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INTERNATIONAL DEVELOPMENT ASSOCIATION

DOCUMENT FOR A PROPOSED GRANT

IN THE AMOUNT OF SDR 31.9 MILLION
(US$45.0 MILLION EQUIVALENT)

TO THE REPUBLIC OF MADAGASCAR

FOR THE

PUBLIC FINANCE SUSTAINABILITY AND INVESTMENT DEVELOPMENT POLICY FINANCING II OPERATION

October 20, 2017

Macroeconomics and Fiscal Management Global Practice
Africa Region

THE REPUBLIC OF MADAGASCAR

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENT

(Exchange Rate Effective as of September 30, 2017)
Currency Unit = Malagasy Ariary (MGA)
US$1 = SDR 0.70756386

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AGOA	African Growth and Opportunities Act
BoP	Balance of Payments
CBM	Central Bank of Madagascar
CNM	*Commission Nationale des Marchés* (National Commission for Public Procurement)
CPF	Country Partnership Framework
CSBF	*Commission de Supervision Bancaire et Financière* (Commission for Banking and Financial Supervision)
DPF	Development Policy Financing
DPO	Development Policy Operation
DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
EDP	Economic Development Paper
ESIA	Environmental and Social Impact Assessment
ESMAP	Energy Sector Management Assistance Program
EU	European Union
FSAP	Financial Sector Assessment Program
GDP	Gross Domestic Product
IDA	International Development Association
IEG	Independent Evaluation Group
IMF	International Monetary Fund
JIRAMA	*Jiro sy Rano Malagasy* (State-Owned Electricity and Water Company)
kW.h	Kilowatt hour
MDB	Multilateral Development Bank
MFB	Ministry of Finance and Budget
MGA	Malagasy Ariary
NDP	National Development Plan
NEO	National Environment Office
PA	Prior Action
PAP	Priority Action Plan
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
PFSI	Public Finance Sustainability and Investment
PIM	Public Investment management
PPP	Public Private Partnership
PV	Present Value
RCF	Rapid Credit Facility
SDR	Special Drawing Rights

SOE	State-Owned Enterprise
SSA	Sub-Saharan Africa
TA	Technical Assistance
US$	United States Dollar
VAT	Value Added Tax
WB	World Bank
WBG	World Bank Group

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THE REPUBLIC OF MADAGASCAR

PUBLIC FINANCE SUSTAINABILITY AND INVESTMENT DEVELOPMENT POLICY FINANCING II OPERATION

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SUMMARY OF PROPOSED GRANT AND PROGRAM

THE REPUBLIC OF MADAGASCAR

PUBLIC FINANCE SUSTAINABILITY AND INVESTMENT DEVELOPMENT POLICY FINANCING II OPERATION

Borrower	Republic of Madagascar
Implementation Agency	Ministry of Finance and Budget
Financing Data	IDA grant: SDR 31.9 million (US$45.0 million equivalent).
Operation Type	Second in a programmatic series of two operations – single tranche
Pillars of the Operation And PDO	The program development objectives, which are reflected in the two pillars of the operations are to: (i) Strengthen the fiscal framework by creating fiscal space to support priority expenditures; and (ii) Improve the environment for investment.
Result Indicators: (Baseline: 2015 unless otherwise noted; Target 2019)	Revenue effort increased: Baseline: 10.1 percent of GDP (2015); Target: 12.0 percent of GDP (2019) Value of tax expenditures eliminated Baseline: MGA 0 billion (2017); Target: MGA 70 billion (2019) Selected transfers reduced as a share of total expenditure Baseline: 13 percent (2015); Target: 3 percent (2019) [o/w: transfer to the Pension Fund reduced from 5.8 percent to 1.6 percent; o/w: Fuel subsidies reduced from 1.8 percent to 0 percent] Share of priority spending on social sectors Baseline: 0.7 percent of GDP (2015); Target: 1.3 percent of GDP (2019) Share of new PPPs that follow appraisal and selection processes under the PPP Act Baseline: 0 percent (2015); Target: 100 percent (2019) Share of domestically financed investment projects above MGA 5 billion subject to the new standardized selection criteria and appraisal methodology Baseline: 0 (2015); Target: 100 percent (2019) Share of new power generation contracts awarded competitively and published of the total contracts Baseline: 0 percent (2015); Target: 70 percent (2019) Percentage of cases randomly assigned Baseline: 0 (2015); Target: 100 (2019) Number of days to resolve a commercial conflict Baseline: 871 (2015); Target: Less than 600 days (2019) Extent of risk based supervision. Baseline: no risk based supervision (2015); Target: risk based supervision in place for MFIs (2019)
Overall risk rating	Substantial
Climate and disaster risks *(required for IDA countries)*	Are there short and long term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? Yes [ ] No [X]
Operation ID	P164137

IDA PROGRAM DOCUMENT FOR A PROPOSED GRANT

TO THE REPUBLIC OF MADAGASCAR

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This Program Document proposes the second operation in a development policy operation (DPO) focused on strengthening Madagascar's fiscal framework and on improving the investment climate.** The proposed operation is the second in the Public Finance Sustainability and Investment (PFSI) (DPO2) programmatic series of two International Development Association (IDA) grants and is intended to deepen and consolidate the set of reforms implemented under the first series (DPO1 - P160866)[1] which seeks to (i) strengthen the fiscal framework by creating fiscal space to support priority expenditures, and (ii) improve the environment for investment. The proposed operation will be in the amount of SDR 31.9 million (US$45.0 million equivalent). This programmatic DPO series complements a proposed Inclusive and Resilient Growth DPO (P162279) which supports structural reforms aiming at building the resilience of the rural poor so that they can benefit from the growth momentum promoted by this operation.

2. **The prior actions proposed under this DPO2 are consistent with the triggers identified and approved under DPO1.** The Government has continued to implement the program over the last year, with all prior actions being at least as strong or stronger than envisaged a year ago, (Table 4). This strong performance has continued despite two major natural disaster related shocks in early 2017: a severe drought and a category 4 cyclone, the strongest of its kind in 13 years.

3. **Strengthening the fiscal framework is critical for ensuring that resources are available for spending on national development priorities.** Subdued levels of economic activity, particularly during the most recent political crisis period (2009-2013)[2], and poor tax administration procedures have resulted in low levels of domestic revenues. High levels of transfers to regressive areas of expenditures such as fuel subsidies and pensions have further constrained fiscal space. Building on the reforms supported in the Reengagement DPO (P150503) in 2014, the Resilience DPO (P153084) in 2015 and PFSI DPO1, the authorities have made significant headway in the reform agenda. Fuel subsidies have been eliminated, the transfer to the Pension Fund reduced, and revenue collection has been steadily increasing. Reforms supported under the PFSI programmatic DPO series are expected to increase tax revenues by 0.6 percent of gross domestic product (GDP) and reduce regressive expenditures by 0.8 percent of GDP.

4. **Improving the investment climate is fundamental for stimulating private sector led growth.** As discussed in the Country Partnership Framework (CPF - 2017-2021), Madagascar is an island nation blessed with many assets. The country has a population of 24 million, of which more than two-thirds are under 25 years and largely literate. A small but reasonably diversified private sector has the potential to thrive, but this has been limited by poor access to electricity, high costs of credit and weaknesses in

[1] Public Finance Sustainability and Investment DPF Operation (P160866), approved by the Board on November 22nd, 2016.

[2] A five-year political crisis started in March 2009 with an unconstitutional regime change. The transitional Government that came to power was not recognized by the international community. The election of a new President through a democratic electoral process took place in December 2013.

enforcing contracts.[3] As of the last enterprise survey (2013) firms reported lack of access to electricity to be the biggest constraint to their business after political instability, reflecting unreliable and expensive electricity supply from *Jiro sy Rano Malagasy* (State-Owned Electricity and Water Company (JIRAMA). An unreliable judicial system has compromised the fairness of resolving commercial disputes, and increased the cost of doing business.[4] And the stability of the financial sector has been compromised by a rapidly growing microfinance sector, which has led to the deterioration of portfolio quality. Reforms under DPO2 seek to build on the achievements in the first year of this programmatic operation by improving JIRAMA's procurement practices, reducing the number of days needed to resolve commercial cases, and improving the stability of the microfinance banking sector.

5. **Reforms to the fiscal framework and the investment climate are expected to stimulate the broad-based growth necessary for addressing Madagascar's deep levels of poverty.** Since 2001, there have been two political crises, disruptions in access to markets for textiles and manufacturing exports, severe climatic shocks, and global food price fluctuations. Against this backdrop, the headcount poverty rate declined slightly over the 2001-2012 period, but it remains exceedingly high at 70.7 percent in 2012. In 2012[5], only 30 percent of Malagasy lived above the national poverty line and only 10 percent above the international poverty line. Inequality is defined not by an excessive concentration of wealth for a few but by deep poverty, where the average Malagasy consumes 46 percent less than a person living right at the national poverty line. Various factors have entrenched poverty in Madagascar. The latest Poverty Assessment of 2016 found that access to electricity is one of the most important predictors of higher consumption levels among the poor.[6]

6. **This DPO series supports a comprehensive program of reform outlined in the Government's Economic Development Paper (2017-2019).** The reforms under this programmatic operation support the implementation of the Economic Development Paper, which specifies the priorities for stimulating growth and reducing poverty. Key areas of focus include increased revenue and rationalized spending to support public investment, a resilient and inclusive financial system to promote growth, energy development, and a strong business climate to stimulate the private sector.

7. **This DPO series further supports the implementation of specific sectoral strategies approved by the Government.** Sectoral strategies include the Public Financial Management (PFM) Modernization Strategy (2017-2026), which has measures to increase tax revenues and reduce the transfer to the Pension Fund, a Roadmap for reforming the petroleum sector that outlines the timetable for improving the institutional framework, a Public Investment Management Priority Action Plan (PAP) that supports the improved selection and appraisal of investment projects, a business plan to improve JIRAMA that includes procurement related reforms, and measures to improve the Investment Climate as outlined in a strategy to improve commercial justice.[7] The reforms supported under this programmatic DPO are well-aligned with the World Bank's investment projects and supported by ongoing Technical Assistance (TA). Finally, the reforms are complementary to the measures included in the International Monetary Fund

[3] As of the latest Doing Business Report, Madagascar ranks 185/190 on Getting Electricity, 170/190 on Getting Credit and 158/190 on Enforcing Contracts. The latest Financial System Stability Assessment (FSAP) highlights the vulnerability of the financial sector associated with the emergence of a lending expansion.
[4] Risks related to the poor institutional environment for commercial justice have contributed to higher interest rates.
[5] Most recent data available drawn from the *Enquête Nationale de Suivi des Objectifs du Millénaire pour le Développement* 2012 – a household survey combined with a monitoring of Millennium Development Goals.
[6] Republic of Madagascar, Employment and Poverty Analysis, Imperfect Information, Shocks, and Policy Responses, World Bank, 2016.
[7] These sectoral strategies are discussed in greater detail in Section 4.

(IMF) Extended Credit Facility (ECF) Program (2016-2019), where the first review in June 2017 concluded that satisfactory progress had been made.

8. **The authorities intend to scale-up public investments to implement the National Development Plan (NDP).** Public investment spending is expected to increase from 3.5 percent of GDP in 2015 to 10.2 percent of GDP in 2020. The external financing landscape is also expected to change following a successful Donors and Investors Conference in December 2016, where US$6.4 billion was pledged by development partners for the 2017-2020 period, including US$2.1 billion of undisbursed commitments and US$4.3 billion of new commitments. In addition, private sector operators announced US$3.3 billion worth of investment projects. The authorities are developing the institutional framework necessary to follow up on this financing and strengthen public investment management (PIM) capacity. The Government is actively seeking to attract private investment (particularly for energy projects), and is also strengthening the framework for Public Private Partnerships (PPPs), which is well-aligned with the World Bank's 'cascade' approach.[8] Continuing the reforms to debt management supported under the Re-engagement DPO in 2014, the scale-up in public investments is not compromising debt sustainability, as financing is largely on a concessional basis, and the Government is taking a proactive approach to managing potential fiscal risks. This increase in investment spending follows years of under-investment during the political crisis, resulting in a decline in the stock of capital both as a percentage of GDP and on a per capita basis since 2009.

9. **Madagascar's relative political stability provides an opportunity to continue the reform momentum.** Madagascar's return to constitutional order in 2014 has seen a much-anticipated pick-up in growth. Nevertheless, as discussed in the World Bank's CPF 2017-2021, strengthening governance remains key to addressing the country's deep-rooted fragility, and is therefore central to the reforms being supported in this programmatic DPO series. The reforms supported under this operation complement those under the proposed Inclusive and Resilient Growth DPO (P162279) which seek to promote access of the poorest to the benefits of growth and to promote resilience.

10. **While the Government has implemented the DPO program and managed the macroeconomic shocks from the two natural disasters (keeping the IMF ECF program on track), the risks to implementation remain high.** As preparations are underway for elections scheduled at the end of 2018 / early 2019, it will be important to maintain the reform momentum. To address this risk, the design of this programmatic DPO considers the *criticality*[9] of key reforms needed to strengthen fiscal space and promote the investment climate.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS[10]

11. **Since independence in 1960, Madagascar has not experienced sustained economic growth, as periods of prosperity have been punctured by political crises.** The post-independence period has seen

[8] The cascade approach seeks to maximize financing for development by leveraging the private sector and optimizing the use of scarce public resources.

[9] Criticality refers to the need to focus on the key elements to support the transition from fragility to resilience (as discussed in the Good Practice Note on DPL in Situations of Fragility, World Bank, 2011).

[10] The authorities have recently re-based their GDP figures and these will be incorporated in the World Bank's calculations in 2018, once the authorities have absorbed the new figures.

four major political crisis periods, in 1972, 1991, 2001-2002, and 2008-2009. In each case, the political crisis followed a period of economic growth, and resulted in a contraction of the economy. During times of political stability, growth has been driven by the secondary and tertiary sectors. The agricultural sector is characterized by low productivity, and is highly vulnerable to climatic variations. Before the 2001-2002 political crisis, average real growth was 3.8 percent, led by activities in the transport, public works, information and communications technology and banking sectors. Between 2003 and 2008, a period of political stability saw growth rates improve to an annual average of 6.3 percent, driven by private sector led activity and two large mining investments for nickel and other minerals. Following the return to constitutional order in 2014, economic growth is again rebounding, and is estimated to have averaged 3.7 percent between 2014 and 2017.

12. **In 2017, the estimated growth rate is 4.1 percent, largely driven by activities in the tertiary sector.** This trend follows performance in 2016, where the economy is estimated to have grown by 4.2 percent, also underpinned by tertiary sector led growth. Strong performance has been recorded in trade, services and transport. The increase in services-related activities is likely to reflect a pick-up in tourism, as the number of foreign visitors to Madagascar increased by over 4 percent in the first half of 2017, compared with the same period last year. Public works related activities, in support of the planned scale-up in public investments, as well as emergency reconstruction works in response to the recent natural disaster shocks, are also contributing to growth. Activities from industrial processing zones have been increasing, reflecting stronger textiles exports following the reinstatement of eligibility to the African Growth and Opportunities Act (AGOA).[11] The process of certain agricultural products such as sugar has been increasing, which is captured under the secondary sector. Growth in the extractive industries remains modest, as global nickel prices remain low in comparison with other metals. Agricultural activities have contracted following the climatic shocks, as local production has declined.

Figure 1: Sectoral contributions to growth (%), 2013 – 2017

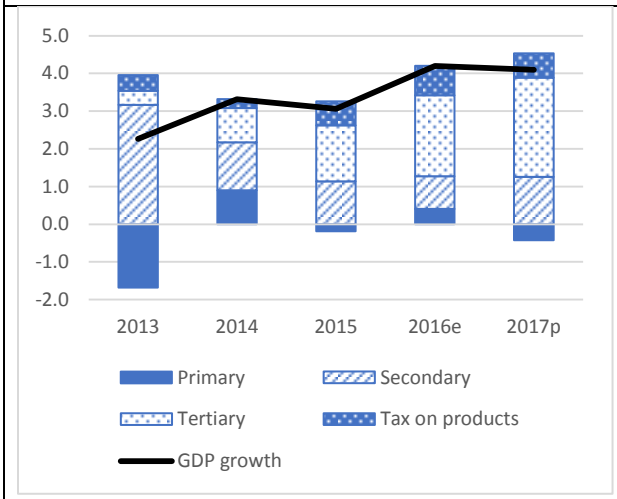
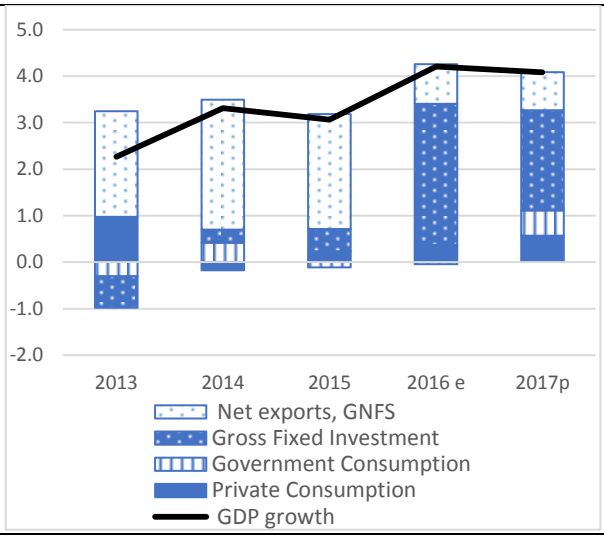


Figure 2: Contributions to growth by expenditure category (%), 2013 – 2017



Source: National Institute of Statistics and World Bank staff calculations, October 2017

[11] AGOA is a United States Trade Act that enhances market access for countries in SSA, which improve the rule of law, human rights, and respect for core labor standards. Madagascar lost AGOA eligibility in 2009 following the political crisis and regained it in 2014 after the return to constitutional order.

