counterpart funds. Guidance from Washington suggests that the decision on whether and to what extent to become involved should be based on an assessment of the advantages and disadvantages of joint-programming in terms of increasing the overall impact of the AID program in the country. The key factors are 1) how much influence can AID realistically be expected to have on the final allocation of host government resources, 2) will this influence be greater if the programming is done at the program or at the project level, and 3) will the disadvantages of joint programming (usually disagreements between AID and the host government on the programming and monitoring of counterpart funds) outweigh the benefits of improved resource allocation. It is worth noting that, based on the analysis of these factors, most AID missions have chosen to be directly involved in the programming of counterpart funds.

Assuming a decision to jointly program counterpart funds, the key AID policy guidelines are:

1. The specific uses of the counterpart funds should be negotiated at the time that the agreement is signed. This recognizes that once the program is underway and generating counterpart funds, AID is likely to have little leverage over how they will be used. The reasons for this are discussed in the section that explains how the GDRM programs counterpart funds.

2. Missions need to monitor host government budget allocation decisions to assure that the programming of the counterpart funds results in funds being spent on specified development activities or programs over and above what would have been spent in the absence of the joint programming. This monitoring also needs to be provided for at the time that the agreement is signed.

3. Counterpart funds should be spent as closely as possible to the time of import. This helps avoid possible inflationary or deflationary impacts that may be inconsistent with macro-economic stabilization programs.

4. In the implementation plan for the use of counterpart funds, host governments should be assigned most of the responsibility for monitoring project implementation and assuring that the funds are used according to the provisions of the agreement.

Finally, AID policy addresses the accountability and reporting requirements of project-level versus program-level programming. If the Mission chooses to program counterpart funds at the project level, it is responsible for assuring that:

1. technical, financial, administrative, and accounting standards are adequate;

2. implementing institutions have adequate implementation capacity; and

3. periodic audits and field visits will be conducted.

If the projects to be supported are designed and funded by another donor or if they are implemented by a strong, highly respected public or private institution, the Mission can assume that the above requirements are assured. Otherwise, the mission must become closely involved in monitoring each counterpart-funded project.

When the mission chooses to program counterpart funds at the non-project level, it must assure that 1) the quality of the program being supported is satisfactory, 2) the host government programming and budgeting system is adequate, and 3) the host government will not allocate other budgetary resources out of activities financed with counterpart funds. Having assured the above, missions are not required to trace funds to their ultimate end use.

The main difference between project-level and program-level programming is that the former requires that the mission closely monitor the implementation of individual projects. The latter relegates much of that responsibility to the host government but requires a much more in-depth analysis

of the host government capacity to allocate and disburse the funds in a fiscally sound manner and its capacity to implement the projects effectively. The implied requirement for the non-project programming of counterpart funds is that the host government has a budgeting system which allows the mission to determine after the fact that the joint programming has resulted in the government allocating more resources to specified development programs than would have been the case without the joint programming. This puts a heavy analytical burden on the mission at the time that the agreement is negotiated.

In short, AID policy regarding the use of counterpart funds allows for a wide range of programming approaches based primarily on the role of AID in the overall development program and on the capacity of the host government to design and implement sound development programs and projects.

THE BUDGETARY AND ECONOMIC IMPACT OF COUNTERPART FUND GENERATIONS

The macro-economic impact of an aid program that generates local currencies occurs at three levels:

A. The Resource Transfer

Most aid programs that generate local currencies are designed to provide balance of payments support for a macro-economic or sectoral adjustment program. The aid program is based on an analysis of the resource or foreign exchange gap that must be filled in order to achieve the objectives of the host government's structural adjustment program. The foreign exchange can be used for imports or to repay foreign debt. In either case, the result is an increase in foreign exchange available for imports, more specifically intermediate and capital goods needed for economic growth and development.

It should be noted that when food aid does not substitute for commercial imports there is no foreign exchange savings and therefore no balance of payments support. In this case, the effect is to increase domestic supplies over what they would have been. If the additional food is consumed by individuals who would not otherwise have been able to purchase it there is no significant economic impact. If, on the other hand, the food is sold on the open market, the effect is to lower prices which tends to increase the demand for food and reduce production.

B. The Budgetary Impact

The budgetary impact of an aid program that generates local currencies is to increase government revenues over what they would have been in the absence of the program. This

occurs regardless of how the foreign exchange is used. Perhaps most frequently, the foreign exchange (or commodities in the case of food aid and certain Commodity Import Programs) is sold to the non-government sector for local currency. This results in a transfer of local resources from the non-government to the government sector, i.e., there is a net increase in government revenues equal to the value of the foreign exchange in local currency. This is generally what happens in Madagascar.

