ICR Review
Operations Evaluation Department

Report Number : ICRR11603

1. Project Data:		Date Posted : 09/22/2003		
PROJ ID :	P057378		Appraisal	Actual
Project Name :	Structural Adjustment Credit Ii	Project Costs (US$M)	100	100
Country:	Madagascar	Loan/Credit (US$M)	100	100
Sector(s):	Board: EP - Central government administration (50%), Oil and gas (17%), Mining and other extractive (17%), Telecommunications (8%), Aviation (8%)	Cofinancing (US$M)		
L/C Number:	C3218; CP788			
		Board Approval (FY)		99
Partners involved :		Closing Date	12/31/2001	12/31/2002

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2. Project Objectives and Components

a. Objectives

The objective of SAC-II was to support Madagascar's adjustment program, in particular achieve a higher level of growth and reduce poverty.

b. Components

The Credit supported reforms in four areas: (i) consolidation of macro-economic stability; (ii) privatization and introduction of competitive regulatory frameworks; (iii) improvement in the business environment by targeting promising sectors and promoting transparency in licensing for the exploitation of natural resources; and (iv) strengthening of public finance by expanding the tax base, increasing non -tax revenues, and ensuring that resources allocated to the social sectors are effectively used for the poor .

The Credit was to be disbursed in three tranches .

c. Comments on Project Cost, Financing and Dates

In December 2001, the Board approved a waiver to one of the second tranche conditions, allowing its release once a winner of the bidding process was chosen and invited to negotiate the final sales contract of the telecom company, instead of a requirement of sale of at least 34 percent of the voting stock. The purpose was to remove undue pressure on GOM during contract negotiations. At the same time the closing date was postponed by one year to December 31, 2002. The second tranche was released in January 2002.

Following the political crisis of the first half of 2002, GOM requested a restructuring of the conditions for third tranche release to reflect changes in circumstances and priorities . The conditions were substantially diluted. The request was accompanied by a Supplement to the original Letter of Development Policy . In September 2002, the Board approved such a restructuring and the tranche was released in October 2002.

The Credit was complemented by two Supplemental Credits for US$ 50 million : (i) the first one on July 2000 for US$20 million to respond to the emergency arising from three cyclones that hit the country from February to April 2000; (ii) the second one on December 2000 for US$30 million to cushion the impact of the 2000 petroleum price shock on the economy. Disbursement of the first supplemental Credit was not subject to conditions but GOM indicated that it would withdraw the funds in two installments, the first one after effectiveness, and the second one after meeting agreed quantitative targets in terms of primary schools and health centers rehabilitated and /or reconstructed. The first installment was disbursed in September 2000 and the second one in July 2002. The second Credit was disbursed in July 2001 without prior condition.

SAC-II was concomitant with the "Projet d'Appui Technique au Secteur Privé - PATESP" of US$23.8 million, the "Projet d'Appui Institutionnel à la Gestion Publique - PAIGEP" of US$13.8 million, and an APEX operation of US$48.0 million, all supported by the Bank at the same time. OED reviewed the PATESP, the PAIGEP and the SAC-II simultaneously.

3. Achievement of Relevant Objectives:

The development objectives were partly achieved. Up to 2001, SAC-II contributed largely to maintaining macro-economic stability and achieving growth averaging 5.1 percent over 1999-01 due to increased private investment and FDI. As a result of the 2002 crisis, the situation dramatically reversed with a drop of some 12 percent in GDP and a drastic reduction in FDI flows (from US$93 million in 2001 to an estimated US$8.5 million in 2002) due to loss of foreign investors' confidence. Despite this reversal, the sometimes hesitant commitment of the authorities, and the weak institutional capacity of the country, SAC-II established a foundation for liberalization and private sector-led growth, provided, however, that political stability is maintained.

The objective of reducing poverty was not attained with only slight progress in urban areas (related to FDI growth) but a stagnating or worsening situation in rural areas. Although judgment on poverty reduction cannot be made on the basis of a short period, the better than average growth rate did not translate into reduced poverty. Reducing poverty, in particular, its urban-rural disparity, will be dependent on developing new sources of growth, such as mining, tourism, and fishing outside of the capital city area, and on strengthening revenue policies.

4. Significant Outcomes/Impacts:

1. Liberalization and privatization led to a substantial increase in private investment, from 6.9 in 1998 to 11.2 percent of GDP in 2001, with FDI leading the surge from 0.4 to 2.0 percent of GDP during the same period. The industries most affected were: the sectors under privatization (telecom, petroleum), textile/clothing (with an additional 100,000 jobs), tourism and related industries (arrivals increased from 100,000 in 1997 to 170,000 in 2001).