13. **The economy has been affected by a number of shocks in 2017.** Madagascar suffered from a serious drought in late 2016 and early 2017, which depressed agricultural activities. Rice output, the country's main staple, is estimated to have fallen by 20 percent. Hydroelectric power supply was also affected and the electricity utility JIRAMA needed higher subsidies. The worst cyclone in 13 years hit Madagascar in March 2017, imposing costs estimated at US$400 million (4 percent of GDP), of which approximately one-third fell on the public sector and two-thirds on households and the private sector.

14. **Inflation has increased but remains under control.** Inflation accelerated from 7.0 percent at end-2016 to a peak of 8.6 percent in May 2017, with food (especially rice) and housing (rents) as main drivers, and then started to decelerate reaching 8.2 percent in July 2017. The Central Bank reacted by tightening monetary policy and by raising the policy rate from 8.3 to 9 percent in May 2017, the highest level since October 2015.

15. **The projected scaling-up of investment is expected to weaken the current account balance.** Madagascar runs a structural current account deficit, but 2016 was an exception, with the current account recording a small surplus of 0.6 percent of GDP, reflecting an increase in vanilla export prices, higher textile exports, and a decline in imports to support the development of two large mining operations. Going forward, the current account balance is expected to fall back into deficit, at around 3.4 percent of GDP in 2017. The current account deficit is expected to be primarily financed by external financing of public sector investment and foreign direct investment.

16. **Madagascar officially maintains a flexible exchange rate.** Central Bank interventions have typically sought to smooth large exchange rate fluctuations and meet foreign reserve targets. Between January and August 2017, the MGA has appreciated against the US dollar by an estimated 10.8 percent in nominal terms, and depreciated against the Euro by 0.4 percent. Nevertheless, trade data indicates that demand for Malagasy exports such as vanilla and garments remains strong. The appreciation of the MGA against the US dollar was most pronounced in June and July 2017, which coincides with the opening of the vanilla season and a rise in foreign exchange earnings.

17. **While the financial sector should be robust against normal economic fluctuations, risks arising from financial deepening underscore the need to enhance supervision.** Financial soundness indicators signal that:

- All banks fulfill the capital adequacy requirements, although banks are operating with a relatively limited amount of capital;
- Banks are on average highly profitable, mostly due to high spreads between loan and deposit rates and a comfortable fee income, but there are large differences among the banks;[12]
- Liquidity is ample in aggregate, with banks' deposits exceeding loans, although liquidity management is hindered by the lack of an effective secondary market in Government securities and a segmented interbank market;
- Dollarization of deposits and credits is not pronounced and banks' foreign assets exceed foreign liabilities; and
- The non-performing loan (NPL) ratio remains elevated at around 9.8 percent (as of June 2017,) but is on a declining trend;

[12] The high spread is partly explained by the transfer of credit risks to consumers, linked to the mistrust to the judicial institutions.

- However, risks to the financial sector (as demonstrated by the failure of a bank and a microfinance network in 2015) highlight the need to enhance supervision.

18. **The authorities have recast the 2017 budget to offset damage caused by the recent shocks.** The revised budget law, adopted in June 2017, reflects the authorities' efforts to maintain macroeconomic stability, while reprioritizing expenditures given the shocks to the economy. The adjustments to the budget law are consistent with the first review of the IMF's ECF arrangement. Total revenues and grants are now projected at 15.0 percent of GDP for 2017 compared with 13.9 percent of GDP in the original budget law. Expenditures are projected at 18.4 percent of GDP.[13]

19. **Current expenditures in the revised budget are expected to increase compared to 2016 to address the shocks.** Current expenditures are forecast to increase from 10.8 percent of GDP in 2016 to 12.2 percent of GDP in 2017. This increase is driven by higher transfers, which include: larger subsidies to JIRAMA (from US$74 million to US$133 million),[14] emergency-relief related expenditures of US$35 million to be channeled through line ministries, and a one-off transfer to Air Madagascar of US$89 million to cover debt obligations.[15] To safeguard planned spending on social priority sectors, the Government is making efforts to reduce selected transfers, notably to the Pension Fund, and has eliminated the fuel subsidy.

20. **Capital expenditures are also increasing in 2017.** Capital expenditures are now forecast at 6.3 percent of GDP in 2017 (compared to 5.2 percent of GDP in 2016). Higher capital spending is intended for projects planned to support the implementation of the NDP and new projects for emergency related expenditures in sectors such as water, roads, transport, agriculture, social protection, health and education. As plans materialize to scale up public investment spending, reforms supported under this programmatic DPO seek to strengthen the PIM capacity so that the available resources are well utilized.

21. **The upward revision of revenues in the revised budget partly reflects progress in implementing tax administration reforms, including those supported through this programmatic DPO.** Different measures to strengthen tax administration have been implemented, such as reinforced risk-based controls, and closer collaboration between tax and customs directorates. As a result, tax revenues are forecast to reach 11.4 percent of GDP in 2017 compared with 10.9 percent in 2016.

22. **The fiscal deficit is expected to be slightly higher in 2017 compared with 2016.** The (cash) deficit in the revised budget law is 4.3 percent of GDP, compared with 2.0 percent in 2016.[16] Of the total financing requirements, it is expected that 2.3 percent of GDP will be financed through foreign borrowing and the remainder from domestic borrowing. To meet the exceptional financing needs following the cyclone, the IMF increased its financing by SDR 30.6 million (equivalent to about US$42.3 million) to help offset pressures on the balance of payments (BoP) from the shocks, while also supporting the authorities' plans for the Central Bank to on-lend about US$50 million of the IMF disbursements in 2017.[17]

[13] Madagascar's fiscal year runs from January to December. The original budget law was approved in January 2017.
[14] Because of the drought, the main hydropower site that supplies the Antananarivo network could not be used to its full potential.
[15] Clearing Air Madagascar's debt liabilities is part of the authorities' efforts to restructure the under-performing airline.
[16] The fiscal deficit is calculated on a cash basis and considers the Government's float and arrears repayments.
[17] Under the ECF arrangement member countries can request augmentation of access of quota when there are shocks. A proposal to increase Madagascar's allocation by 12.5 percent was approved by the Board in June 2017.

2.2. MACROECONOMIC OUTLOOK

23. **The medium-term economic growth outlook is positive, largely reflecting the scaling-up in investments.** Based on current projections, economic growth is estimated to reach 5.1 percent of GDP in 2018, and then average 5.3 percent over the 2019 to 2022 period. The tertiary sector is expected to remain a key growth driver, supported by activities in public works, transport and services. Foreseen improvements to the country's national airline, Air Madagascar, could result in increased tourism-related activities. Activities in special economic zones are expected to continue to remain strong, underpinned by strong demand for Malagasy garments from major importing countries, France and the United States. A projected increase in demand for nickel, largely from China, could contribute to increased mining related activities over the medium-term.[18] The energy sub-sector is projected to grow at an average of 10.4 percent over the 2018-2022 period, as private production expands, provided JIRAMA's governance reforms start to bear fruit. Improved electricity supply is expected to have positive spillover effects in other sectors.

24. **Reflecting the country's significant external financing needs, the current account deficit is expected to widen further in 2018.** The deficit is expected to average 4.2 percent of GDP over the 2018 to 2022 period, as scaled-up public and private investments should increase the demand for imports. The current account deficit will be offset by related surpluses in the capital and financial accounts from public sector grants and loans and foreign direct investment.

25. **Monetary policy is expected to maintain its focus on controlling inflation.** Over the medium-term, inflation is expected to stabilize around 5 percent. Monetary policy will need to be vigilant to address unexpected upside pressures. For example, unfavorable climatic conditions may depress agricultural productivity, reducing the supply of key consumer goods such as rice, contributing to upward pressures on prices.

26. **The Government is readjusting fiscal policy over the medium-term to support the implementation of the NDP.** Provided the momentum for reforms continues, tax revenues are expected to rise to 13.1 percent of GDP by 2022, underpinned by higher domestic taxation. Over the medium-term, expenditures are expected to reach an average of 19.5 percent of GDP. Current expenditures are expected to be contained, with a stable wage bill and declining transfers and subsidies. The added fiscal space from higher revenues and reduced subsidies and transfers is expected to be channeled to social spending and public investment expenditures, which is projected to average 9.5 percent of GDP over the period 2018 to 2022 in support of the growth outlook.

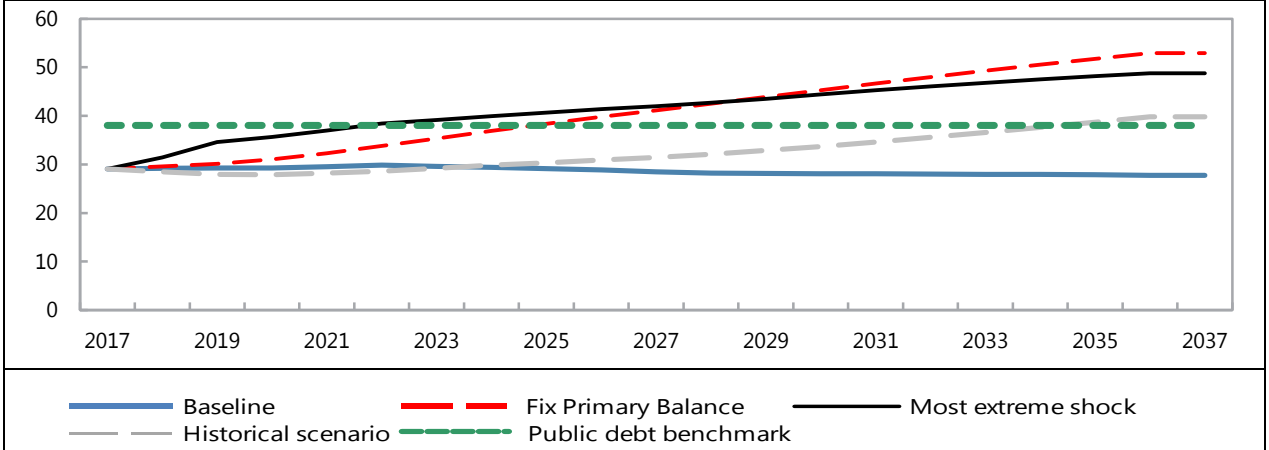
27. **The level of external debt distress risk remains moderate.** According to the joint IMF-WB Debt Sustainability Analysis (DSA) undertaken in June 2017, the present value (PV) of debt-to-GDP ratio stood at 29.1 percent in 2017. Debt dynamics are assessed to have improved since the previous DSA undertaken in July 2016 due to more favorable financing assumptions following the Donors and Investors Conference in December 2016. The PV of debt-to-GDP ratio is expected to stay steady at around 29 percent over the medium-term. Under the baseline scenario all indicators remain below debt burden thresholds. Stress tests indicate that debt sustainability is vulnerable to shocks, poor revenue collection, and contingent liabilities associated with state-owned enterprises (SOEs).[19] The most extreme

[18] Commodity Markets Outlook, World Bank, April 2017

[19] According to the last IMF Article IV 5.5 percent of GDP for JIRAMA long term and short term debt and another 1 percent for a possible recapitalization of the *Caisse d'epargne*.

shock—a one standard deviation reduction in GDP growth in 2018-2019—would lead to a rapid and persistent breach of the threshold starting in 2022. An alternative scenario where the primary deficit remains unchanged as a proportion to GDP throughout the forecast horizon also results in a breach in the PV of debt-to-GDP ratio in the outer years.

Figure 3: Present Value of Debt-to-GDP Ratio



Source : Joint IMF-WB DSA, June 2017

28. **The macroeconomic policy framework is considered adequate.** Madagascar has a good track record in managing inflation and controlling spending. During the political crisis period the authorities cut back fiscal spending as tax revenues dwindled and support in the form of external grants and loans fell dramatically. Since reengagement with the international community, the authorities have successfully implemented a series of reforms that have been supported by two standalone DPOs, the first year of this operation, and IMF facilities. Progress is evident in a number of areas such as higher revenue collections and eliminated fuel subsidies. The policy response to the shocks early this year has contributed to maintaining an adequate macroeconomic framework.

29. **However, there are downside risks.** Madagascar's vulnerability to natural disasters could give rise to further unforeseen shocks, which would require appropriate adjustments to monetary and fiscal policy. If planned improvements to SOEs (in particular, JIRAMA and Air Madagascar) were to progress at a slower pace than expected, public finances could be further strained. Slower than expected disbursements of external financing could slow growth. The authorities' intention to scale-up investments partly through PPP risks generating contingent liabilities that need to be carefully managed. To address these potential pressures, the authorities are strengthening their capacity to manage fiscal risk, including through TA support being provided by the World Bank and the IMF.

Table 1: Selected Macroeconomic Data

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
		Actuals		**Est**			**Projections**			
Real sector										
GDP (billions of MGA)	23397	25775	28585	31769	35751	40493	45653	51042	56633	62571
Real GDP growth	2.3	3.3	3.1	4.2	4.1	5.1	5.6	5.4	5.2	5.0
GDP per capita (US$)	462.5	452.8	402.1	401.4	447.6	479.0	501.2	525.4	548.1	569.0
GDP per capita growth	-0.5	0.5	0.3	1.4	1.3	2.3	2.8	2.6	2.4	2.2
Unemployment rate (ILO definition)	1.3	1.4	1.8	2.1	…	…	…	…	…	…
GDP deflator (annual % change)	5.1	6.6	7.6	6.7	8.1	7.8	6.8	6.1	5.5	5.2
Inflation, consumer prices (annual %, end of year)	6.3	6.0	7.6	7.0	8.0	7.9	6.2	5.7	5.4	5.0
Public Finance (%GDP)										
Revenues, excluding Grants	9.6	10.1	10.4	11.2	11.7	12.1	12.1	12.5	13.0	13.3
o/w:Tax Revenues	9.3	9.9	10.1	10.9	11.4	11.9	11.9	12.3	12.8	13.1
Grants	1.3	2.3	1.5	3.5	3.2	3.0	3.1	1.9	1.8	1.6
Total spending (commitment basis)	14.9	14.7	15.1	16.0	18.4	18.0	20.2	19.6	19.3	19.0
o/w: Capital spending	3.1	3.9	3.5	5.2	6.3	8.1	10.5	10.2	9.8	9.1
Overall balance (cash basis)	-2.0	-2.4	-3.7	-2.0	-4.3	-3.5	-5.2	-5.3	-4.7	-4.1
Total public debt	33.9	34.7	41.3	38.4	36.2	36.2	37.2	39.8	41.9	43.4
Monetary accounts (annual % change)										
Money Supply (M2)	9.0	9.8	15.8	21.4	18.5	13.1	15.0	16.1	16.4	14.7
Net Foreign Assets	-12.7	17.3	20.9	37.4	10.9	12.9	14.9	16.2	16.7	13.0
Net Domestic Assets	8.0	8.3	11.4	10.8	22.9	12.2	13.3	14.0	14.4	14.3
of which: Credit to the Private Sector	16.7	18.4	16.5	8.2	12.8	16.9	15.1	14.7	14.4	14.0
External sector (%GDP)										
Exports of goods	18.1	20.6	21.0	21.6	20.8	20.2	20.7	21.5	22.2	22.6
Imports of goods	30.7	30.2	28.7	28.6	31.0	30.1	31.3	31.7	31.9	32.2
Current account balance	-5.9	-0.3	-1.9	0.6	-3.4	-4.1	-4.3	-4.1	-4.3	-4.4
Foreign Direct Investment	5.2	2.9	4.5	4.5	3.6	3.4	3.4	3.4	3.4	3.5
Overall Balance	0.7	0.2	1.0	2.9	0.8	0.6	1.0	1.3	1.4	1.1
Foreign Reserves (months of imports)	2.2	2.5	2.9	3.9	3.7	4.0	4.2	4.3	4.4	4.4
External debt	43.8	45.0	48.6	45.4	45.3	45.6	45.7	44.9	44.0	43.1
Terms of Trade (percent change)	-0.1	-0.7	1.2	23.2	-6.9	2.5	-3.1	0.3	-0.9	-0.8
Exchange Rate LCU/US$(average)	2207	2415	2934	3177						

Source: Malagasy authorities, IMF and WB Staff calculations, October 2017.