There are times, however, when the foreign exchange is used by the government either to import goods for the government sector or to repay official foreign debt. In these cases, the budgetary effect of the program is to prevent the government from having to use its budget resources to purchase foreign exchange. This frees up those resources to be used for other government expenditures. The net effect is to raise budget revenues the same as if the government had earned local currency from selling the foreign exchange to the private sector.

It must be emphasized that these programs provide foreign exchange or commodities as balance of payments support. The local currencies accruing to the government as a result of the programs were already in the economy and do not consitute an aid flow. This is clearest in the case of sales of foreign exchange to the private sector where the buyer of the foreign exchange pays for it by transferring local currencies from his bank account to a government bank account.

The nature of the transfer is also clearer in the case of loans. The Government incurs a debt to obtain foreign exchange needed to achieve the objectives of its structural adjustment program. The rationale is that when the program achieves its growth targets the Government will have the means to repay the loan. When the Government sells the foreign exchange, it receives local currencies which in principle it can spend as it sees fit. This is why the World Bank and the IMF do not program the local currencies generated by its programs. In the case of grants, the Government does not incur an obligation to repay but the nature of the transaction is the same as for loans.

As noted above, this is well recognized by AID. AID policy is not that missions should control these funds, but rather that when they can influence their use in a way that improves the overall allocation of host government resources for development purposes they should do so.

If the government spends these funds as they are generated there is no net effect on the budget deficit or surplus -- revenues and expenditures are increased by the same amount. If the funds are not fully spent, the immediate effect is to reduce the government deficit which in turn can affect

the money supply and the rate of inflation. These possible effects are discussed below.

C. The Impact on Money Supply and Inflation

The impact on money supply and inflation depends entirely on whether or not the Government increases its expenditures by the amount of local currencies generated. Here it is useful to differentiate between local currencies and counterpart funds. The latter refer specifically to local currencies that are generated by non-project foreign aid and set aside for joint programming by the donor and the host government. This is in contrast to non-project foreign aid that generates local currencies which are in no way differentiated from other tax or non-tax revenues. This is the case, for example, with World Bank and IMF programs. The foreign exchange is provided to the Government essentially as balance of payments support and the donors have no interest in how the foreign exchange is used. Because the local currencies generated by these programs are not differentiated from other government revenues, they are not set apart as having any particular impact on inflation. The U.S. Food for Progress program treats local currencies in this manner.

The inflation issue arises with respect to counterpart funds because they are placed in special accounts, usually at the Central Bank, and earmarked for specified uses. If the funds are not spent in the year that the resource transfer occurs and other Government expenditures are not increased, the net effect is deflationary. However, they will have an inflationary effect in the year that they are spent. This is because they will be adding purchasing power to the economy in a year when there is no corresponding increase in the supply of goods and services from increased imports financed by foreign aid. The only way to avoid the inflationary effect is for the Government to cut some other expenditure so that total Government demand for goods and services remains unchanged.

The inflationary effect of the spending of counterpart funds in a year following the resource transfer will simply counteract the deflatioary effect of not spending the funds in the year that the transfer occurred. The only difference is that a Government facing continuous budget constraints will find it easier to spend counterpart funds in the year that its revenues have increased than in a subsequent year when the direct effect of the expenditure will be a corresponding increase in the budget deficit.

THE BUDGETARY, ECONOMIC AND DEVELOPMENT IMPACT OF THE USE OF COUNTERPART FUNDS IN MADAGASCAR

A. The Financial Context

The GDRM does not publish the data necessary to reconstruct the overall financial performance of the public sector. In addition to the Central Government budget, there are the budgets of the regional and local administrations, the export crop stabilization fund, transfers to and from public sector enterprises, certain foreign loans and grants that do not appear in the budget and, finally, counterpart funds generated by non-project foreign aid. At the present time, the best source of information on the overall budgetary situation is the IMF. Table 1 presents a summary of the latest IMF recapitulation of GDRM financial operations.

The generation and expenditure of counterpart funds affects the overall budget through their impact on the development budget (Programme d'Investissement Publique (PIP)). The PIP for 1987 and 1988 is presented in Table 2. For funding purposes, the PIP is divided into two parts: the Fonds Nationale de Developpement et d'Equipement (FNDE) which is financed within the GDRM budget, incuding external loans to the Government, and the non-budgetary part which is financed mainly by foreign project grants, loans to public enterprises, and counterpart funds. Counterpart funds can be used to help finance the local costs of development projects that are under the FNDE or other development projects that are "extrabudgetary". As can be seen from Table 2, all counterpart fund expenditures appear outside of the FNDE and therefore outside of the GDRM budget.