2. Results of the privatization program are significant, although progress was slow due to numerous delays: (i) the sale of one bank (BTM) was completed; (ii) the liberalization of the petroleum sector and the privatization of the former national monopoly is virtually completed and a regulatory authority in place and functioning; (iii) the telecom sector was liberalized with a regulatory body operational; the mobile segment is increasing rapidly, but the privatization of the national telecom company was still not completed at closing of the Credit due to delays, several of which were of a legal nature; and (iv) the air transport sector, both domestic and international, was liberalized with several international airlines now operating in and out of Madagascar and a regulatory body also established; Air Madagascar is now operated under a two-year performance-based management contract with Lufthansa Consulting. In each of these sectors, prices have come down. The privatization of these large companies was expected to send a strong signal to the international community about Madagascar's economic policy direction.

3. A new mining code was issued and a mining cadastre set up; management of the fishing and forestry sectors was streamlined with the adoption of a transparent, competitive, and nondiscretionary licensing system. These are pre-requisites for developing new sources of growth, but it is too early to judge the effective application of the new measures and their results in terms of growth and employment.

4. The finance and budget ministries were merged, a decision delayed by GOM for much too long.

5. SAC-II has raised the governance issue by putting the subject prominently on the reform agenda.

6. The reforms carried out under SAC-II and the more open climate created as a result, certainly helped minimize the negative consequences of the 2002 crisis and are likely to speed up a recovery.

5. Significant Shortcomings (including non-compliance with safeguard policies):

Revenue mobilization and reforms in social expenditure management were disappointing and remain very weak spots in the country's economic policies, with negative consequences on poverty reduction. The amount of energy and time spent on the privatization component was probably at the expense of a better performance in this area. Furthermore, the weak institutional set-up of the central ministries was also responsible for poor performance in financial management, a fact amply demonstrated by the several changes in the organizational structure of the central ministries. This was sufficient reason to pay much more attention to this situation at entry: SAC-II and PAIGEP may have missed an opportunity in this area.

Despite the very large amount of the supplemental credits and the fact that there were no legal release conditions, the Bank failed to pay sufficient attention to meeting the quantitative targets for withdrawing the installments under the Cyclone Credit.

The Bank overestimated the commitment of the Government with respect to certain reforms while it underestimated the capacity to carry out several reforms in different areas simultaneously and the complexity of the privatization program, therefore undermining quality at entry.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	The poverty reduction objective was not met. Results under component four (Section 2 b), i.e., revenue mobilization and reform in social expenditure management, were disappointing.
Institutional Dev.:	Substantial	Substantial	
Sustainability:	Likely	Likely	
Bank Performance:	Satisfactory	Satisfactory	Although there were several weaknesses at entry, the Bank team worked effectively with the Government to broaden the basis for PSD and to restructure the program after the 2002 political crisis.
Borrower Perf.:	Satisfactory	Satisfactory	
Quality of ICR:		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

A flexible approach to tranche release, such as the menu-based one in this operation, is a good way to respond to the specific circumstances faced by a borrower, especially in a climate of fragile political environment.

Growth is not a guarantee for a reduction in poverty and explicit poverty reduction measures should be addressed at preparation/appraisal.

Even though the Bank tends to respond generously with supplemental financing in times of negative external shocks, more attention should be paid to the design and supervision of these operations to ensure that the funds are used in a cost effective way and are directed to the victims of external shocks.

Privatization of large PEs requires considerable preparation, notably in its legal aspects. This is a common weakness in many Bank operations, where the complexity of transactions is underestimated, leading to long delays during project execution.

8. Assessment Recommended? ● Yes ○ No

Why? As part of a cluster comprising the present project, SAC-I, PAIGEP, PATESP, and PSD 2, to assess progress in reforms and poverty reduction. This would be very useful, especially given the deep political and economic crisis of 2002.

9. Comments on Quality of ICR:

While overall the ICR is satisfactory, the quality of the analysis is deficient in several areas. First, there is little discussion of the reasons for the lack of impact of growth on poverty reduction. Second, the discussion of the waiver and of the restructuring for the second and third tranche release is inadequate (e.g., the memo to the Board for the restructuring provides a much clearer and more comprehensive picture). References to memos to the Board and to amendments to the DCA should have been spelled out. Third, the analysis of sustainability and institutional development impact is weak. Finally, the ICR would have benefited from editing.