Table 2: Balance of Payments financing requirements and sources (% of GDP)

	2015	2016	2017	2018	2019	2020	2021	2022
	Actual	**Est**			**Projections**			
Total financing requirements	8.6	9.1	10.2	9.9	12.0	10.6	9.9	9.1
Current account deficit	1.9	-0.6	3.4	4.1	4.3	4.1	4.3	4.4
Net repayment of private sector debt	1.6	2.1	2.2	1.8	1.5	1.4	1.4	1.4
Repayment of Government debt	0.4	0.7	0.8	0.6	0.5	0.7	0.7	0.7
Gross reserves accumulation (+= increase)	1.3	3.6	1.8	1.3	1.7	1.2	1.2	0.8
IMF repayments	-0.2	0.1	0.1	0.1	0.0	0.1	0.1	0.2
Other (inc. unrepatriated export revenues)	3.6	3.1	1.9	2.1	3.6	2.7	1.9	1.3
Available financing	8.6	9.1	10.2	9.9	11.6	10.2	9.6	8.9
Foreign direct and portfolio investment	4.3	4.5	3.6	3.4	3.4	3.4	3.4	3.5
Budgetary support	1.4	0.2	1.1	0.0	0.0	0.0	0.0	0.0
Project support	2.5	4.0	4.2	5.7	7.5	6.8	6.2	5.4
IMF: RCF and ECF arrangement	0.4	0.4	1.2	0.8	0.7	0.0	0.0	0.0

Source: Malagasy authorities, IMF and WB Staff calculations, October 2017.

Table 3: Fiscal operations of the Central Government (% GDP)

	2014	2015	2016	2017	2018	2019	2020	2021	2022
	Actuals		**Est**			**Projections**			
Total revenues and grants	12.4	11.8	14.7	15.0	15.1	15.2	14.4	14.7	15.0
Tax revenues	9.9	10.1	10.9	11.4	11.9	11.9	12.3	12.8	13.1
Non-tax revenues	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Grants	2.3	1.5	3.5	3.2	3.0	3.1	1.9	1.8	1.6
Total expenditure	14.7	15.1	16.0	18.4	18.0	20.2	19.6	19.3	19.0
o/w: social priority spending	0.9	0.7	0.8	1.0	1.1	1.3	1.5	1.8	1.9
Current expenditure o.w	10.8	11.7	10.8	12.2	9.9	9.6	9.4	9.6	9.9
Wages	5.6	5.5	5.6	5.8	5.6	5.4	5.2	5.2	5.4
Goods and Services	0.9	0.5	0.6	0.9	0.9	1.0	1.1	1.2	1.3
Transfers and Subsidies	3.2	3.4	3.1	4.0	2.3	2.0	1.9	2.0	1.9
Interest	0.6	0.8	0.9	0.8	1.0	1.0	0.9	0.9	1.0
Capital expenditures	3.9	3.5	5.2	6.3	8.1	10.5	10.2	9.8	9.1
Domestically financed	1.2	1.0	1.2	2.0	2.4	3.0	3.4	3.6	3.7
Externally financed	2.8	2.5	4.0	4.2	5.7	7.5	6.8	6.2	5.4
Primary balance	-0.5	-1.3	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (commit. Basis)	-2.3	-3.3	-1.3	-3.5	-3.0	-5.0	-5.2	-4.6	-4.0
Arrears variation and float (+= accumulation)	-0.1	-0.4	-0.7	-0.9	-0.6	-0.2	-0.1	-0.1	0.0
Overall balance (cash basis)	-2.4	-3.7	-2.0	-4.3	-3.5	-5.2	-5.3	-4.7	-4.1
General Government financing	2.4	4.1	2.0	4.3	3.5	5.2	5.3	4.7	4.1
External (net)	1.2	2.2	0.7	2.3	3.1	4.8	4.6	4.0	3.3
Domestic (net)	1.2	2.0	1.4	2.1	0.4	0.4	0.6	0.7	0.8

Source: Malagasy authorities, IMF and WB Staff calculations, October 2017.

2.3. RELATIONS WITH THE IMF

30. In July 2016, the IMF Board approved a three-year ECF agreement covering the 2016-2019 period for Madagascar for an amount of SDR 220 million (equivalent to about US$295 million). This approval followed satisfactory progress under two rapid credit facility programs in 2014 and 2016 respectively and a six-month IMF Staff Monitored Program between September 2015 and end-March 2016. The arrangement under the ECF supports the Government's program to reinforce macroeconomic stability and promote sustainable and inclusive growth. The program focuses on (i) boosting prospects for inclusive growth through scaling-up of investment and improved access to education, health care, and social protection; (ii) creating fiscal space through improved revenue generation and spending prioritization; (iii) reinforcing economic governance by strengthening public financial management and intensifying anti-corruption measures; and (iv) strengthening macroeconomic stability by bolstering central bank operations and financial supervision. A first review of the ECF agreement in June 2017 concluded that progress had been satisfactory so far. However, in light of numerous shocks including a severe drought and the cyclone, the IMF Board at its meeting on June 28, 2017 approved: (i) a waiver for the nonobservance of the continuous performance criterion on accumulation of new external payment arrears[20] and (ii) a disbursement of SDR 62.0 million (equivalent to about US$86 million), including an augmentation of SDR 30.6 million (equivalent to about US$42.3 million). The World Bank maintains a close working relationship with the IMF, with regular collaboration across policy issues between the two institutions.

3. THE GOVERNMENT'S PROGRAM

31. **In April 2017, the Government consolidated its approach to stimulating growth and reducing poverty through the 2017-2019 Economic Development Paper (EDP), which incorporates sectoral strategies.** The EDP sets out the priorities for poverty reduction, which include: increased revenue and rationalized spending to support public investment, a resilient and inclusive financial system to promote growth, energy development, and a strong business climate to stimulate the private sector. The EDP directly supports the implementation of the NDP.

32. **The areas of the EDP that this programmatic DPO focuses on are (i) strengthen the fiscal framework; and (ii) improve the investment climate.** The specific sectoral strategies are further elaborated below.

(i) Fiscal Framework:

- **Tax administration reforms are included in the national PFM Modernization Strategy.** Reforms include: (i) using a new Tax Identification Number throughout all departments of the Ministry of Finance and Budget (MFB) and *Caisse Nationale de Prévoyance Sociale pour le secteur privé* (the private sector insurance fund - CNAPS). This measure is benefitting from TA under the World Bank's Public Sector Performance Project (P150116) and is also included in the IMF's ECF program; (ii) improving the exchange of information between banks and the authorities to support the recovery of unpaid taxes; (iii) modernization of payment systems at the central and regional levels, through online and mobile payments; (iv) establishing a Tax Policy Unit at MFB (included in the IMF's ECF program); and (v) extending performance contracts to the anti-fraud service at customs (part of the

[20] This was due to a technical difficulty in paying Libya and is being resolved.

IMF's ECF program and the Public Sector Performance Project (P150116)).

- **Pensions reforms are included in the PFM Modernization Strategy:** Pensions in Madagascar are financed on a pay-as-you-go basis, where contributions from current employees and employers are used to pay benefits of existing pensioners, and deficits are financed by the budget through a transfer to the Pension Fund.[21] To reduce the transfer to the Pension Fund by an annual target of MGA 50 billion (0.14 percent of GDP in 2017), the authorities have implemented administrative reforms in the management of the pensions fund since 2016 including the: (i) clean-up of the rosters of beneficiaries; (ii) harmonization of the contributions to the two pension funds in preparation of their future merging; and (iii) increase in contribution rates in 2017. Selected pensions reforms are being supported in this DPO series, and through World Bank TA.

- **Roadmap on the review of the fuel pricing mechanism.** While Madagascar's petroleum sector is formally liberalized, the Government introduced ceilings to pump prices in 2010, in the context of rising oil prices. Fuel subsidies were paid to petroleum companies, based on the difference between a fuel reference price structure for petroleum products and pump prices. Between 2012 and 2015, pump prices of fuel were subsidized, with an annual average cost of 1.3 percent of GDP in 2013-2014.[22] Arrears were accumulated when subsidies could not be paid. Following reforms supported under the Re-engagement DPO in 2014, arrears were cleared. And since November 2015, fuel subsidies have been eliminated. A Roadmap has been agreed to update the fuel reference price structure, following a diagnostic study undertaken with support from World Bank TA.

- **The PAP for Public Investments.** This strategic document aims to improve the selection, budgeting and monitoring of public investment and strengthen the institutional framework for the management of public expenditures, given the Government's intentions to scale-up public investments. The PAP has benefited from IMF TA and responds to the recommendations in the joint IMF-WB PIM Assessment. Given low levels of domestic resource mobilization the authorities are actively pursuing various initiatives to attract external financing, which is well-aligned with the World Bank's cascade approach. To this end, a new decree has been passed that establishes the Organization for the Coordination and Monitoring of Investments and their Financing, which intends to follow-up on financing pledged during the Donors and Investors Conference, as well as ensuring effective project execution.

- **The increased fiscal space generated by the reforms supported in this operation are expected to support the implementation of key strategies in social sectors,** such as in Social Protection, the Health Development Plan (2015-2019), the Education Sector Plan (2018-2022), and the Third National Action Plan for Nutrition (2017-2021). The improved composition of expenditures supported in this DPO series will help provide the resources needed for the implementation of these strategies. The achievement of the objectives of these strategies are also backed by the reforms under the Inclusive and Resilient Growth DPO, such as those aiming to increase access to basic public services and infrastructure.

[21] The first one is the *Caisse de Retraite Civiles et Militaires* (CRCM) which covers career civil servants and the military, and the second one is the *Caisse de Prévoyance et de Retraite* (CPR) which covers contractual Government employees.

[22] The subsidy mechanism has been formalized from 2013. Thanks to favorable international development, subsidies represented only 0.2 percent of GDP in 2015.

(ii) Investment Climate:

- **The Letter of New Energy Policy (2015-2019)** aims to increase access to electricity from 14 percent in 2010 to 70 percent in 2030. To achieve this target and to improve power supply, a Business Plan for JIRAMA was approved in April 2017 that seeks to operationalize governance reforms including the recruitment of a new management through a competitive process, and improving JIRAMA's financial performance. To this end, JIRAMA increased its tariff rates in July 2017. The approval of JIRAMA's business plan is a prior action in the IMF's ECF program.

- **Improvement of Commercial Justice Diagnostic (2016)** sets out a reform pathway for the sector, including updates to the legal framework, enhancement of administrative procedures, capacity building, and modernization of IT systems. The diagnostic discusses the importance of randomizing the allocation of cases and reducing delays in the treatment of commercial cases. The strategy was prepared with support from the World Bank Integrated Growth Poles and Corridor Project (P083351), and is part of a wider package of reforms for improving the investment climate that are being implemented by the Economic Development Board of Madagascar.

- **The Financial System Stability Assessment** published in December 2016 provides recommendations aiming to preserve the stability of the financial system with a clear timeline. The microfinance sector plays a critical role in reaching underserved segments of the population and it has been growing rapidly over the past years.[23] However, the rapid growth of the sector has come with a deterioration of credit portfolio quality at some MFIs and a poor control of certain operational and governance risks. The reforms include strengthening the capacity of the Malagasy financial sector supervisory agency, *Commission de Supervision Bancaire et Financière* (Commission for Banking and Financial Supervision - CSBF), and of the regulatory framework to preserve stability and the confidence of customers.

33. **The Government's commitment to reforms is further emphasized under the IMF ECF arrangement.** Government reforms supported under this program aim to reinforce macroeconomic stability and to promote sustainable and inclusive growth. The key topics addressed by the ECF program are aligned and complementary to this programmatic DPO, reflecting the criticality of the reforms. Complementary areas in the program include: (i) revenue mobilization where the ECF program has a component on enforcing the collection of tax arrears, while this DPO is supporting other tax administration measures; (ii) support to fuel subsidy removal, where the ECF program is focused on continuous implementation of the automatic pricing formula, while this DPO is focused on improving the underlying institutional framework; (iii) PPPs, where the ECF has a continuous benchmark to publish the terms and conditions of all contracts, while this DPO series is supporting the adoption of a new institutional framework for PPPs and ensuring that all contracts are properly tendered in line with the law; and (iv) JIRAMA where the ECF and DPO series both focus on procurement related reforms although emphasizing different aspects, in recognition of the criticality of this reform measure for improving cost-effective electricity supply.

[23] The number of individual accounts at Madagascar's 22 MFIs has increased from 0.4 million in 2009 to about 1.4 million in June 2016.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

34. The program development objectives of this programmatic operation are to: (i) strengthen the fiscal framework by creating fiscal space to support priority expenditures; and (ii) improve the environment for investment. The first development objective has been more tightly focused compared with DPO1 to emphasize that improvements to the fiscal framework are intended to increase priority expenditures.24 The proposed operation is the second in a series of two programmatic operations aiming at supporting the Government in its goal of accelerating growth and reducing poverty.

35. The DPO1 (P160866) supported the first layers of reforms to achieve the PDO. Key reforms to strengthen the fiscal framework included: increasing customs revenue collection through restricting the scope of exemptions, introducing a risk-based approach to screening customs goods to reduce fraud and establishing performance contracts for customs agents; eliminating the fuel subsidy through transiting to a flexible fuel pricing mechanism; and removing ineligible beneficiaries from the pensions roster in urban areas. Reforms to the investment climate pillar included: improving procurement procedures for JIRAMA and transparency of electricity supply costs; improving the management of commercial cases; and completing four on-site supervision visits of large banks to reinforce the stability of the banking sector.

36. The proposed series DPO2 seeks to deepen and consolidate the reforms in the first year of the operation. The reforms to the fiscal framework are being deepened by: increasing transparency of tax expenditures and eliminating those that do not have an economic, social or environmental benefit; taking a risk-based approach to reducing fraud through auditing customs and tax data for large economic operators; updating the institutional framework to eliminate fuel price subsidies; completing the removal of ineligible pensions beneficiaries; and reforming the institutional framework for PIM to better use domestic resources and crowd-in private investments. Reforms to the investment climate are being strengthened through continued improvements to JIRAMA's procurement procedures; updating the legal framework to incorporate reforms on the management of commercial cases; and strengthening the stability of the microfinance sector, following previous microfinance institutional failures.

37. The programmatic DPO builds on the achievements in two stand-alone DPOs in 2014 and 2015. These two operations put a strong focus on improving the fiscal framework through supporting transparency in the management of public finances, spending on social priorities, improving governance practices of JIRAMA, and enhancing the investment climate. Specific achievements related to reforms to the fiscal framework and the investment climate under the two stand-alone DPOs are outlined below:

Reengagement DPO (P150503):[25]

- Reduction of domestic arrears, which are expected to be fully cleared by 2021. Specifically, the clearance of arrears payments to petroleum companies during the political crisis period has set the basis for removing the fuel subsidy, and strengthening the supporting legal framework.

[24] Social priority spending refers to the sum of budget allocations to the Ministries of Health, Education, Population and Water excluding salaries and externally financed investment (consistent with the IMF's ECF).
[25] The development objective of the Reengagement DPO is to 'Improve the efficiency and transparency of public service delivery.'

- Increase in pro-poor expenditures, from MGA 71.7 billion in 2014 to MGA 197 billion in 2015 with a 98 percent execution rate (exceeding a program target of MGA 139.4 billion).
- Efforts to reduce system losses at JIRAMA through a revenue protection program, where 8,500 smart meters are being installed in large consumer premises to monitor consumption to reduce non-technical losses, presenting a permanent way to increase sales and the collection ratio.
- The adoption of a law on public debt has set the basis for ensuring the planned scaled-up of public investments does not compromise debt sustainability.

Resilience DPO (P153084):[26]

- Removal of ineligible beneficiaries from the payroll roster, setting the foundation for the elimination of ineligible pensions beneficiaries supported under this programmatic DPO series.
- Publication of monthly statistics on the delivery of diesel by JIRAMA. The ratio of diesel consumption to electricity generation is progressively declining from 0.2 in December 2015 to 0.2 in June 2017. This set the basis for the enhanced transparency measures in the first year of this programmatic DPO series, where JIRAMA has published statistics on the cost of existing power supply contracts.
- Publication of companies that receive benefits under the Free Zone Regime, setting the basis for systematic publication of tax expenditures under the second year of this programmatic DPO series, and the elimination of selected tax expenditures as a results indicator.
- Other reforms to strengthen the fiscal framework focused on the Treasury Single Account, the timely submission of audited accounts to Parliament (which is the first time in the country's history that the public financial management law has been respected), and the publication of in-year budget execution reports. These measures further strengthened the fiduciary control environment.