B. The GDRM Counterpart Fund Programming Process

1. The IMF Ceiling on the Budget Deficit

A key factor in the programming of counterpart funds in Madagascar is the IMF stabilization program. This program limits total Government spending by limiting the amount of credit to government by the domestic banking sector and limiting the cumulative drawings on medium and long term foreign loans. The objectives of these conditions are to 1) help control the money supply by reducing the total amount of domestic credit to the Government, and 2) control foreign indebtedness by limiting the amount of foreign borrowing by the Government. The net effect of these conditions is to place a ceiling on the size of the overall budget deficit. In 1987, the deficit was about FMG 69 billion, about 3.0 percent of GDP and below the target that had been set with the IMF. For 1988, the target is about FMG 73 billion, or 2.7 percent of GDP (see Table 1).

Table 1

Government Financial Operations: 1986 - 1988
(billions of Malagasy francs)

	1986 (actual)	1987 (est.)	1988 (proj.)
Revenues	280.4	458.4	602.4
- Budgetary	211.0	344.3	460.3
- Extrabudgetary 1/	54.5	91.1	107.0
- Grants	14.9	23.0	35.0
Expenditure	353.0	527.4	675.3
Current	223.0	300.7	373.2
- budgetary	(209.9)	(282.4)	(350.2)
- extrabudgetary 1/	(13.1)	(18.3)	(23.0)
Capital	117.9	198.1	272.1
Budgetary	(63.1)	(110.0)	(147.4)
-foreign-financed	31.9	70.0	99.4
-domestic-financed	31.2	40.0	48.0
Extrabudgetary 2/	(19.5)	(32.1)	(45.9)
On-lending 3/	(35.3)	(56.0)	(78.8)
Additional expend.	5.9	13.0	20.0
Payment delays	7.0	10.3	10.0
Arrears settlement	-	5.3	-
Deficit	72.6	69.0	72.9
Financing:			
Foreign loans	51.3	92.0	110.9
Domestic loans	21.3	- 23.0	- 38.0

1/ Mainly FNUP (export stabilization fund).
2/ Mainly financed through foreign assistance in kind and financial aid.
3/ On-lending to public enterprises financed through external loans.

Source: IMF, Second Review under the Madagascar Stand-by Arrangement, July 1987.

Table 2

Origin of Resources for the PIP
(billions of FMG)

	1987		1988	
	FNDE	Other	FNDE	Other
Budget revenues	61.7	-	82.1	-
Counterpart funds	-	20.8	-	28.4
Self-financing	-	9.8	-	16.1
Other domestic sources	-	4.2	-	5.6
Sub-total, domestic	61.7	34.8	82.1	50.1
Public loans	63.4	-	74.0	-
External grants		22.6	-	52.9
Onlending a/	-	45.5	-	94.3
External banks	-	-	-	1.3
Subtotal, external	63.4	68.1	74.0	148.5
Total by category	125.1	102.9	156.1	198.6
General total	228.0		354.7	

a/ Official loans on-lent to parastatals.
Source: World Bank, Review of the 1988 PIP, December 1987.

2. The Impact of the IMF Deficit Ceiling on the Use of Counterpart Funds

Although the measures adopted by the GDRM to stay within the IMF ceilings are arrived at in consultation with the IMF, the Ministry of Finance in fact has considerable flexibility in how it chooses to limit the size of the deficit. The procedure is to begin by preparing the GDRM Operating Budget. Revenues from the FNUP (the extrabudgetary export stabilization fund) are added to budgetary revenues, yielding a surplus available for financing the FNDE portion of the PIP. This is followed by budgeting the PIP itself, both the FNDE and the non-FNDE components. It will be noted that, although the proposed reforms to combine all of the different public sector budgets into one global budget have not yet been implemented, the IMF already analyzes government financial operations from a global standpoint. Because of the IMF ceilings, the Ministry of Finance is obliged to approach the preparation of the budget in the same global manner.

The size of the PIP is based on the total amount of reources available to finance development activities, i.e., the

current budget surplus, foreign borrowing by the Government, foreign borrowing by parastatals, foreign project grants, and counterpart funds generated by non-project foreign aid (see Table 2). During this process, two key decisions need to be made with respect to counterpart funds: 1) what will be the total amount spent, and 2) how is it to be allocated.

a. The Ceiling on Counterpart Fund Expenditures

Although this is not an absolute requirement, it appears that the IMF is consulted in deciding the total amount of counterpart funds to be spent in a given year. For the last several years, the ceiling has been determined by the expected level of grant-generated counterpart funds in that year, plus an allowable excess of expenditures over receipts. Thus, in 1987 the ceiling was about FMG 20 billion and in 1988 the ceiling is about FMG 31 billion. The calculation for 1988 was:

Expected grant-generated counterpart funds:	FMG 27.0
minus associated costs (frais d'approche):	2.9
plus, excess expend. agreed to with the IMF:	6.9
Total counterpart fund expenditures:	31.0