38. This programmatic operation builds on the lessons emerging from previous DPOs. As discussed in the Implementation Completion Report for the Reengagement DPO (P150503)[27], a key lesson is to ensure close coordination between DPOs and investment projects to maintain continuity in the policy dialogue. Other lessons learned from the Reengagement DPO and the Resilience DPO include engaging early on with decision-makers on the reforms, focusing on selected reforms that balance ambition with realism, and leveraging ongoing TA. Several of the reforms supported in this DPO are linked to the World Bank's investment projects and are supported with TA. These lessons learned are also consistent with the *World Development Report (2011), Conflict, Security and Development*[28] and an *Independent Evaluation Group (IEG) report* on engaging with fragile states, which emphasized closely integrating reforms with investment projects, being realistic on the reform agenda and using TA effectively.[29]

[26] The development objective of the Resilience DPO is 'Strengthening reporting and increasing availability of information relevant to assessing the effectiveness of public finance, improving payroll management and consolidating accounts in line with the treasury single account principle.'
[27] Report No: ICR00003826.
[28] Available at : https://siteresources.worldbank.org/INTWDRS/Resources/WDR2011_Full_Text.pdf.
[29] World Bank Group Assistance to Low-Income Fragile and Conflict-Affected States: An IEG Evaluation (2013).

4.2 PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar A: Strengthen the fiscal framework by creating fiscal space to support priority expenditures

Increasing tax revenues

39. **Rationale**. Madagascar has one of the lowest tax-to-GDP ratios in the world, at 10.9 percent in 2016 compared with a sub-Saharan average of 16.8 percent. Low levels of domestic tax collection constrain fiscal space available for spending on social sectors and public investments that could benefit the poor. Current tax administration practices favor well-connected private enterprises, which compromises revenue collection. Madagascar's tax-to-GDP ratio is low in part due to generous exemptions to tax regimes, including for goods that do not have a direct social or economic benefit,[30] low levels of compliance and widespread tax evasion. Tax evasion often goes undetected in Madagascar due to lack of controls that consider economic activity and levels of risk. A lack of transparency regarding the magnitude of tax revenue foregone due to the granting of tax expenditure provisions has constrained decision-making on the importance of reforming the current exemptions scheme.

40. **Reforms: To address the issues around tax expenditures, the reforms in this programmatic DPO series have focused on strengthening controls and improving transparency.** DPO1 focused on strengthening customs administration through rationalizing the scope of customs exemptions, expediting customs clearance processes based on objective measures,[31] and establishing performance contracts for customs inspectors at the Port of Toamasina (prior action – DPO 1). In DPO2, the reforms intend to increase transparency on tax expenditures, through the publication of a statement summarizing all tax expenditures, which should be incorporated in the annual budget law for subsequent years. Going further, the authorities have committed to cancelling tax expenditures for certain items, where the social and economic benefits were not proven.[32] In addition, a further reform has been added to DPO2, which seeks to increase the tax base by taking a risk-based approach to verifying tax payments at customs and tax offices.

- ***Prior action 1:*** The Recipient has, through its MFB, published the first annual tax expenditure statement.
- ***Prior action 2:*** The Recipient has, through its customs and tax directorates, issued a *Protocole d'Accord* establishing procedures for verifying customs and tax data for 20 large, high risk importers and exporters, following a risk based approach to reducing fraud and expanding the tax base.

41. **Results**. The improvements to tax administration supported by this operation are part of a package of reforms implemented by the Government to achieve its target of increasing revenues from 10.1 percent of GDP in 2015 to 12 percent of GDP in 2019. This target is an important step to realizing Madagascar's tax potential, estimated at 17 percent of GDP.[33]

[30] While some tax expenditures are provided for in the legal framework (such as Special Economic Zones), other tax expenditures are awarded without due consideration of economic and social benefits, largely benefiting selected economic operators.
[31] The eligibility to the expedited clearance process is measured based on six criteria related to the operator's implication in tax litigation (magnitude and frequency), tax settlement, share of forward declaration, and the speed of withdrawal of goods from customs warehouse.
[32] Tax expenditures will be cancelled for propane gas, papers and imported oil, which do not make up a significant share of the consumption basket for the poor.
[33] IMF Country Report No. 15/25, Madagascar, 2015. Madagascar's tax potential was calculated by empirically estimating a tax frontier using stochastic frontier analysis.

42. **The customs-related reforms initiated in 2016 under DPO1 are expected to have increased customs revenues.** Specifically, efforts to tighten the exemptions regime are expected to have increased customs tax receipts by MGA 106 billion, equivalent to a 15 percent increase in tax receipts and 0.3 percent of GDP. The screening of customs goods and performance contracts for customs agents have induced behavioral change among custom agents. More scrupulous control of tax declarations has led to improved tax revenue collection. The risk-based screening process has reduced the processing time for files under the green channel. These developments have led to a reduction in fraud, contributing to an increase in customs tax revenues of MGA 63 billion, an increase from 5.1 percent of GDP in 2015 to 5.3 percent of GDP in 2016.[34]

43. **The reforms in DPO2 are expected to improve transparency, and reduce fraud through joint auditing procedures.** Following the publication of a tax expenditures statement, the Government has committed to cancelling selected tax expenditures that were approved on an exceptional basis, outside of the legal framework, to the value of MGA 70 billion by 2019, an estimated 0.15 percent of GDP in 2019, which is being monitored under this operation. The reforms on the transparency of tax expenditures have benefited from TA from the World Bank's Public Sector Performance Project (P150116). The risk-based auditing reforms undertaken by tax and customs directorates are projected to contribute to additional revenues of 0.1 percent of GDP in 2017. This risk-based auditing reform with tax and customs directorates has benefited from IMF TA Center for Southern Africa (AFRITAC South). These measures to raise revenues are consistent with the recently approved PFM Modernization Strategy.

Reducing the cost of selected transfers

44. **Rationale**. Selected transfers such as fuel subsidies and contributions to the Pension Fund have resulted in significant levels of regressive spending as a proportion of total spending, estimated at 7.6 percent in 2015. Social expenditures need to be recalibrated to benefit the poor more.

45. **Reforms**.

Fuel subsidies: While the downstream petroleum sector law[35] liberalizes the petroleum sector, fuel prices charged to consumers have in practice been capped by the Government since 2010. This policy resulted in a fuel subsidy being paid to petroleum companies. Under DPO1, the reform supported an increased pass-through of global oil prices to consumers, which eliminated the need for a subsidy payment from the budget to petroleum companies. This reform partially benefitted from lower global oil prices and favorable exchange rates, risking the possibility of being reversed if oil prices increased. DPO2 addresses this sustainability risk by supporting the passing of a decree which states that fuel prices will be determined without recourse to a subsidy. Fuel prices follow trends in global oil prices, although a price smoothing mechanism has been applied to protect consumers from market volatility, without any implementation of a fuel subsidy. This reform complements the IMF ECF program which supports full cost-recovery of fuel prices, by improving the legal framework.

[34] It is not possible to rationally isolate by how much the performance contracts and risk-based screening measures contributed to higher revenues. Improvements to tax administration cannot be credibly quantified since this requires assessing changes to voluntary compliance tax behaviors.

[35] *Loi N°99-010 Du 17.04.99 Regissant le Secteur Petrolier Aval, Modifiee Par la Loi N° 2004-003 du 23 Juin 2004 Portant Liberalisation Du Secteur Petrolier Aval.*

Pension Contributions: Contributions from the budget to the pension fund were in the order of 0.9 percent to GDP in 2015 and 2016, benefitting an estimated 110,000 public servants in 2016 or 0.9 percent of Madagascar's labor force. The Government is currently seeking to improve controls on the number of beneficiaries. In DPO1 the MFB completed the verification of all pension beneficiaries in urban areas, where approximately 8534 ineligible beneficiaries were eliminated, 8 percent of all beneficiaries.[36] In DPO2 this reform is extended to beneficiaries in rural areas. A further measure has been added to ensure that officials from 45 public entities in Antananarivo pay contributions on time, instead of only upon retirement as per current practice, to reduce the accumulation of arrears that could result in further transfers to the Pension Fund. These arrears are in the order of MGA 8 billion (0.02 percent of GDP).

- **Prior Action 3:** The Recipient has passed *Décret n°2017- 472 portant fixation des prix maxima affichés à la pompe,* a decree which eliminates the fuel subsidy.[37]
- **Prior Action 4:** The Recipient has: (i) completed a verification of the roster of pension beneficiaries in rural collectives to remove ineligible beneficiaries; and (ii) issued *Circulaire no. 475-2017 du 9 août relative à la Standardisation des procédures de versement de cotisations à la Caisse de Prévoyance des Retraites et à la Caisse de Retraite Civile et Militaires,* establishing the obligations and process related to the payment of contributions, and sanctions in the case of non-compliance, in order to reduce the transfers to the Pension Fund.

46. **Results**. The fiscal management reforms supported by this DPO series are expected to reduce selected transfers as a share of total expenditures that are regressive in nature, to increase much needed fiscal space for priority social spending and investment.[38] This programmatic operation also tracks priority social spending, which has been increasing from 0.7 percent of GDP in 2017 to 0.8 percent of GDP in 2018, demonstrating that progress is on track. This indicator is also a quantitative performance target that is tracked under the IMF's ECF program.

Fuel subsidies: The elimination of the fuel subsidy is expected to reduce transfers to petroleum companies from 1.8 percent of expenditures in 2015 to 0 percent in 2019. This result reflects estimations that the removal of the fuel subsidy will lead to savings of 0.72 percent of GDP over the programmatic DPO series, through savings of 0.46 percent of GDP in DPO1 and 0.26 percent of GDP in DPO2.[39] This reform is supported by ongoing World Bank TA (P160866) on fuel subsidies removal through the Energy Sector Management Assistance Program (ESMAP).

Pension Contributions: The pensions reforms are estimated to reduce the transfer to the Pension Fund from 5.8 percent of expenditures in 2015 to 1.6 percent in 2019. This follows estimations that the pension reforms have contributed to savings of 0.08 percent of GDP in the two-year programmatic DPO, with savings of 0.04 percent of GDP in DPO1 and DPO2 respectively. These reforms have been supported by analytical work on pensions parametric reforms and TA on pension projections.

[36] There are 72,576 primary beneficiaries (pensioners) over age 60; 1,010 primary beneficiaries under age 60 (mostly disabled), and 36,031 survivors and orphans.
[37] The decree states that the determination of the pump price will in no way lead to the payment of a subsidy.
[38] Priority spending is defined as the sum of budget allocations to the Ministries of Health, Education, Population, and Water, excluding salaries and externally financed investment.
[39] Calculation is based on the difference between pump and reference prices, which was 9.5 percent on average in 2014 and 2015. The assumption is that this 9.5 percent differential will continue to be subsidized in 2016 and 2017 in the absence of the elimination of the fuel subsidy (i.e. the counterfactual).

Strengthening Public Investment Management

47. **Rationale.** The Government plans to use PPP agreements to scale up public capital investments, but needs to develop an appropriate institutional framework. The Government is also planning to scale-up public capital spending, from 3.5 percent of GDP in 2015 to 10.5 percent of GDP in 2019 (see Table 3). As highlighted in the joint IMF-WB PIM Assessment, PIM implementation capacity is weak, including the poor prioritization of projects.

48. **Reforms.** This programmatic DPO series supports both the strengthening of the institutional framework for PPPs and PIM capacity for domestically financed projects. In DPO2 the reform supports the publication of application decrees to ensure the PPP law is applied to all new PPP contracts. This measure is supported by the Ministry in Charge of Presidential Projects and a new PPP unit in the MFB. In addition, there are two PPP decrees which specify exceptions to the PPP law, and will be approved once the PPP framework is operationalized. The reforms under DPO2 seek to ensure that all large domestically financed projects are subject to a new appraisal procedure that ensures the project supports the NDP, and is formalized through the budget process.[40]

- ***Prior action* 5:** The Recipient has adopted application decrees to give effect to the PPP Law: *Décret No. 2017-150 du 2 mars 2017 relatif au cadre institutionnel and Décret No.2017-149 du 2 mars 2017 relatif aux modalités d'application des dispositions concernant la passation des contrats de partenariat public-privé.*[41]
- ***Prior action* 6:** The Recipient has issued a *Circulaire relative à la preparation des projets du Programme d'Investissement Public 2018-2020, Tranche 2018 (sur financement intérieur) N. 007-MFB/SG/DGB du 30 juin 2017* to improve the selection process of domestically-financed investment projects through standardizing selection criteria and screening of all project proposals with pre-defined parameters, in line with the NDP.

49. **Results.** The expected results are that all large projects that are being considered for domestic financing (above a threshold of MGA 5 billion) are subject to a new appraisal mechanism. This should ensure that projects are only selected if they support the objectives of the NDP, and therefore adequately invest in human and physical capital. The expected result is that 100 percent of new PPPs will be subject to the appraisal and contractual procedures as outlined in the law. The reforms have benefited from World Bank TA. The reforms also complement the IMF ECF program which seeks to develop a PAP for PIM, where the use of an appraisal methodology should support the implementation of the plan.

Pillar B: Improve the environment for investment

Promoting the recovery of the electricity sector

50. **Rationale**. Madagascar has one of the highest costs of energy supply in Africa and the quality of electricity supply is unreliable. This affects productivity in the country adversely. JIRAMA's poor operational performance is largely a result of inadequate governance structures within the utility. Lack

[40] The appraisal procedure is defined in the *Circulaire relative à la preparation des projets du Programme d'Investissement Public 2018-2020, Tranche 2018 (sur financement intérieur) N. 007-MFB/SG/DGB du 30 Juin 2017.*

[41] There are two application decrees: one related to the PPP institutional framework and the second related to the procedures for the preparation, conclusion and follow-up of PPP contracts.

of transparency around the costs of electricity supply and non-competitive procedures around contracts awarded with Independent Power Producers have raised electricity costs unnecessarily.

51. **Reforms**. The reforms in this DPO series seek to improve the operational performance of JIRAMA to improve its financial viability by addressing deep-rooted governance procedures. In DPO1, the reforms improved procurement controls of JIRAMA's contracts, and increased transparency by publishing quarterly statistics on the cost of electricity per kilowatt hour (kW.h) for each existing power supply contract on its website[42] (prior action – DPO1).

- ***Prior action* 7:** The Recipient has caused JIRAMA to adopt standard contracts for all new Power Generation Agreements.

52. **Results.** The result is to increase the share of power generation contracts (in value) that are awarded competitively. This target refers to new contracts that are agreed and is timely as several of JIRAMA's contracts are expiring. The target is 70 percent because the law provides for contracts to be single-sourced in emergency situations (such as the drought). Transparent and well-managed procurement processes will increase value for money and contribute to improving JIRAMA's financial position. A World Bank project on the energy sector (P151785) has provided TA on the drafting of standard contracts. The IMF ECF program also monitors whether JIRAMA's contracts are being awarded competitively.

Reinforcing commercial justice

53. **Rationale**. It takes 871 days in Madagascar to enforce a contract, compared to 655 days on average in Sub-Saharan Africa (SSA). Delays in the justice system impact Madagascar's economy adversely: weak contract enforcement keeps firms from formalizing[43] and credit to be rationed as banks fear that they cannot enforce collateral.[44] Enforcement delays also discourage firms' from developing more contract-intensive goods and discourage foreign investors from investing. Strengthening commercial justice and the legal framework for business is an important prerequisite for stimulating private sector dynamism and growth in Madagascar.

54. **Reforms**. Delays in contract enforcement in Madagascar are largely related to weaknesses in the case management of courts in the country. Case allocation to particular judges based on connections, rather than objective criteria have compromised the independence of judgments and led to back-logs in the handling of cases. A practice of granting an unlimited number of adjournments have led to further delays. To address these challenges, reforms in DPO1 focused on mandating in practice the random allocation of commercial cases to judges. In DPO2, the reform is to adopt a new Civil Procedures Code that limits the number of adjournments per case (prior action). Both reforms were developed in consultation with working groups comprised of Government officials, the courts / magistrates and the private sector. The measures are included in the Government's diagnostic and strategic action plan for commercial justice reforms.

[42] There is a lag of three months between the end of each quarter and the date of publication.
[43] Dabla-Norris and Inchauste (2007).
[44] Economies with a more efficient judiciary, in which courts can effectively enforce contractual obligations, have been found to have more developed credit markets and a higher level of development overall. See, for example, Mehnaz Safavian and Siddharth Sharma (2007).

- ***Prior Action 8:*** The Recipient has adopted *Loi No. 2016-039 du 15 decembre 2016 modifiant et complétant certaines dispositions du Code de Procedure Civile Malagasy* to integrate commercial justice reforms in the legal framework and reduce the number of postponements of commercial cases.

55. **Results**. The reforms in DPO1 and DPO2 are designed to reduce the discretionary powers of magistrates to promote objectivity. Preliminary information provided by the Ministry of Justice indicates that the delay in cases has already been reduced from 871 days in 2015 to 471 days in 2016, showing good progress in achieving the reform.[45] Following the reforms supported in DPO1, there has been 100 percent randomization of commercial cases. The reforms are being supported World Bank TA as part of the Integrated Growth Poles and Corridor Project (P083351).

Promoting the stability of the financial sector

56. **Rationale.** The microfinance sector plays a critical role in reaching underserved segments of the population and it has been growing rapidly over the past years.[46] However, the rapid growth of the sector has come with a deterioration of credit portfolio quality at some MFIs and a poor control of certain operational and governance risks. The sector has recently seen the failure of one important MFI network while another one is under temporary administration. These episodes are undermining the confidence of customers and ultimately posing risks to the stability of the microfinance sector.

57. **Reforms.** The Malagasy financial sector supervisory agency, CSBF, has identified multiple institutions facing financial difficulties and expects to consolidate the sector to preserve stability and the confidence of customers. However, since the existing regulatory framework does not include resolution schemes for MFIs, the CSBF does not have the tools to intervene in times of crises. There is a need to strengthen prudential regulations to permit (i) a consolidation of the sector; and (ii) the introduction of risk-based supervision. In DPO1 the reforms aimed at promoting stability of the banking sector at large through completing on-site supervision of the two largest banks.[47] DPO2 complements DPO1 by focusing on the micro-finance sector: the microfinance law has been revised to further promote stability. The revised law seeks to introduce: (i) resolution powers for the CSBF; (ii) the principle of a deposit guarantee fund for MFI clients; (iii) prudential and non-prudential measures such as minimum capital requirements, consumer protection;[48] (iv) simplified categorizations of MFIs;[49] and (v) enhanced risk-based supervision for the CSBF, including tools derived from the "CAMELS" approach.[50]

- ***Prior* action 9:** The Recipient has submitted to Parliament the *Projet de Loi No. 025/2017 du 27 septembre 2017 sur la microfinance,* the draft law on microfinance, including resolution schemes for microfinance institutions.

58. **Results.** The expected result is a more stable and better supervised financial sector, with higher trust of microfinance clients in the system particularly for the safety of their deposits. This outcome will

[45] Information provided by the Ministry of Justice and must be validated by the Doing Business team. The latest Doing Business statistics only go up to June 2016 and therefore do not reflect the new reforms.
[46] The number of individual accounts at Madagascar's 22 MFIs has increased from 0.4 million in 2009 to about 1.4 million in June 2016.
[47] The prior action was to complete the on-site supervision visit of two large banks. The CSBF superseded this target and completed supervision of four banks.
[48] Prudential measures include: strengthened minimum capital requirements, prudential ratios, internal control mechanisms to manage risks, governance in particular for cooperatives) and non-prudential measures such as consumer's protection
[49] From level 1-2-3 to MFI "A" or "B", merging *de facto* the categories 2 and 3.
[50] CAMELS is the acronym of Capital adequacy, Asset quality, Management, Earnings, Liquidity (ALM) and Sensitivity to market risks.

be determined by an intensification of on-site inspections of MFIs followed by the adoption of a risk-based (as opposed to a compliance-based) approach to supervision. In DPO1 on-site supervision of the four largest banks took place. In DPO2, it is expected that the risk-based supervision mechanism will be fully in place for MFIs. The reforms are supported by the Madagascar Microfinance Supervision Project (P153761).

59. **The prior actions in DPO2 are aligned with the triggers proposed in DPO1.**

Table 4: Comparison of Triggers and Prior Actions for DPO2

Trigger identified in DPO 1 for DPO2	**DPO2 prior action**	**Comment**
T#1. The Recipient has, through its MFB published the first annual tax expenditure statement.	**PA#1.** The Recipient has, through its Ministry of Finance and Budget, published the first annual tax expenditure statement.	No change.
	P#2. The Recipient has, through its customs and tax directorates, issued a *Protocole d'Accord* establishing procedures for verifying customs and tax data for 20 large, high risk importers and exporters, following a risk based approach to reducing fraud and expanding the tax base.	New prior action to strengthen revenue collection.
T#2: The Recipient has conducted a review of fuel pricing structures and strengthened the underlying legal framework.	**PA#3.** The Recipient has passed *Décret no.2017-472 du 13 juin 2017 portant fixation des prix maxima affichés à la pompe,* a decree which eliminates the fuel subsidy.	No change.
T#3: The Recipient has completed the verification of pension beneficiaries in the remaining territories.	**PA#4.** The Recipient has (i) completed a verification of the roster of pension beneficiaries in rural collectives to remove ineligible beneficiaries; and (ii) issued *Circulaire no. 475-2017 du 9 août relative à la Standardisation des procédures de versement de cotisations à la Caisse de Prévoyance des Retraites et à la Caisse de Retraite Civile et Militaires,* establishing the obligations and process related to the payment of contributions, and sanctions in the case of non-compliance, in order to reduce the transfers to the Pension Fund.	New component of the prior action added to reduce the transfer to the Pension Fund.

T#4: The Recipient has adopted the implementing decrees related to procedures and institutions for the PPP law.	**PA#5.** The Recipient has adopted application decrees to give effect to the PPP Law: *Décret No. 2017-150 du 2 mars 2017 relatif au cadre institutionnel and Décret No.2017-149 du 2 mars 2017 relatif aux modalités d'application des dispositions concernant la passation des contrats de partenariat public-privé*.	No change.
T#5: The Recipient has adopted procedures to strengthen the investment project appraisal and selection process for large projects.	**PA#6.** The Recipient has issued a *Circulaire relative à la preparation des projets du Programme d'Investissement Public 2018-2020, Tranche 2018 (sur financement intérieur) N. 007-MFB/SG/DGB du 30 juin 2017* to improve the selection process of domestically-financed investment projects through standardizing selection criteria and screening of all project proposals with pre-defined parameters, in line with the National Development Plan.	No change.
T#6: JIRAMA has adopted standard contracts for power generation agreements.	**PA#7.** The Recipient has caused JIRAMA to adopt standard contracts for all new Power Generation Agreements.	No change.
T#7: The code des procedures civiles has been updated to integrate commercial justice reforms in the legal framework.	**PA#8.** The Recipient has adopted *Loi No. 2016-039 du 15 decembre 2016 modifiant et complétant certaines dispositions du Code de Procedure Civile Malagasy* to integrate commercial justice reforms in the legal framework and reduce the number of postponements of commercial cases.	No change.
T#8: The Government has submitted the draft revised law on microfinance institutions to parliament.	**PA#9.** The Recipient has submitted to Parliament the *Projet de Loi No. 025/2017 du 27 septembre 2017 sur la microfinance,* the draft law on microfinance, including resolution schemes for microfinance institutions	No change.

Table 5: DPO Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Pillar A: Strengthen the fiscal framework by creating fiscal space to increase priority expenditures	
PA#1. The Recipient has, through its Ministry of Finance and Budget, published the first annual tax expenditure statement.	The World Bank policy note on custom data mirror analysis and the Tax Policy Diagnostic report by the IMF (2015) identified sizeable leakages through the abuse of some exemption regimes and weaknesses in customs administration.
P#2. The Recipient has, through its customs and tax directorates, issued a *Protocole d'Accord* establishing procedures for verifying customs and tax data for 20 large, high risk importers and exporters, following a risk based approach to reducing fraud and expanding the tax base.	The IMF report on Tax and Customs Administration (2014) recommends the shift to risk-based approach to strengthen the efficiency of control. Analysis of data from Tax and Customs Administrations undertaken by the MFB (2017) reveals that almost half of importers underestimate VAT declaration.
PA#3. The Recipient has passed *Décret no.2017-472 du 13 juin 2017 portant fixation des prix maxima affichés à la pompe,* a decree which eliminates the fuel subsidy.	Fuel subsidies are regressive and a heavy fiscal burden according to a World Bank study (2014) and further World Bank analysis in 2017, as well as IMF TA on pump price subsidies.
PA#4. The Recipient has (i) completed a verification of the roster of pension beneficiaries in rural collectives to remove ineligible beneficiaries; and (ii) issued *Circulaire no. 475-2017 du 9 août relative à la Standardisation des procédures de versement de cotisations à la Caisse de Prévoyance des Retraites et à la Caisse de Retraite Civile et Militaires,* establishing the obligations and process related to the payment of contributions, and sanctions in the case of non-compliance, in order to reduce the transfers to the Pension	World Bank policy note on pension funds (2016) and World Bank TA in 2017 recommended reforms to the current system – to improve controls and implement parametric reforms.
PA#5. The Recipient has adopted application decrees to give effect to the PPP Law: *Décret No. 2017-150 du 2 mars 2017 relatif au cadre institutionnel and Décret No.2017-149 du 2 mars 2017 relatif aux modalités d'application des dispositions concernant la passation des contrats de partenariat public-privé*.	The CPF discusses the significant potential for using PPPs to scale-up investments but emphasizes to need to improve the regulatory environment.

Prior actions	Analytical Underpinnings
PA#6. The Recipient has issued a *Circulaire relative à la preparation des projets du Programme d'Investissement Public 2018-2020, Tranche 2018 (sur financement intérieur) N. 007-MFB/SG/DGB du 30 juin 2017* to improve the selection process of domestically-financed investment projects through standardizing selection criteria and screening of all project proposals with pre-defined parameters, in line with the National Development Plan.	The Public Investment Management Assessment (PIMA) discusses significant weaknesses in the capacity to prioritize, select and appraise domestically financed projects.
Pillar B: Improve the environment for investment	
PA#7. The Recipient has caused JIRAMA to adopt standard contracts for all new Power Generation Agreements.	Reengagement policy notes (2014), Doing Business Survey and Entrepreneurs Survey have found access to electricity to be one of the most significant constraints to private sector activities.
PA#8. The Recipient has adopted *Loi No. 2016-039 du 15 decembre 2016 modifiant et complétant certaines dispositions du Code de Procedure Civile Malagasy* to integrate commercial justice reforms in the legal framework and reduce the number of postponements of commercial cases.	The Madagascar Doing Business assessments and the World Bank study of the commercial justice system both highlighted the difficulties in enforcing contracts and the importance of effective commercial justice for attracting private investment to Madagascar; as well as challenges to the framework for insolvency.
PA#9. The Recipient has submitted to Parliament the *Projet de Loi No. 025/2017 du 27 septembre 2017 sur la microfinance,* the draft law on microfinance, including resolution schemes for microfinance institutions.	The Reengagement policy notes (2014) and the Madagascar FSAP (2015) underline the importance of risk-based supervision.

4.3 LINK TO CPF, OTHER WORLD BANK OPERATIONS AND THE WBG STRATEGY

60. **The proposed operation is an integral part of the World Bank's CPF (2017-2021), discussed by the Board of Executive Directors on June 27, 2017.**[51] The CPF aims to build on the current relative political stability to enhance resilience, and promote sustainable human and economic development in Madagascar. The CPF has two Focus Areas to: i) increase resilience and reduce fragility; and ii) promote inclusive growth. The program development objectives of this programmatic operation play a key role in the attainment of Objective 5 of the CPF on increased fiscal space to finance priority social and infrastructure spending, and Objective 6 on the improved business environment and access to finance. The DPO also contributes to Objective 4 on enhanced transparency and accountability, and Objective 8 on improved access to energy and transport.

[51] Report No.114744-MG

61. **The proposed operation is designed to complement the investment and TA projects that are ongoing or under preparation.** This second operation consolidates the reforms initiated under the first operation in the series (P160866). The goal of strengthening the fiscal framework is complemented by the Public Sector Performance project (P150116), approved in 2016, which has an objective to strengthen revenue mobilization through improved tax administration. The TA provided through the ESMAP Fuel Subsidy Removal (P160866) supports the Government in removing fuel subsidies. The Social Safety Net Project (P149323) has assisted the Government in pension reforms. The Donor Coordination for Results TA (P164136) seeks to improve PIM practices. The Energy Sector Operations and Governance Improvement project (P151785), approved in 2016, seeks to improve the operational performance of JIRAMA, and improve the reliability of electricity supply in the project area. The Integrated Growth Poles and Corridor Project (P083351) supports commercial justice reforms, and the Madagascar – Microfinance supervision project (P153761) seeks to support financial sector stability. While this programmatic DPO supports the country's efforts to generate growth, the Inclusive and Resilient Growth DPO (P162272) supports reforms aiming to channel these benefits to the poor.

4.4 CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

62. **This operation supports the implementation of the Government's national and sectoral strategies, which were prepared through extensive consultative processes.** The NDP and sectoral strategies that this operation supports were developed through wide consultative processes, including with civil society, academia, private sector representatives, and development partners. Further details on consultative arrangements are provided below:

(i) Fiscal Framework:

- The PFM Modernization strategy was developed through close collaboration between the MFB and sectoral ministries. Development partners were consulted throughout the process.
- The Roadmap on the fuel pricing mechanism has benefited from extensive consultations with the private petroleum companies. All World Bank TA in this area has been informed by a stakeholder analysis, which discussed broad support for the removal of fuel subsidies from the Government, petroleum companies, urban transport companies and consumer groups.
- The PAP for Public Investments, which followed on from the PIMA, incorporated inputs from different ministries in Government involved in public investments, as well as SOEs that benefit from substantial state financing and the private sector.
- The NDP consultations highlighted the need to improve the PPP framework.

(ii) Investment Climate:

- The overall design of the reforms under this pillar were informed by a public-private dialogue working group, which included representative from the public and private sectors that identified priorities for business reforms.
- JIRAMA's business plan was discussed with development partners and JIRAMA's labor union.
- The commercial justice reforms are based on a diagnostic and action plan that was developed through working groups comprised of the Ministry of Justice, the judiciary (including the commercial courts), bailiffs, lawyers, the private sector, and academia (such as training centers for magistrates and clerks).

- The Financial System Stability Assessment involved consultations with Central Bank of Madagascar (BCM), the CSBF, the MFB, other relevant government agencies, and representatives of financial institutions and the legal profession.

63. **The proposed operation is part of a program of a coordinated reform dialogue with other institutions engaged in budget support.** The *Cadre de Partenariat*, co-chaired by the MFB and the World Bank, provides a forum for collaboration among development partners. Members include the African Development Bank (AfDB), the French Development Agency, the European Union (EU), the United Nations Development Program, the IMF, and the World Bank. The AfDB's pipeline budget support program for 2017-2019 has the theme of increasing competitiveness, and supports reforms to JIRAMA and Air Madagascar. The EU's budget support program for 2017-2018 is closely aligned with the Government's PFM Modernization Strategy. The complementarity of the different programs reflects the convergence of views on priorities and the feasibility of reforms.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT [52]

64. **The operation is expected to have an overall positive poverty and social impact, but some mitigation measures are needed for certain households.** The policy reform with the largest expected effects on the distribution of income is the fuel subsidy removal [PA3], while the elimination of certain tax expenditures and exemptions [PA1] and the reduction of budget transfers to the Pension Fund [PA4] may also have welfare effects. While the other policy reforms may have beneficial poverty and social effects in the longer-run if complementary conditions are present, assessing their potential distributional impacts at present is not possible in a credible way.

65. **Reforms to fuel subsidies, tax expenditures, and transfers to the Pension Fund are expected to reduce the extent to which public spending is regressive significantly.** As of 2012, when the household survey was conducted, the top quintile of the income distribution in Madagascar benefitted from an estimated 40 percent of total expenditures due to the untargeted nature of subsidies on fuel. Similarly, 73 percent of future pension beneficiaries (public sector employees who are entitled to social benefits-including SOEs) are currently in the top consumption quintile, with another 17 percent in the fourth quintile. Likewise, the list of tax expenditures to be cancelled under the reform proposal relates to goods that are not typically consumed by the poor, such as hand-made sports clothes and propane gas.[53]

66. **Any residual effects on the poor need to be mitigated through the scale-up of social safety systems.** Because of their dependence on kerosene for lighting, the bottom 40 percent of Madagascar's population accounted for 14 percent of total fuel consumption in 2012. However, the fuel subsidy reform has been more aggressive on non-kerosene fuel products resulting in only a marginal increase in the price of kerosene. As a result, the subsidy removal on kerosene has reduced the purchasing power of households in the bottom 40 percent by 1 percent.

67. **The Government, with support from the World Bank, is scaling up its social protection programs.** The World Bank's Social Safety Net program in Madagascar is composed of three programs: a

[5252] The PSIA presented in this Program Document is a summary of a full PSIA that was jointly led by POV and MFM GPs.
[53] In Madagascar propane gas is only used by the top income quintile.

conditional cash transfer, a productive safety net program, and an emergency cash transfer program in the drought-affected southern regions. In May 2017, the program consisted of more than 130,000 households (approx. 650,000 people), with more than 68 percent of cash transfers paid to the female head of the household. The Government is also making improvements to the institutional framework for social protection, with better coordination among key line ministries. This progress in developing and implementing social protection programs was reflected in a higher Country Policy and Institutional Assessment score.