The key decision here is to exclude loan-generated counterpart funds when calculating the expenditure ceiling. Some GDRM officials have explained that spending these funds is inflationary because they will be spent a second time when the loan is repaid. The actual effect, however, is that, if the funds are not spent, revenues to the Government will be increased without a corresponding increase in expenditures. Whether counterpart funds are loan- or grant-generated, their initial effect is to increase government revenues. If they are spent, there is no inflationary impact. If they are not spent, the effect is deflationary. The only solution to this problem is to remove the ceiling on counterpart funds and to permit their expenditure according the agreements reached between the Government and the donors concerned. This means that, in any given year, expenditures may be greater or smaller than funds generated, but over time expenditures will equal generations with no net impact on the deficit

The counterpart funds that have accumulated in the Central Bank as a result of deliberate underspending will certainly become a nagging problem for the GDRM and donors. This is because they are in fact no longer available for the purposes for which they were programmed. The counterpart funds can increase government revenues only in the year that they are generated. If they are left unspent, they either decrease the government deficit or they enable the government to increase expenditures elsewhere. In any event, during any subsequent year, the use of these funds can only increase the deficit unless the Government reduces other budgeted expenditures. Since GDRM counterpart fund accounts in the Central Bank will

almost certainly exceed FMG 100 billion by the end of 1988, it seems very unlikely that they will ever be spent for the purposes originally intended. There is no way that the Government can cut other budget expenditures by this amount, even over a period of several years, and the IMF will not accept the increased deficits that would result from spending these funds.

One way that the funds can be disposed of in a non-inflationary manner is to use them to repay the Government debt to the Central Bank. This would have no effect on either the deficit or the money supply, but would require the approval of the donors concerned. One possible solution for some donors would be to agree to the allocation of counterpart funds for development activities already in the budget that fit into the overall objectives of their aid programs. This could be done, for instance, in the context of the upcoming budget policy reforms. The reallocation would be based on an assessment that, because the budget reform has improved the overall allocation of resources for development purposes, the donor is willing to allocate accumulated counterpart funds for the overall development program. The GDRM resources that would be freed up by the reallocation of counterpart funds would then be used to repay the Government debt to the Central bank. This approach is possible only if a significant portion of the development program is funded by the Government with its own resources. As can be seen in table 2, budget revenues funded FMG 61.7 billion of the PIP in 1987, and FMG 82.1 billion has been budgeted for 1988.

The implied reasoning of the GDRM in deciding to exclude loan-generated counterpart funds from the expenditure ceiling is that, because these funds have to be repaid, the Government should be allowed to spend them according to its own priorities. In this respect, the loan-generated counterpart funds are treated much like the local currencies generated by World Bank and IMF loans, which are integrated with other revenues and allocated as part of the GDRM's normal budget process. By leaving loan-generated funds unspent, the Government is able to use the increased revenues that these funds represent in the same way that it uses its other budgetary revenues.

This raises the issue of whether counterpart funds should even be programmed. The World Bank and IMF position is that these are host government-owned local currencies which should be used by the Government according to its own priorities. The basic reason for this position is that earmarking government revenues is not good fiscal management. Whenever funds are eramarked they are no longer available to be allocated according to overall national priorities. In Madagascar, total non-project aid, including the World Bank and IMF, generates between FMG 100 and 200 billion per year in increased GDRM revenues. This compares to total GDRM renenues from domestic

sources of about FMG 450 billion (see Table 1). These figures illustrate clearly that, if all the local currencies generated by non-project aid were to be programmed, the GDRM's ability to allocate its resources according to its own priorities would be significantly restricted.

The disagreement is really one of what conditionalities to put on aid programs that generate counterpart funds. The World bank and the IMF tie their non-project aid to economic policy reforms, but do not get involved in the allocation of government resources except through overall budget reform. Other donors consider the allocation of resources for development as a valid area of policy dialogue and consider the joint programming of counterpart funds as a way of increasing the overall impact of their development programs. By programming all of their funds for development activities, donors are insisting that the entire increase in GDRM revenues resulting from their non-project aid be allocated to the development budget. This assures that none of these funds will be used to finance increases in the current budget. There will probably never be agreement among donors on this issue but, as a general rule, the stronger the programming and budgeting system of the host government, the less development impact is obtained from donor programming of counterpart funds.

b. The Allocation of Counterpart Fund Expenditures

As noted above, counterpart funds are programmed entirely in the context of the PIP. The Direction Generale de Plan (DGP) begins by requesting the proposed development budgets of each ministry. When these budgets are aggregated they exceed available resources by a substantial margin. Cuts are then made on a project by project basis based on overall GDRM development objectives and priorities. The World Bank has been involved in this process in recent years, and improvements in the system are planned as part of the upcoming budget reforms.

Once the composition of the PIP is set, the counterpart funds are allocated. In principle, top priority is given to aid-financed projects where the Government is committed to funding the local costs and counterpart funds have been programmed for this purpose. Second priority is given to Government projects that are entirely local cost, e.g., the micro-projects financed with AID counterpart funds.

What has happened in recent years is that the total obligations of the Government to fund the local costs of aid-funded development projects have exceeded the spending ceilings for counterpart funds. This is because 1) the Government commitments are based on previous project agreements, while the ceiling is based on counterpart funds generated in the present budget year; and 2) many of the counterpart funds made available to the Government to finance

local costs were loan-generated so that inevitably the spending ceilings will be lower than requirements. The objective of the DGP would normally be to fund all Government commitments to development projects but is unable to do so because of the decision of the GDRM in consultation with the IMF to allocate its available resources elsewhere. The ceiling on counterpart fund spending could have been raised only by reducing other parts of the government budget. This is essentially a case of resource allocations reflecting Government priorities.

DGP decisions on where to make cuts in the counterpart fund budget are generally made on the basis of which projects have the highest development priority. However, a small amount of funds is always set aside for development projects that have no foreign exchange costs. An additional consideration is that grant-generated counterpart funds tend to be spent faster than loan-generated funds. Table 3 shows how counterpart funds were allocated in 1987 and 1988. It was not possible to obtain the allocation for all donors in 1988.

It will be noted that, although the 1988 ceiling was increased by 50 percent over 1987, AID expenditures are

Table 3

Counterpart Fund Expenditures, 1987 - 1988
(billion FMG)

Donor	1987	1988
IDA	.3	-
CCCE	-	7.6
EEC (FED and STABEX)	2.3	4.1
France	2.6	n.a.
Japan	.4	n.a.
Lybia	1.3	n.a.
RFA	.3	n.a.
Switzerland	1.0	3.0
USSR	1.0	7.5
USA, PL480	4.3	2.5
USA, MARS	-	1.2
Misc. costs	6.2	-
Total Expenditures	19.8	31.0

Source: DGRM, Direction General de Plan

projected to decline by 15 percent. This is despite the fact that AID agreements signed in 1988 will generate about FMG 25 billion of counterpart funds. At the same time several other donors received substantially higher allocations. According to the DGP, although the ceiling is much higher in 1988, the

programming process was much more difficult. Many major Government commitments to donor-funded projects were programmed for 1988 but could not be met, apparently to the great consternation of the donors concerned. Under the circumstances, allocating FMG 3.7 billion of AID-generated counterpart funds was considered a major accomplishment.

C. Donor Approaches to Programming Counterpart Funds

The most common approach is for donors to program counterpart funds for the local cost components of the development projects they are financing. Counterpart funds are programmed for this purpose at the time that the agreement is signed. The consensus among donors is that the local costs of their projects are much more likely to be funded when counterpart funds are earmarked for that purpose. The donors which program their counterpart funds in this way are: FED, FRG, Switzerland, FAC, USSR, and Italy. Other donors which do not finance development projects or generate more counterpart funds than their projects require, do not program the funds at the time that they are generated. The agreements, however, do specify the types of activities eligible for funding. In these cases, the DGP proposes uses for the funds which are agreed to by the donors. Donors in this category are: USAID, Lybia, and Japan. Finally, there is the special case of the CCCE, which makes its counterpart funds available for the local costs of CCCE-financed projects, but does not program the funds at the time that they are generated.

Generally, programming the funds at the time that they are generated tends to assure that they are spent faster but not necessarily on schedule. FED counterpart funds, for example, are fully programmed, but there are funds generated as far back as 1978 which are not yet spent. This is also the case for other donors, especially the USSR.

The worst situation concerns the CCCE. In 1984, FMG 12 billion were generated and programmed, but only FMG 2.7 billion were spent. In 1985, FMG 13 billion were generated, FMG 4 billion programmed and none spent. In 1986 and 1987, another FMG 24.1 billion was generated but not programmed, so that at the present time total unspent counterpart funds generated by the CCCE amount to FMG 44 billion. The 1988 CCCE structural adjustment loan will generate an additional FMG 51 billion. The main causes of the CCCE's problems seem to be that 1) their counterpart funds are generated by loans rather than grants, and 2) the projects to be supported with these funds mostly involve the recapitalization and restructuring of public enterprises. At a time when the GDRM is struggling to stay within IMF deficit ceilings, it is unlikely to want to reduce its own expenditures so that substantial resources can be allocated to the public enterprise sector.

D. Effectiveness of the Counterpart Fund Programming Process in Madagascar

1. Consistency with GDRM Development Priorities

In programming counterpart funds, the DGP has relatively little flexibility. Most of the funds are earmarked for the local costs of externally-financed development projects which the Government is committed to funding. The only programming concerns the need to balance total commitments against a lower level of available funds. The DGP decides which projects to cut in consultation with the requesting ministry and the donor concerned. Counterpart funds not earmarked for externally-funded projects are programmed by the GDP using the same general approach as for the overall PIP. The process consists of the following steps:

1. The DGP receives project proposals from ministries.

2. The proposals that obviously do not qualify because of eligibility criteria or unsatisfactory design are eliminated.

3. The remaining projects, which always total more than available funds, are then ranked on the basis of 1) the priority of the sector or sub-sector, 2) feasibility and development impact, and 3) intangibles such as geographic area or political considerations.