68. **A new transport subsidy was introduced to mitigate the impact of rising fuel prices on urban households.** The removal of the fuel subsidy mainly affects the wealthier parts of society as their consumption patterns include cars and generators that heavily use fuel. However, the urban poor also benefitted from the fuel subsidy because of the reduced cost of urban transport. The Government has therefore put in place a subsidy for urban public transportation fares to mitigate the effect of the reform on the urban poor. The subsidies are being distributed to owners of urban buses through the cooperative association of urban transport companies. As a result, there has been no change in the bus fare. The cost of the transport subsidy is 19 times lower than the fuel subsidy.[54]

5.2 ENVIRONMENTAL ASPECTS

69. **The reforms supported by this operation are expected to have positive climate co-benefits at an estimated value of US$6.6 million.** This calculation is based on the new Multilateral Development Bank (MDB) methodology on assessing climate co-benefits. The removal of the fuel subsidy has been assigned 100 percent mitigation co-benefits, where the policy is aligned with category *9.1 Support for national, regional or local policy, through TA or policy lending* on the MDB list of eligible activities for mitigation. Prior action 6 has 50 percent mitigation co-benefits assigned for improving procurement regime to increase hydropower generation under *category 9.1 Support for national, regional or local policy, through TA or policy lending* on the MDB list of eligible activities for mitigation. The environmental impact from the elimination of the exemption on propane gas is expected to be insignificant, even though the measure may contribute to higher charcoal usage, since less than 1 percent of households declared using propane gas in the latest household survey.

70. **The scaling-up of investments and PPPs may have potential environmental impacts, which are regulated by the Environment Charter,[55]complemented by a wide range of sectoral regulatory frameworks.[56]** By the end of this programmatic DPO, total investments are projected to increase to 21.4 percent of GDP, supported by an improved investment climate. the potential impact on the environment, positive or negative, depends on the nature of the investment projects. The legislation requires that all investment projects private or public, including domestic investments that undergo the budget appraisal and selection process, that are likely to have an environmental impact and require administrative approval, prepare an Environmental and Social Impact Assessment (ESIA).[57] Each ESIA must be approved by the Ministry of Environment, and thereafter published in the project area and the National Environment Office (NEO). The environmental impact assessment might require the elaboration of a Project Environmental Management Plan, the execution of which is monitored by the NEO. The recently adopted PPP decrees states that a preliminary assessment of a project is undertaken

[54] This is based on the total value of the transport subsidy and the total savings from the removal of the fuel subsidy for the years 2016 and 2017 and assumes an all else equal scenario.
[55] Law No. 90-033 of 21 December 1990 modified by Law No. 97-012 of 6 June 1997 and Law No. 2004-015 of 19 August 2004
[56] Some of these regulatory frameworks are listed in the World Bank (2003) Country Environmental Analysis.
[57] See decree No. 2004-167 of 3 February 2004 on Development of Investment Compatibility with the Environment (MECIE).

to estimate the environmental and social feasibility (amongst others) and that this information is presented in a risk matrix.

71. **The reforms to JIRAMA and the PPP framework have the potential to increase the use of renewable energy**. The authorities are seeking to develop small solar and hydro projects to reduce the reliance on expensive fossil fuels. The environmental impact is expected to be positive. Moreover, the decentralized use of small solar and run-of-river hydro sites, located closer to demand, is further reducing any potential negative impacts on the environment compared to larger sites Most of these projects are however at an early stage, thus making it challenging to quantify the environmental effects.

72. **The World Bank energy project includes measures to strengthen the Government's implementation capacity of social and environmental assessment mechanisms** particularly in the areas of preparing, reviewing, implementing and monitoring social and environmental assessment, management documents and resettlement plans and linking these documents with bidding and contract documents. The development of small hydro IPPs in Madagascar would be mainly financed with private sector investment. Safeguard frameworks, namely Environmental and Social Management Framework (ESMF) and Resettlement Policy Framework (RPF), have been prepared to guide the development of priority small hydro sites.

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

73. **Addressing the fiduciary risk and strengthening the PFM system has been part of the ongoing dialogue and has benefitted from TA over the last decades.** Tax administration, budgeting, treasury, and cash management reforms are underway. The 2014 Public Expenditure and Financial Accountability (PEFA) self-assessment showed that revenue forecasting has improved. The budget law is published on the MFB website in a timely manner, and the Citizen's Budget[58] and Citizen's Budget Execution reports are published. The Resilience DPO (P153084) supported the timely publication of Quarterly Budget Execution Reports and the annual consolidated accounts. The Supreme Audit Institution (*Cour des Comptes*) published its first report covering the year 2014 in May 2016. The audited final accounts for 2009 to 2012 were validated by Parliament in 2015 and 2016, thereby catching up on the delay in auditing reports following the political crisis period.

74. **The Government must continue to respond to challenges in some areas**. The 2014 PEFA self-assessment indicates that limited progress has been made on improving the credibility of the budget. This finding reflects the policy adopted by the authorities during the political crisis, where cash was tightly controlled as revenues declined. A PEFA self-assessment is being prepared in 2017 and the results are expected in 2018. Further progress is required to consolidate and publish the accounts of quasi-fiscal entities, such as SOE and special funds. There are still a number of accounts that operate outside of the Government's treasury system, with efforts to consolidate this process underway. The Government has made progress in arrears management through the negotiation of special government bonds, and the establishment of an escrow account with the Treasury to meet value added tax (VAT) refunding and

[58] As part of broader efforts to increase budgetary transparency, this document recounts, in a simplified manner, the recent developments and the economic and fiscal outlook, new fiscal and customs measures, the reorientation of public spending, and the level of indebtedness.

avoid arrears accumulation.[59] The recently approved PAP of the PFM modernization strategy (2016-2019) includes a number of reforms to address these challenges.

75. **Progress has been made in strengthening the safeguards framework at the Central Bank of Madagascar (CBM)**. Governance arrangements and Central Bank autonomy have been strengthened through the new Central Bank Act. The CBM has also reinforced its audit oversight and control environment, and is committed to undertake the necessary steps to implement International Financial Reporting Standards. However, the timeliness of audit completion and publication of audited financial statements needs further improvement. The functioning of the foreign exchange market has improved since the CBM discontinued buy-back operations in September 2016. The 2017 IMF safeguards assessment noted that foreign exchange investment practices, and currency procurement practices required improvement, which the CBM is committed to reforming.

76. **The World Bank is working with other partners to provide coordinated TA.** The Public Sector Performance Project (P150116) will help advance improvements in revenue management, improved controls at the local level and performance monitoring. The IMF's TA AFRITAC South has a substantial TA program covering PIM (through coordinated support with the World Bank), fiscal risks management, and cash and arrears management. The US Treasury has seconded an advisor to support Treasury Single Account reforms. The AfDB and the EU are supporting civil service reforms. The EU and the IMF are also engaged in medium-term budget reforms.

77. **The proposed grant will be disbursed following the standard IDA procedures for DPOs**. A grant in the amount of SDR 31.9 million (US$45.0 million equivalent) will be made available upon effectiveness and, provided IDA is satisfied with the implementation of the development policy financing (DPF) program and the appropriateness of the Recipient's macroeconomic policy framework, disbursed as a single tranche following the submission of an acceptable withdrawal application by the Government. IDA will disburse the proceeds into the treasury account US dollar-denominated account designated by the Recipient that is part of the country's foreign exchange reserves account at the Central Bank of Madagascar. The dedicated account will be used exclusively for the proceeds of the DPF grant. The Recipient shall ensure that upon the deposit of the grant proceeds into said account, an equivalent amount is credited in the Recipient's budget management system, in a manner acceptable to IDA. The Recipient will report to IDA on the amounts deposited in the foreign-currency account and credited to the budget-management system within 30 days of the disbursement.

78. **The financial support provided under this operation is not intended to finance goods or services on the standard negative list**. If the proceeds of the grant are used for ineligible purposes as defined in the Financing Agreement, IDA will require the Recipient, promptly upon notice from IDA, to refund an amount equal to the ineligible expenditure. Amounts refunded to IDA upon such request shall be cancelled. At the request of the Association, an audit of the dedicated account could be carried out by the Recipient and the result of such audit will be furnished to the Association within four months of the request. Considering the limited capacity of the Supreme Audit Institution (*Cour des Comptes*), a legally registered, private and independent audit company meeting appropriate international standards

[59] In 2015, the stock of arrears was estimated at 3 percent of the GDP. Arrears on January 1, 2016 were of MGA 1,105 billion (General Directorate of Budget) of which 380 billion (i.e. 34 percent of total arrears, or 1.2 percent of GDP according to IMF-ECF document) were repaid in 2016. At the end of 2016, the stock of arrears corresponds to 14 percent of total expenditure. No additional arrears were accumulated in 2016. An additional 32 percent of remaining stock is expected to be cleared in 2017 based on 2017 Budget Law. (Note that the budget process covered here only for the Government at Central level).

will be contracted to perform the audit, in accordance with the Terms of Reference agreed upon with the Association. All audit costs will be borne by the Government of Madagascar.

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

79. **Progress on the results indicators will be monitored and evaluated jointly by the Recipient and the World Bank**. The Government has established an Economic Council team, which consists of high level officials that are responsible for spearheading and implementing the reform agenda. This team comprises of members from the MFB, the CBM, the Presidency and other relevant ministries. The Government's team is well-coordinated, and as the experience in implementing DPOs with the World Bank deepens, they are increasingly well prepared to obtain and share data to monitor implementation against the agreed results indicators. The World Bank closely follows this progress through supervision activities, and where relevant, joint monitoring activities are carried out with partners in the *Cadre de Partenariat.*

80. **A number of direct measures have been taken to improve monitoring and evaluation practices.** A new Tax Policy Unit is being implemented at the MFB (structural benchmark in the IMF program) to produce the annual tax expenditure statement and assess the target on the elimination of tax expenditures. The indicators on public expenditures are regularly monitored through in-year budget execution reports. The indicator on PPPs will be monitored by the PPP Unit which is in charge of the appraisal of PPP projects. The indicator on PIM will be reported on by the Directorate of Budget. The Ministry of Justice regularly publishes statistics related to the progress in implementing the commercial justice reform action plan. The information on risk-based supervision will be generated by the CSBF.

81. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the World Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the World Bank's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate GRS, please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

82. **The overall risk rating for the operation is 'substantial,' with five main sources of risk that are inter-connected and that could potentially jeopardize the expected outcomes and benefits of this operation**. The risks are (i) political and governance; (ii) macroeconomic; (iii) institutional capacity for implementation and sustainability; (iv) fiduciary; and (v) vulnerability to weather-related shocks and natural disasters. Measures to mitigate these risks are outlined below. The potential benefits of the proposed operation outweigh the residual risks and warrant IDA's assistance.

Risk categories	
1. Political and governance	High

Risk categories	
2. Macroeconomic	Substantial
3. Sector strategies and policies	Moderate
4. Technical design of program	Moderate
5. Institutional capacity for implementation and sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and social	Moderate
8. Stakeholders	Moderate
9. Others (i.e. vulnerability to weather-related shocks and natural disasters)	Substantial
Overall	Substantial

83. **Political tensions and weak governance present high risks to maintaining reform momentum**. The country has deep rooted governance challenges that contribute to political fragility. Key drivers of fragility include influential networks that shift alliances to access rents, social fragmentation, growth of a trafficking economy, and a nascent system of checks and balances, as discussed in the CPF. The upcoming election, planned toward the end of 2018/early 2019 may intensify some of these drivers of fragility. While this operation supports the efforts of reformers, political tensions may slowdown the reform momentum. In particular, procurement reforms in JIRAMA may result in certain individuals losing out financially. These risks have been incorporated in the design of the operation by balancing ambition with realism. The reforms supported in this DPO are also actively supported by other development partners, ensuring consistency in the policy dialogue.

84. **Macroeconomic risks are substantial, and are closely related with the political situation.** The fiscal framework is based on an upward trajectory of growth, which is expected to contribute to higher revenues and be reinforced by a scale-up of investment activity. The needed increase in public and external financing is expected to be met largely through development partners' support to the infrastructure spending scale-up. However, growth prospects could plummet in the event of political instability. Delays in reforms to JIRAMA and Air Madagascar could continue to drain public finances. To mitigate the impact of the risks it will be important to continue SOE reforms.

85. **Fiduciary risks remain substantial despite the ongoing implementation of PFM reforms.** While there has been progress in implementing PFM reforms, the remaining fiduciary weaknesses are significant. They are partially mitigated by continued TA in PFM and public administration reforms, including the World Bank Public Sector Performance project.

86. **Institutional capacity is weak and represents a significant risk.** Weak capacity, particularly at the technical level, poses the risk that the actions supported by this program might not be implemented as successfully as expected in the agreed timeframe, or that the capacity constraints prevent the attainment of the expected results. This operation mitigates these risks in two ways. First, it seeks to attain the strongest possible actions needed to build the reform momentum without overwhelming the capacity of the post-crisis Government. Second, it complements other projects and TA provided by IDA and development partners, providing a more holistic support environment than one operation can offer.

87. **Madagascar's vulnerability to natural disasters and weather-related shocks represents a substantial risk to this operation.** Madagascar ranks among the countries most exposed to droughts, floods and cyclones. Severe natural hazards present threats to public health, food security, and the Government's poverty reduction goals. Natural disasters can also have a significant impact on the fiscal framework. This risk is mitigated by the ongoing dialogue on enhancing resilience to natural disasters,

and support being provided by the World Bank and other partners. For example, the World Bank is currently supporting the rehabilitation of cyclone and flood early warning systems and hydro meteorological station nationwide. However, the impact of natural disasters cannot be totally controlled.

ANNEX 1: POLICY AND RESULTS MATRIX

Rationale	Prior Action (2016) (DPO 1)	Prior Action (2017) (DPO 2)	Results (2019)
***Pillar A:* Strengthen the fiscal framework by creating fiscal space to support priority expenditures**			
	1.1 Increasing tax revenues		
Tax revenue in Madagascar is low relative to peer countries. While tax policy is sound, tax administration is weak due to poor levels of governance, which was exacerbated during the political crisis. As part of the Government's development program and PFM strategy a number of tax administration reforms are underway. This DPO supports two areas of tax administration: **(i)** Rationalizing tax expenditures and exemptions by improving the institutional framework on customs exemptions and increasing transparency on tax expenditures as a basis for improved decision-making; and (ii) improving customs and tax controls through risk-based and objective audits, which focus on high-risk economic operators	**PA#1.** The Recipient has, through its Ministry of Finance and Budget, issued an *Arrêté portant exonération des droits et taxes à l'importation* that restricts the scope of the customs exemption regime in the Customs Code dated May 4, 2016 (N° 10416/2016/MFB/SG/DGD). **PA#2.** The Recipient has, through two decisions of its General Directorate of Customs dated November 6, 2015 and September 19, 2016 respectively: (a) adopted an expedited custom clearance process based on objective measures for large importers, and (b) established a practice of performance contracts for customs inspectors at the port of *Toamasina*.	**PA#1.** The Recipient has, through its Ministry of Finance and Budget, published the first annual tax expenditure statement. **P#2.** The Recipient has, through its customs and tax directorates, issued a *Protocole d'Accord* establishing procedures for verifying customs and tax data for 20 large, high risk importers and exporters, following a risk based approach to reducing fraud and expanding the tax base.	Revenue effort increased: Baseline: 10.1 percent of GDP (2015) Intermediate result: 10.9 (2016) Target: 12.0 percent of GDP (2019) Value of tax expenditures eliminated Baseline: MGA 0 billion (2017) Target: MGA 70 billion (2019)
	1.2 Reducing the costs of selected transfers		

Low levels of tax collection and high levels of untargeted expenditures (e.g. to the fuel subsidy, the Pension Fund and to poorly performing SOEs) have constrained fiscal space. These reforms seek to improve the composition of public spending by reducing selected transfers and increasing spending on priority social sectors. The reforms focus on two areas of non-priority spending: (i) continuing to support the elimination of fuel subsidies through strengthening the institutional framework; and (ii) reducing transfers to the Pension Fund by improving controls of pension beneficiaries.	**PA#3.** The Recipient has through its Ministry of Energy and Hydrocarbons, issued an *Arrêté relative au mécanisme d'ajustement automatique des prix maxima affichés à la pompe,* that establishes an automatic adjustment mechanism of fuel prices at retail locations , dated July 1, 2016 (N°14176/2016). **PA#4.** The Recipient has completed the verification of pension beneficiaries in the large urban centers to remove ineligible beneficiaries from the Pension Register.	**PA#3.** The Recipient has passed *Décret no.2017-472 du 13 juin 2017 portant fixation des prix maxima affichés à la pompe,* a decree which eliminates the fuel subsidy. **PA#4.** The Recipient has (i) completed a verification of the roster of pension beneficiaries in rural collectives to remove ineligible beneficiaries; and (ii) issued *Circulaire no. 475-2017 du 9 août relative à la Standardisation des procédures de versement de cotisations à la Caisse de Prévoyance des Retraites et à la Caisse de Retraite Civile et Militaires*, establishing the obligations and process related to the payment of contributions, and sanctions in the case of non-compliance, in order to reduce the transfers to the Pension Fund.	Selected transfers reduced as a share of total expenditure[60] Baseline: 13 percent (2015) Target: 3 percent (2019) • o/w: transfer to the Pension Fund reduced from 5.8 percent to 1.6 percent • o/w: Fuel subsidies reduced from 1.8 percent to 0 percent Intermediate results: Selected transfers: 11 percent (2016) • o/w: transfer to the pension fund: 5.7 percent (2016) • o/w: Fuel subsidies: 0 percent (2016) Share of priority spending on social sectors[61] Baseline: 0.7 percent of GDP (2015) Target: 1.3 percent of GDP (2019) Intermediate result: 0.8 percent of GDP (2016)
	1.3 Strengthening Public Investment Management		
The authorities intend to revive growth by scaling-up public investments, and through attracting private sector investment, particularly through PPPs (in line with the cascade approach). However, PIM capacity is weak and the institutional framework requires strengthening, as discussed in the WB-IMF PIM assessment (August, 2016).		**PA#5.** The Recipient has adopted application decrees to give effect to the PPP Law: *Décret No. 2017-150 du 2 mars 2017 relatif au cadre institutionnel and Décret No.2017-149 du 2 mars 2017 relatif aux modalités d'application des dispositions concernant la passation des contrats de partenariat public-privé*.	Share of new PPPs that follow appraisal and selection processes under the PPP Act Baseline: 0 percent (2015) Target: 100 percent (2019) Intermediate result: no new PPP contract in 2016

[60] This indicator refers to reducing transfers to JIRAMA (an SOE and the utilities company), Air Madagascar (an SOE and the national airline company), the Pension Fund, and fuel subsidies.
[61] Social priority spending is defined as the sum of budget allocations to the Ministries of Health, Education, Population and Water excluding salaries and externally financed investment. This is consistent with the IMF's Extended Credit Facility program.