Annex A presents the format used in presenting development projects to the DGP for inclusion in the PIP . The process is designed to provide all of the information needed to determine the development priority, feasibility and cost of the project. This same basic approach is used in programming counterpart funds. However, based on the proposals prepared for PL 480 funding, it appears that many of the proposals are not well prepared, and the analysis is less than rigorous. All that can be said about the process at this time is that the DGP system is designed to ask the right questions. Further improvements will have to be achieved in the context of the proposed budget reform to be supported by the World Bank.

2. The Additionality of Counterpart Funded Projects

In a situation of stringent budget constraints, it can be said that whenever government revenues are increased, as is the case with counterpart funds, the result will be an increase in budget expenditures. Joint-programming should help determine where these additional expenditures occur. The general consensus of donors is that when counterpart funds are earmarked for the local costs of development projects, this greatly increases the chances that these local costs will be funded adequately. Thus, this type of programming is

considered additional despite the fact that the Government is usually obligated to finance these local costs whether or not counterpart funds are made available. It should be noted, however, that if there were no counterpart funds the GDRM would try to fund at least some of the local costs to which they are committed. To the extent that counterpart funds replace other government resources that would have been used for the same purpose, they are not additional. The higher the priority of the project being supported, the less likely the counterpart fund expenditures are of being additional, because the project would have been funded from some other source.

From discussions with the DGP, it appears that counterpart funds allocated to projects that are entirely local cost are also additional. Ministries generally propose activities that do not have a high enough Government priority to be funded through the normal budget process but qualify for funding under the eligibility criteria of donors generating counterpart funds.

Thus, the overall impact of joint programming counterpart funds by donors, including AID, is that government resources have been allocated to activities that would not have been funded if the counterpart funds had not been jointly programmed. Once again, it must be emphasized that additionality does not increase the government deficit or the rate of inflation. The effect of successful joint programming is that government resources are allocated differently than they would have been. The total amount of spending or the size of the deficit are not affected.

3. On-budget versus Off-budget Programming

The GDRM programs all counterpart funds off-budget using a well established procedure that tries to achieve as much additionality as possible. Each year, ministries submit requests for counterpart funding to the DGP. The DGP matches requests with available funds and obtains donor approval for the proposed use of those funds. At the end of the process a ceiling is set for each donor, and that ceiling is allocated among the projects that were agreed to by the donor and the implementing ministry (see Table 3). Spending shortfalls in one project can be used to increase funding of another project within each donor ceiling. The entire procedure is clearly and deliberately extrabudgetary. By its nature, the system results in considerable additionality in the programming of counterpart funds.

The system can be considered within the budget in one respect. Some externally-funded government development projects show up in the FNDE, which is part of the GDRM budget, and the local costs of these projects are budgeted by each ministry concerned. When counterpart funds are earmarked for these local costs, they are being programmed for activities

that the GDRM is committed to funding. This is the case, for instance, for MAELP counterpart funds which are being programmed for the World Bank Seventh Highway Project. The main effect of programming in this manner is that the additionality is less certain. If the project being supported has a high Government priority, it would have been funded anyway.

The extreme case of on-budget programming would be to allow the GDRM to use the funds for any development activity consistent with the provisions of the FAA or PL480. As noted earlier in this paper, this can include virtually any activity related to agriculture, rural development, nutrition, or health. In this case, the funds would be placed in a separate account and would be used by the Ministry of Finance to fund the development expenses of, say, the Ministry of Agriculture or the Ministry of Forestry and Livestock.

Here again, this change would not have the effect of reducing the GDRM deficit. The total amount of Government spending remains the same as if the activities had been additional. Programming the funds in this way does mean that expenditures would be less likely to be limited by the IMF ceiling. The Ministry of Finance could still decide not to spend the funds, especially if they were loan-financed. However, the donor should find it easy to negotiate rapid disbursements since the Ministry of Finance could simply earmark the funds for development activities that would have been funded from general budget revenues.

RECOMMENDATIONS FOR OAR/MADAGASCAR

In recommending approaches to the programming of AID counterpart funds, the basic assumption is that AID recognizes that these funds are owned by the host government but also recognizes that the generation of the local currencies increases government revenues over what they would have been. The policy of AID is to influence the use of these funds in order to improve the overall allocation of government resources for the development objectives being supported by the AID program. Therefore, the possibility of not programming counterpart funds is not considered in this section.

To implement this policy it is necessary to place the counterpart funds in the context of the overall AID program. The stated goal of the AID program in Madagascar is to help increase rural incomes while improving nutrition and maintaining the country's natural resource base. The strategy for achieving this goal is to support the GDRM economic liberalization program, with an emphasis on the agriculture sector. In the past, AID support for the liberalization program has been primarily through balance of payments support, i.e., PL 480, and the CIP component of the MARS project.

CONCLUSION AND RECOMMENDATIONS

Except for the IMF, World Bank, and ADB, donors in Madagascar program the local currencies generated by non-project foreign assistance. The policy of most donors is to earmark the local currencies for the local costs of the development projects that they finance. Some donors, including AID, generate more local currencies than are needed by their development projects. These donors program their counterpart funds jointly with the GDRM. The counterpart funds are deposited in special accounts at the Central Bank and, until 1984, were disbursed as the agreed upon projects were implemented.

Since 1984, the GDRM has adopted a policy of deliberately undersponding counterpart funds, i.e., the Government has set an annual expenditure ceiling on counterpart funds that is lower than the amount generated in that year. This is one of several measures adopted by the GDRM to reduce government expenditures and remain within the deficit ceilings set by the IMF.

Counterpart funds pose a particular dilemma for the GDRM because, if they are spent as programmed, the activities that they finance are in effect exempt from budget cuts. This means that virtually all of the expenditure cuts would have to be absorbed by the current budget. The GDRM appropriately determined that all government activities should be subject to cuts, including development projects financed by counterpart funds. This was achieved by setting a ceiling on counterpart fund spending equal to the amount of counterpart funds generated by grants during the budget year (i.e., counterpart funds generated by loans were not counted in setting the ceiling). As a result, many development projects have been underfunded and implementation has been delayed.

A secondary effect has been the accumulation of unspent counterpart funds in special GDRM accounts at the Central Bank. For AID, it was July 1988 before the GDRM programmed counterpart funds generated in 1986. Virtually no funds generated in 1986, 1987, or 1988 have been spent. Not spending these funds has helped the GDRM to stay within the IMF deficit ceiling. However, the unspent funds that have accumulated in the Central Bank can no longer be spent without increasing the government deficit and increasing the money supply. These funds are in effect no longer available for the purposes for which they were programmed.

At the present time, there are about FMG 23 billion of AID-generated counterpart funds accumulated in Central Bank accounts. In addition, in 1988, AID will sign agreements that will generate about FMG 26 billion of counterpart funds during the first year of implementation. This compares to total counterpart fund expenditures of FMG 20 billion in 1987 and a projected FMG 31 billion in 1988.

At this juncture, AID needs to take the following actions to assure that its counterpart funds are effectively utilized and that the problem of accumulated potentially inflationary counterpart funds is not aggravated:

1. The key to the effective use of counterpart funds for development purposes is budget reform. This will help assure that all government resources, including counterpart funds, are allocated according to overall national priorities. AID should use counterpart funds to encourage the upcoming budget reforms supported by the World Bank. Specifically, the counterpart funds to be generated by the first tranch of the MAELP should be programmed for general budget support, on the understanding that the improved budgeting process will be in place by 1990.

2. AID should encourage the GDRM to remove the existing arbitrary ceiling on counterpart fund expenditures. Activities to be included in the GDRM current and development budgets should be based on overall government priorities; and counterpart funds should be allocated to development projects based on the importance of the project, not on the amount of counterpart funds that may have been generated in a given year.

3. Assuming satisfactory progress in budget reform (including the removal of the counterpart fund spending ceiling in its present form), AID should program counterpart funds for general budget support. In the context of the IMF stabilization program and the severe GDRM budget constraints, this is by far the most effective and desirable use of counterpart funds.

4. However, if the budget reforms prove unsatisfactory, i.e., if there is not a clear link between the resource allocation process and national priorities, AID should program its counterpart funds at the project level. For project-level programming to be effective: 1) activities to be funded should be identified at the time that the agreement is signed, 2) the activities should be related to the overall objective of the program (e.g., oilseed self-sufficiency for the upcoming Title II program), and 3) the GDRM must provide effective assurances that, assuming no worsening of the budgetary situation, the agreed-upon activities will be funded regardless of counterpart fund expenditure ceilings.

5. AID and other donors should initiate discussions with the GRDM on ways of spending the accumulated counterpart funds in a non-inflationary manner. One possibility is to use the funds to repay the GDRM debt to the Central Bank as described on page 11 above. This reprogramming of counterpart funds recognizes that the activities they were to have financed were delayed by the GDRM in order to stay within the deficit ceilings set by the IMF, and that these

delays reflected overall national priorities as perceived by the GDRM.