The reforms focus on two areas: (i) strengthening the institutional framework for PPPs); and (ii) improving the selection of investment projects to be financed with domestic resources		**PA#6.** The Recipient has issued a *Circulaire relative à la preparation des projets du Programme d'Investissement Public 2018-2020, Tranche 2018 (sur financement intérieur) N. 007-MFB/SG/DGB du 30 juin 2017* to improve the selection process of domestically-financed investment projects through standardizing selection criteria and screening of all project proposals with pre-defined parameters, in line with the National Development Plan.	Share of domestically financed investment projects above MGA 5 billion subject to the new standardized selection criteria and appraisal methodology Baseline: 0 (2015) Target: 100 percent (2019) Intermediate result: available after approval of 2018 budget law
***Pillar B*- Improve the environment for investment**			
	2.1 Promoting the recovery of the electricity sector		
The index for reliability of supply and transparency of tariff index, as measured by DBI is 0 out of 8 is 2016. While the quality of supply is poor and unreliable, electricity tariffs are high compared to the region (and were recently increased in July 2017). Bad service and high costs are due to poor governance of this SOE, and more specifically, improper procurement practices. Therefore, the reforms seek to: (i) improve procurement practices through bringing procedures in line with the Public Procurement Code and using standardized contracts; and (ii) improve transparency on the cost of purchasing electricity with the aim of enhancing competition from other service providers.	**PA#5.** The Recipient has, through its Ministry of Finance and Budget, issued an *Arrêté précisant le mode de computation des seuils des marchés publics et fixant leurs montants*, that imposes *a priori* review of all JIRAMA procurement by the CNM in accordance with the provisions of the 2004 Public Procurement Code dated March 31, 2016 (N°7275 /2016/MFB). **PA#6.** The Recipient has caused JIRAMA to begin publication of quarterly statistics on the cost of electricity per KW.h for each existing power supply contract beginning with the first two quarters of 2016.	**PA#7.** The Recipient has caused JIRAMA to adopt standard contracts for all new Power Generation Agreements.	Share of new power generation contracts awarded competitively and published of the total contracts Baseline: 0 percent (2015) Target: 70 percent (2019)
	2.2 Reinforcing commercial justice		

Mistrust in the judicial system is undermining the business environment. The reforms seek to improve the quality of judicial independence and judicial processes.	**PA#7.** The Recipient has strengthened the judicial procedures for commercial cases by its Ministry of Justice issuing a *Circulaire pour l'Amélioration de la Justice commerciale et réduction des délais de traitement des dossiers commerciaux* that mandates the random allocation of commercial cases to magistrates dated May 25, 2016 (N°016-MJ/SG/DGAJER/DAJ/CIR/16).	**PA#8.** The Recipient has adopted *Loi No. 2016-039 du 15 decembre 2016 modifiant et complétant certaines dispositions du Code de Procedure Civile Malagasy* to integrate commercial justice reforms in the legal framework and reduce the number of postponements of commercial cases.	Percentage of cases randomly assigned Baseline: 0 (2015); Target: 100 (2019) Intermediate result: 100 Number of days to resolve a commercial conflict Baseline: 871 (2015) Target: Less than 600 days (2019)[62] Intermediate result: 471[63] (2016)
	2.3 Promoting the stability of the financial sector		
The development of the private sector relies on the availability of accessible financing. The latest Financial System Stability Assessment (FSAP) highlights that financial deepening exposes the financial sector to vulnerability. The reforms seek to reinforce the stability of the financial sector. Microfinance institutions have collapsed in the past and are at risk.	**PA#8.** The Recipient has caused the Central Bank, through the *Commission de Supervision Bancaire et Financière (CSBF)*, to complete on-site supervision of the two largest banks in its territory**.**	**PA#9.** The Recipient has submitted to Parliament the *Projet de Loi No. 025/2017 du 27 septembre 2017 sur la microfinance,* the draft law on microfinance, including resolution schemes for microfinance institutions.	Extent of risk based supervision. Baseline: no risk based supervision (2015) Target: risk based supervision in place for MFIs (2019)[64] Intermediate result: no risk based supervision (2016)

[62] Initial target readjusted to reflect average targets in the region.
[63] Information provided by the Ministry of Justice and must be validated by the Doing Business team. The latest Doing Business statistics only go up to June 2016 and therefore do not reflect the new reforms.
[64] RBS looks at anticipating possible risks and therefore directs supervisory efforts on those entities that are likely to be exposed to risks.

ANNEX 2: LETTER OF DEVELOPMENT POLICY

Translated from the original French

MINISTRY OF FINANCE
AND BUDGET
****
The Minister
****

Antananarivo, September 20, 2017

Dr. Jim Yong Kim
World Bank
1818 H Street NW, Washington DC

Mr. President,

Madagascar is pursuing the implementation of the National Development Plan (NDP) and the related Implementation Plan (PMO) with the aim of reducing poverty and promoting inclusive and sustainable development. The Government sets its objectives around three pillars, namely: (i) improving governance, (ii) promoting economic recovery, and (iii) expanding access to basic social services. This letter reflects the Government's commitment to meeting the challenges of economic development in the medium term by strengthening the tax and customs revenue performance and optimizing the allocation of resources in favor of investment projects and sectors with tangible impact on the population (education, health, and infrastructure). The Government is also implementing its action plan to improve the business climate by removing the barriers constraining the development of the private sector, with particular attention to access to electricity. These measures are an integral part of the Government's program to ensure sustainable growth and to ensure that the Malagasy population as a whole benefits from this growth.

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Social indicators have not improved despite the Government's willingness to promote the mechanisms and systems for enhancing human capital and social protection. The 2016 Report on Human Development in Africa, established by the United Nations still confirmed that Madagascar is among the poorest countries in Africa, as it is ranked 154th out of 188 countries with a low Human Development Index of 0.510.

Economic activities are gradually recovering, recording a 4.1 percent growth rate in 2016 and is expected to reach 4.3 percent in 2017. This momentum is mainly due to the performance of the export processing zones following the return of African Growth and Opportunities Act (AGOA), the expansion of the construction industry and the recovery of the mining sector. However, climate hazards during 2016 and 2017, including a prolonged drought in the highlands and cyclone Enawo affected in particular, the northeastern area of the country, and has affected growth potential. These hazards have impacted the price level; the inflation rate for 2017 is estimated at an average of 7.8 percent.

The main economic and strategic orientations of the State have been aligned with the National Development Plan. The different sectoral strategies supporting the implementation of the NDP are summarized in the Economic Development Letter to ensure effectiveness in interventions. The Government is determined to face the urgent economic and social challenges of the country with the support of the Technical and Financial Partners.

To this end, the Government organized the Conference of Donors and Investors in Paris in December 2016, bringing together donors, technical and financial partners and private investors in order to support the country in its development projects. A US$ 9.7 billion commitment was then announced, of which US$ 3.3 billion coming from the private sector.

In June 2017, the Executive Board of the International Monetary Fund granted an additional SDR 30.55 million (about US$42.3 million) credit for Madagascar under the Extended Credit Facility (ECF). This credit was disbursed immediately with the expected second tranche in response to the impact of the natural disasters. The amount disbursed for 2017 is thus increased to SDR 61.98 million (approximately US$86 million). The Article IV review in March 2017 concluded that the results recorded by Madagascar as part of its economic program supported by the Extended Credit Facility are solid.

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Public finance strategies aim to preserve the macroeconomic stability and will be based on support to socio-economic development as well as good governance practices.

Fiscal policy aims to increase fiscal space through reinforcement of tax administration in terms of collection, and intensification of efforts focused on public spending efficiency. Administrative reforms and improved coordination between the two tax departments were initiated. The net tax to GDP ratio will be 11.4 percent in 2017 versus 10.9 percent in 2016.

Public spending is estimated at 20.2 percent of GDP in 2017, which records significant increase compared to that of 2016, estimated at 16 percent. Spending is focused on reconstruction, rehabilitation and humanitarian activities following the damage caused by the cyclone Enawo. The difficulties of public enterprises, especially JIRAMA and AIR MADAGASCAR, continue to weigh on the Malagasy economy. For JIRAMA, this predicament was compounded by the drought that plagued the country and will therefore require additional subsidies from the State.

The social sectors (health, education, social protection) remain as priority despite the limited resources available to meet the needs of the State. The operating and capital expenditures of the four social ministries (Ministry of Water, Ministry of National Education, Ministry of Public Health, and Ministry of Population) will increase and reach 1.3 percent of GDP in 2019. These expenditures are estimated at 0.8 percent of GDP in 2016 and 2017.

To support inclusive and sustainable growth, the Government will intensify public investments. Capital expenditures will account for 8.3 percent of GDP in 2017, while they were estimated at 5.2 percent in 2016.

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Progress is visible following the reforms undertaken in recent years and the reforms achieved in 2016 have begun to bear fruit. This is reflected in the performance of tax and customs revenues. The target in raising revenue by 0.5 points per year was exceeded. In 2016, the tax to GDP ratio is estimated at 10.9 percent versus 10.1 percent achieved in 2015. The gradual reduction in transfers and subsidies is ongoing. The replenishment of pension accounts decreased by MGA 10 billion compared to the initial forecast. Subsidies on petroleum products were abolished as real prices were applied. Efforts have already been made on public investment expenditures; a 1.7 percentage point increase was observed compared to 2015.

The Government has put in place a Public Finance Modernization Strategy Plan up to 2026 in order to include medium and long-term public finance management reforms and to allow better monitoring of their implementation.

The Government will continue the reforms to strengthen the performance of tax and customs administrations. The objective is to establish an efficient and fair tax system while improving and ensuring tax revenue collection.

As part of the administrative reforms undertaken by this Government, a medium-term action plan has been established, including improved coordination. A tax policy unit was created and will reconcile data from the 2 tax administrations. It will improve the analysis of tax policy and thus strengthen revenue mobilization. An audit and control plan was adopted for major importers and exporters accounting for at least 80 percent of the total value of exports and imports in 2016. This plan is based on the risks derived from data matching.

In addition, to ensure better fiscal transparency of exceptional tax measures, an inventory of tax expenditures is regularly undertaken with an annual report systematically published. The first report on tax expenditures for the financial year 2015 was published on the website of the Ministry of Finance and Budget in December 2016. Tax expenditures for which the socio-economic benefits are not established will be eliminated.

The structure of public spending will be improved by gradually reducing non-priority transfers and subsidies to the benefit of investment and social spending.

The Government aims to reduce transfers to the pension account by 0.2 percent of GDP for this year 2017. Employees' contributions have been increased. The Decree on this increase has already been adopted by the Council of Ministers in February 2017. A circular letter on the standardization of contribution payment procedures has also been established for the National Public Institutions (EPN), the Local Communities and the other affiliates of the *Caisse de Prévoyance de Retraite* (CPR) and *Caisse de Retraite Civile et Militaire* (CRCM) – [the two public pension funds]. Improvement in the management of the CPR - CRCM began in 2016 with the replacement of pensioners' cards and a physical verification of the beneficiaries in the major urban centers. This is continued by checking the records of all pensioners in both urban and rural areas in order to eliminate ineligible beneficiaries from the pensioners' register.

The price base of petroleum products on the international market has led to the elimination of fuel subsidies. The difference between the pump price and the reference price has been eliminated since October 2015. In March 2016, an automatic pump price adjustment mechanism which is based on international prices and exchange rate fluctuations, was introduced. This mechanism, in agreement with the oil companies, was strengthened by a decree adopted by the Council of Ministers, which specifies the non-use of fuel subsidies. The objective is to sustain the non-use of subsidies.

The Government is committed to prioritizing public investment in sectors stimulating economic growth, including infrastructure, agriculture, tourism, industrial and mining sectors. Recourse to technical and financial partners as well as promoting PPP (Public Private Partnership) is necessary given the limited public resources.

The State has already confirmed its willingness to develop the Public Private Partnership by establishing a PPP Law, which was passed and promulgated in February 2016. In this respect, two decrees on procedures and institutions have been developed and adopted by the Cabinet’s Council.

To improve investment efficiency and impact, the Government will put in place a medium-term strategy to strengthen public investment management capacity. This strategy aims at improving the selection, budgeting, and monitoring of public investment projects and strengthening the related institutional framework. A tool for selecting and prioritizing investment projects has been developed with the support of the World Bank and will be operational in the preparation of the 2018 Public Investment Program.

Proactive measures have been taken by the Government to limit transfers to JIRAMA. The latter has been called upon to adjust electricity tariffs, to switch from diesel generators to more economical fuel oil generators, and to prepare a new law that sanctions electricity and water theft. JIRAMA adopted its business plan in June 2017 to implement governance reforms and improve its financial performance. This plan provides for (i) limiting the need for transfers by improving revenue collection and to generate savings, (ii) cancelling or renegotiating expensive contracts and (iii) exclusively using competitive tenders. JIRAMA will adopt standard contracts for (hydraulic, thermal) power generation agreements.

The Government has strengthened commercial justice by improving judicial procedures in commercial cases. The Ministry of Justice issued a circular letter stating the reforms to improve commercial justice and to reduce processing time for commercial cases. In order to institutionalize these reforms, the Code of Civil Procedures is updated to incorporate the contents of the circular letter. Reforms at the level of Justice have already allowed a reduction in the time taken to process cases brought to the Commercial Court of Antananarivo.

With regard to microfinance, Governmenta regulatory framework has been put in place to ensure the development of microfinance initiatives. A Law on the activity and the control of Microfinance Institutions was adopted in September 2005 and is currently being revised. This revised Law provides for a dispute resolution scheme for microfinance institutions and will be submitted to Parliament for adoption.

The continued implementation of all actions envisaged under the National Development Plan will enable the Government to reach its objectives, through achieving high economic growth and reducing poverty. However, resource constraints have led the Government to seek financial support from the World Bank through budget support.

Les grandes orientations économiques et stratégiques de l'Etat ont été alignées sur le Plan national de Développement. Les différentes stratégies sectorielles soutenant l'exécution du PND sont synthétisées dans la Lettre de Développement Économique pour assurer une effectivité des interventions. Le Gouvernement est déterminé à affronter les défis économiques et sociaux urgents du pays avec l'appui des Partenaires Techniques et Financiers.

Dans cette optique, le gouvernement a organisé la Conférence des Bailleurs et Investisseurs à Paris en décembre 2016 réunissant les donateurs, les partenaires techniques et financiers et les investisseurs privés afin de soutenir le pays dans ses projets de développement. Un engagement de 9,7 milliards USD y a été annoncé dont 3,3 milliards provenant du secteur privé.

En juin 2017, Le Conseil d'Administration du Fonds Monétaire International a accordé un crédit supplémentaire de 30,55 millions de DTS (environ 42,3 millions USD) en faveur de Madagascar au titre de la Facilité Elargie de Crédit (FEC). Ce crédit a fait l'objet d'un décaissement immédiat avec la deuxième tranche prévue, pour faire face aux impacts des catastrophes naturelles. Le montant décaissé pour 2017 est ainsi porté à 61.98 millions DTS (environ 86 millions USD). La revue de l'article IV en mars 2017 a conclu que les résultats enregistrés par Madagascar dans le cadre de son programme économique appuyé par la Facilité Elargie de Crédit, sont solides.

x x

x

Les stratégies des Finances Publiques visent à préserver la stabilité macroéconomique, et se baseront sur l'appui au développement socio-économique ainsi que la pratique de la bonne gouvernance.

La politique budgétaire a pour objectif d'accroître l'espace budgétaire à travers le renforcement des administrations fiscales en matière de recouvrement et l'intensification des efforts axés sur l'efficacité des dépenses publiques. Les réformes administratives et l'amélioration de la coordination entre les 02 départements fiscaux ont été engagées. Le taux de pression fiscale net s'établira à 11,4% en 2017 contre 10,9% en 2016.