Annexe III/2

/ F.N.D.E. 1989 - PIP 1989-1991 /

FICHE DE PROJET

Date :

N° de Code

FNDE :
DGP :

Intitulé :

/ A. DOSSIER D'IDENTIFICATION ET DE FINANCEMENT /

I. DONNEES DE BASE :

a. MINISTERE DE TUELLE :

b. ZONE D'IMPACT ET LOCALISATION :

c. ANNEE DE DEMARRAGE :
(effective ou prévue)

d. DUREE DE REALISATION DE L'INVESTISSEMENT PHYSIQUE :

e. RESPONSABLE DU PROJET :
(Nom, fonction, téléphone/Adresse)

II. NATURE DU PROJET :

PRODUCTION MARCHAND /___/

AUTRE (Infrastructure ou sans recette monétaire directe) /___/

OBJECTIFS :

III. ETAT D'AVANCEMENT DU PROJET

a. Idée du projet ☐

b. Etude de préfactibilité ☐

c. Etude de factibilité ☐

d. Financement sollicité ☐

e. Financement acquis

f. Marché ☐

g. Coûts déjà engagés ☐

IV. FINANCEMENT DU PROJET

Financement domestique

1. A- AUTOFINANCEMENT .....

B- FONDS DE CONTREPARTIE .....

a. acquis .....

b. à rechercher .....

C- FNDE.....

D- AUTRES .....

2. FINANCEMENT EXTERIEUR ACQUIS .....

SOURCE ET REFERENCES

	SOURCE	MONTANT (en devises)	1.000 FMG
Financement 1			

B. DOSSIER D'INVESTISSEMENT

I. NATURE DE L'INVESTISSEMENT

(Montants globaux du projet)

	MONTANT (en 1.000 FMG)			%
	CONTRIB. NATIONALE	FIN. EXT.	TOTAL	
Investissements physiques				
- Bâtiments				
- Génie civil (hors bâtiments)				
- Matériels et équipements				
- Véhicules				
- Autres immobilisations (spécifier)				
Investissements incorporels				
- Etudes (incorporées au projet)				
- Assistance technique				
- Formation (y compris bourses à l'étranger)				
-Fonds de roulement (y compris stock)				
Dépenses de fonctionnement directement liées à l'investissement				
- Salaires personnels locaux et indemnités				
- Carburants				
- Consommation (matières premières et consommables)				
- Autres				
TOTAL INVESTISSEMENT				

II. ECHEANCIER D'INVESTISSEMENT

	ANTERIEUR à 88	EST. 88	89	90	91	RELIQUAT	TAUX DE CHANGE UTILISE

III. NATURE DE L'INVESTISSEMENT (1.000 FMG)

INVESTISSEMENTS PYSIQUES	Est. 88		1989		1990		1991	
	Local	Devis	L	D	L	D	L	D
- Bâtiments								
- Génie civil								
- Matériels et équipements								
- Véhicules								
- Autres								
INVESTISSEMENTS INCORPOREIS								
- Etudes (inclus dans projets)								
- Assistance technique								
- Formation (incl. étranger)								
- Fonds de roulement								
DEPENSES DE FONCTIONNEMENT LIEES A L'INVESTISSEMENT								
- Salaires								
- Carburants								
- Consommation								
- Autres								
TOTAL INVESTISSEMENT								

IV. PERSONNEL ENGAGE PENDANT L'INVESTISSEMENT (Nombre)

CATEGORIES	Est. 1988	1989	1990	1991
Fonctionnaires cadres				
Fonctionnaires temporaires				
Assistance technique (hommes-mois)				

C. DOSSIER D'EXPLOITATION PREVISIONNELLE

I. PROJETS DIRECTEMENT PRODUCTIFS

(Recettes et dépenses d'Exploitation dans l'Après-Investissement)

	Est. 1988	1989	1990	1991
A. RECETTES Recettes directes				
B. DEPENSES Dépenses directes (liées à la production)				
C. REVENUS BRUTS DE L'EXPLOITATION				

II. AUTRES PROJETS-ESTIMATIONS DES CHARGES RECURRENTES : (1.000 FMG)

	1989	1990	1991
Entretien :			
- des immobilisations			
- et renouvellement des équipements			

Annexe III/7

III. EMPLOIS PERMANENTS CREES (Nombre)

	Moyenne en année de croisière
- Cadres Supérieurs	
- Personnel d'exécution	

D. AUTRES INFORMATIONS

I. BIENS ET SERVICES PRODUITS (VOLUME)

	Est. 1988	1989	1990	1991
Biens :				
Services :				

II. BIENS ET SERVICES PRODUITS (VALEUR) ('000 FMG)

	Est. 1988	1989	1990	1991
Biens :				
Services :				

III. IMPACT SUR LE COMMERCE EXTERIEUR

	Est. 1988	1989	1990	1991
A. EXPORTATIONS DES BIENS ET SEEVICES ('000 FMG)				
TOTAL				
B. IMPORTATIONS DE BIENS ET SERVICES ('000 FMG)				
a. matières premières				
b. articles finis				
c. Services				
TOTAL				
BALANCE (A-B)				