Les dépenses publiques sont estimées à 20,2% du PIB en 2017, une hausse significative est enregistrée par rapport à celles de 2016 évaluées à 16%. Les dépenses sont axées sur les activités de reconstruction, de réhabilitation et humanitaire suite aux dégâts causés par le cyclone Enawo. Les difficultés des entreprises publiques, plus particulièrement la JIRAMA et l'AIR MADAGASCAR, continuent de peser sur l'économie malgache. Pour la JIRAMA, cette difficulté a été aggravée par la sécheresse qui a sévi le pays et nécessitera de ce fait des subventions additionnelles de la part de l'Etat.

Les secteurs sociaux (santé, éducation, protection sociale) demeurent prioritaires malgré la limitation des ressources disponibles pour subvenir aux besoins de l'Etat. Les dépenses des 04 ministères sociaux (Ministère de l'Eau, Ministère de l'Education Nationale, Ministère de la Santé Publique, Ministère de la Population) en fonctionnement et en investissement seront augmentées pour atteindre 1,3% du PIB en 2019. Ces dépenses sont estimées à 0,8% du PIB en 2016 et 2017.

MINISTERE DES FINAN
ET DU BUDGET

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Le Ministre

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Monsieur le Préside

Madagascar poursui
de son Plan de Mise en
développement inclusif et
à savoir: (i) améliorer la
l'accès aux services sociaux
de relever les défis pour l
performance des recettes fi
faveur des projets d'investis
(éducation, santé, infrastru
d'action en vue de l'am
contraignants le développe
l'électricité. Ces mesures fo
une croissance durable et
population Malagasy.

Les indicateurs soci
promouvoir les mécanisme
sociale. Le Rapport sur le dé
a encore confirmé que Mad
188 pays avec un Indice de

Les activités économ
à 4,1 % en 2016 et devra att
des zones franches industrie
du BTP et de la reprise du
2017, la sécheresse sur les
Nord-Est du pays ont ralen
d'inflation pour 2017 est es

Pour soutenir une croissance inclusive et durable, le gouvernement mettra l'effort sur l'intensification des investissements publics. Les dépenses en capital représenteront 8,3% du PIB en 2017, si estimées à 5,2% en 2016.

x x

x

Les progrès sont visibles suite aux réformes engagées depuisces dernières années et les réformes entreprises en 2016 ont commencé à porter leurs fruits. La performance des recettes fiscales et douanières en témoigne. L'objectif pour l'augmentation de recettes de 0,5 point par an, a été dépassé.En 2016, le taux de pression fiscale est évalué à 10,9%contre 10,1% réalisé en 2015. La réduction progressive des dépenses de transfert et subventions suit son cours. Le renflouement des comptes des pensions a connu une baisse de 10 milliards d'Ariary par rapport à la prévision initiale. Les subventions sur les produits pétroliers ont été supprimées grâce à l'atteinte de la vérité des prix. Des efforts ont déjà été apportés sur les dépenses d'investissement public, une augmentation de 1,7 point a été constatée par rapport à 2015.

Le Gouvernement s'est engagé à poursuivre ces efforts et a mis en place un Plan de Stratégie de Modernisation des Finances Publiques à l'horizon 2026, afin d'inscrire les reformes en matière de gestion des Finances Publiques dans une démarche sectorielle à moyen et long terme et de permettre un meilleur suivi de leurs mises en œuvre.

Le Gouvernement continuera les réformes pour renforcer la performance des administrations fiscales et douanières. L'objectif étant de mettre en place un système fiscal efficace et équitable tout en tablant sur l'amélioration et la sécurisation des recettes fiscales.

Dans le cadre des reformes administratives engagées par ces administrations, un plan d'action à moyen terme a été établi prévoyant notamment l'amélioration de la coordination. Une unité de politique fiscalea été créeeet rapprochera les données des 02 administrations fiscales. Elle améliorera l'analyse de la politique fiscale et renforcera ainsi la mobilisation des recettes. Un plan d'audit et de contrôle a été adopté pour les principaux importateurs et exportateurs représentant au moins 80% de la valeur totale des exportations et importations en 2016. Ce plan est basé sur les risques établis à partir de la confrontation des données.

Par ailleurs, pour assurer une meilleure transparence budgétaire des mesures fiscales dérogatoires, un inventaire des dépenses fiscales est régulièrement effectué avec publication systématique d'un rapport annuel correspondant. Le premier rapport sur les dépenses fiscales de l'exercice 2015 a été publié sur le site du Ministère des Finances et du Budget en décembre 2016. Les dépenses fiscales dont les bénéfices socio-économiques qui ne sont pas prouvées seront éliminées.

La structure des dépenses publiques sera améliorée en réduisantprogressivement les transferts et subventions non prioritaires au profit des dépenses d'investissement et dépenses sociales.

Le Gouvernement vise à réduirede 0,2% du PIB, les transferts en faveur du compte des pensions pour cette année 2017. La cotisation des employés a été augmentée. Le décret relatif à cette augmentation a déjà été adopté en Conseil des Ministres en février 2017. Une circulaire portant sur la standardisation des procédures de versement de cotisation a également été établie pour les Etablissements Publiques Nationaux (EPN), les Collectivités Territoriales

Décentralisées et les autres établissements affiliés à la Caisse de Prévoyance de Retraite (CPR) et à la Caisse de Retraite Civile et Militaire (CRCM). L'assainissement de la gestion du CPR-CRCM a été entamé en 2016 par un remplacement des cartes des pensionnés et une vérification physique des bénéficiaires dans les grands centres urbains. Cette action se poursuit par la vérification des dossiers de tous les pensionnés, en milieu urbain qu'en milieu rural afin d'éliminer les bénéficiaires inéligibles du registre des pensionnés.

La baisse du prix des produits pétroliers sur le marché international a permis d'alléger les dépenses publiques en éliminant le recours aux subventions aux carburants. L'écart entre le prix à la pompe et le prix de référence a été éliminé depuis octobre 2015. En mars 2016, un mécanisme d'ajustement automatique des prix à la pompe basé sur les cours internationaux et les fluctuations des taux de change, a été introduit. Ce mécanisme, convenu avec les compagnies pétrolières a été renforcé par un décret, adopté en Conseil des Ministres, lequel précise le non recours aux subventions pétrolières. L'objectif étant de pérenniser le non-recours aux subventions.

Le Gouvernement s'est engagé à prioriser les investissements publics dans les secteurs stimulant la croissance économique, notamment l'infrastructure, l'agriculture, le tourisme, les secteurs industriels et miniers. Le recours à l'appui des Partenaires Techniques et Financiers ainsi que la promotion du PPP (Partenariat Public Privé) sont nécessaires compte tenu des ressources publiques limitées.

L'Etat a déjà confirmé sa volonté de développer le Partenariat Public Privé en établissant une Loi sur le PPP, adoptée et promulguée en février 2016. A cet égard, deux décrets sur les procédures et sur les institutions sont élaborés et adoptés en Conseil du Gouvernement.

Pour une amélioration de l'efficience et de l'impact des investissements, le Gouvernement mettra en place une stratégie à moyen terme pour renforcer la capacité de gestion des investissements publics. Cette stratégie vise à améliorer la sélection, la budgétisation et le suivi des projets d'investissements publics et renforcera le cadre institutionnel y afférent. Un outil de sélection et de priorisation des projets d'investissement a été élaboré, avec l'appui de la Banque Mondiale et sera opérationnel dans la préparation du Programme d'Investissement Public 2018.

Des mesures volontaristes ont été prises par le Gouvernement pour limiter les dépenses de transfert à la JIRAMA. Cette dernière a été appelée à ajuster les tarifs d'électricité, à procéder au passage des générateurs diesels en générateurs fioul étant plus économiques, et à préparer une nouvelle loi sanctionnant le vol d'électricité et d'eau. La JIRAMA a adopté son plan d'affaires en juin 2017 visant à mettre en œuvre les reformes de la gouvernance et l'amélioration de sa performance financière. Ce plan prévoit (i) la limitation du besoin de transfert au montant budgétisé assorti des mesures concrètes pour améliorer le recouvrement de recettes et réaliser des économies, (ii) l'annulation ou renégociation des contrats coûteux et, (iii) le recours exclusif aux appels d'offres compétitifs. La JIRAMA adoptera des contrats standards pour les accords sur la production d'électricité (hydraulique, thermique)

Le gouvernement a renforcé la justice commerciale en améliorant les procédures judiciaires relatives aux affaires commerciales. Le Ministère de la Justice a émis une circulaire stipulant les reformes sur l'amélioration de la justice commerciale et sur la réduction des délais de traitement des dossiers commerciaux. Afin de pérenniser ces réformes et de leur donner un cadre légal, le code de procédure civile est mis à jour pour incorporer le contenu de la circulaire.

Les réformes au niveau de la justice ont déjà permis de réduire les délais de traitement des affaires portés au niveau du Tribunal Commercial d'Antananarivo.

Au niveau de la micro finance, la politique du Gouvernement est volontaire et concerne à la fois son développement et sa régulation. Un cadre réglementaire a été mis en place pour assurer le développement des initiatives en micro finance. Une Loi relative à l'activité et au contrôle des Institutions de Micro finance a été adoptée en septembre 2005 et est actuellement en cours de révision. Cette Loi révisée prévoit un schéma de résolution de litiges pour les institutions de micro finance et sera soumise au Parlement, pour adoption.

La mise en œuvre continue de toutes les actions envisagées dans le cadre du Plan National de Développement permettra au Gouvernement d'atteindre ses objectifs, notamment la réalisation d'une croissance économique élevée et la réduction de la pauvreté. Toutefois, la limitation des ressources conduit le Gouvernement à solliciter l'appui financier de la Banque Mondiale dans le cadre d'un appui budgétaire.

MINISTERE DES FINANCES ET DU BUDGET

ANDRIAMBOLOLONA Vonintsalama S.

ANNEX 3: FUND RELATIONS ANNEX

IMF Staff Completes Mission to Review Progress of Madagascar's Economic Program

September 21, 2017

End-of-Mission press releases include statements of IMF staff teams that convey preliminary findings after a visit to a country. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision.

- Economic growth is projected at 4.1 percent in 2017.
- Performance under the ECF-supported program remains strong.
- Prudent monetary policy has helped to contain inflation.

A team from the International Monetary Fund (IMF) led by Marshall Mills, Mission Chief for Madagascar, visited Antananarivo from September 7–21, 2017 to hold discussions on the second review of Madagascar's economic reform program supported by the IMF's three-year Extended Credit Facility (ECF). [1] Good progress was made during the discussions and they will continue in the coming weeks. Following conclusion of ongoing discussions, the IMF Executive Board could consider the second ECF review in December 2017 as planned.

At the end of the mission, Mr. Mills issued the following statement:

"Madagascar's economic conditions continue to be positive in 2017, with sustained macroeconomic stability despite shocks. Economic growth is projected at 4.1 percent in 2017. While still among the highest rates in sub-Saharan Africa, this is lower than expected, partly due to the impact of the cyclone and drought on agriculture and hydropower. Growth is projected to accelerate to 5.1 percent in 2018, led by rising public investment and a rebound in agriculture. Inflation, which ticked up earlier this year due to weather-related shocks, is expected to fall to around 8 percent by end-year, and to decline gradually in 2018.

"Performance under the ECF-supported program remains strong. Based on current data, all quantitative performance targets for end-June were met. Revenue collection continues to exceed program targets. The Central Bank of Madagascar has appropriately managed pressures linked to the positive vanilla price shock, with the accumulation of additional foreign exchange reserves, while the exchange rate appreciated, consistent with its flexible exchange rate regime. Prudent monetary policy has helped to contain inflation. Most structural reforms planned in the program were completed, although some with delays.

"Concerning the remainder of 2017, the authorities are undertaking some additional budget measures to offset unexpected developments. Higher than expected outlays for the wage bill will be offset by over-performance on revenues and containing other spending. The authorities are also working to speed up the execution of foreign-financed investment projects. Work on Air Madagascar's planned strategic partnership is advancing, and a final agreement will require a substantial transfer in the 2017 budget to cover its liabilities accumulated from past losses, as already envisaged under the IMF-supported program.

"Discussions on the 2018 budget focused on the program's goals of increasing revenue collection and enhancing the quality of public spending. The authorities reiterated their commitment to these goals. They

are elaborating additional tax policy and administration reforms to maintain strong revenue growth in 2018, despite the negative impact of the stronger MGA on customs revenues. On the spending side, discussions focused on promoting spending to support inclusive growth, as envisioned under the program. Progress will require faster execution of public investment, containing wage bill growth, and reducing transfers, especially to the public utility JIRAMA. Reforms at JIRAMA are advancing, notably to improve management and lower costs, and continued progress is essential to cut transfers as planned.

"Discussions also addressed priority medium-term structural reforms in monetary policy, financial sector development, tax policy, and governance. The Central Bank is improving its operational framework for monetary policy implementation. Drawing on the recommendations of the Financial System Stability Assessment (FSSA), the authorities are also enhancing risk-based prudential supervision, tightening prudential regulations, and modernizing the banking legislation. On tax policy, discussions focused on ensuring that new tax incentives under consideration to promote private investment are cost-effective, attracting additional investment without jeopardizing future revenue performance. On governance, the Government has submitted draft laws on international cooperation and asset-recovery to parliament. In addition, it has prepared a draft Anti-Money Laundering law, which it also intends to submit to parliament this year. Staff urged the authorities to follow through on the submission this year, as well as to progressively strengthen their asset disclosure regime.

"The mission met with President Hery Rajaonarimampianina, Prime Minister Olivier Mahafaly Solonandrasana, Minister of Finance and Budget Vonintsalama Andriambololona, Minister of Economy and Plan Herilanto Raveloharison, Central Bank of Madagascar Governor Alain Rasolofondraibe, Commissioner General Léon Rajaobelina, senior officials, as well as private sector representatives, and development partners.

"The mission thanks the Malagasy authorities for their strong cooperation and the constructive discussions."

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[1] The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted BoP problems. The arrangement for Madagascar in the amount of SDR 220 million (about US$304.7 million or 180 percent of quota) was approved by the IMF Executive Board on July 28, 2016 (see Press Release No. 16/ 370). Augmentation of access was granted under the program for SDR 30.55 million (about US$42.39 million) or 12.5 percent of the country's quota following the IMF Executive Board on June 28 (see Country Report No. 17/223).

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior actions	Significant positive or negative environment effects (yes/no/to be determined)	Significant poverty, social or distributional effects positive or negative (yes/no/to be determined)
Pillar A: Strengthen the Fiscal Framework by creating fiscal space to support priority expenditures		
PA#1. The Recipient, through its Ministry of Finance, has published the first annual tax expenditure statement.	The elimination of exemption on propane gas might increase the use of charcoal and have negative impact on forest and air pollution. However, only 1 percent of the population use this source of energy.	Yes, positive. The tax expenditures to be eliminated are mostly regressive. Reforming tax expenditures will have positive distributional effect. by increasing available public resources that can be used to increase pro-poor spending.
PA#2. The Recipient, through its customs and tax directorates, has issued a *Protocole d'Accord* to establish procedures for verifying customs and tax data for 20 large importers and exporters at high risk, following a risk based approach to reducing fraud and expanding the tax base.	No. This reform is to improve the tax administration which has been assessed not to have any impact on environment.	Yes, positive. This measure is assessed to have positive poverty impact by increasing tax revenues generated through fraud reduction, and thus will increase fiscal space to invest in pro-poor spending.
PA#3. The Recipient has passed a *Décret n°2017-472 portant fixation des prix maxima affichés à la pompe,* which eliminates the fuel subsidy.	Yes. This reform should have positive environmental impact by curbing fuel consumption. The extend depend on the responses of consumers to price increase.	Yes, positive. The fuel subsidy was regressive. The elimination of the fuel subsidy frees up resources that can be used to increase social spending.
PA#4. The Recipient has (i) completed the verification of the roster of pension beneficiaries in rural collectivities to remove ineligible beneficiaries and (ii) issued a *Circulaire relative à la Standardisation des procédures de versement de cotisations à la Caisse de Prévoyance des Retraites et à la Caisse de Retraite Civile et Militaire n°475-2017/MFB/SG/DGGFPE/DGEAE/DSC du 9 Août 2017* to outline the obligations and process related to the payment of contributions, and the sanctions in the cases of non-compliance, in order to reduce the transfer to the Pension Fund	No. This is an institutional reform that is not expected to have an environmental impact.	Yes, positive. Over 90 percent of future beneficiaries of the Pension Fund are in the top two quintiles. Reducing budget transfers to the Pension Fund will free up budget resources that can be used for social spending.
PA#5. The Recipient has adopted the application decrees for the *Loi n°2015-039 du 3 février 2016 sur le partenariat public-privé*	Environmental impacts could be negative or positive depending on the type of investment that will be	Yes. The investment generated by an improved PPP framework would fill the gap in public infrastructure.

PA#6. The Recipient has issued a *Circulaire relative à la preparation des projets du Programme d'Investissement Public 2018-2020, Tranche 2018 (sur financement intérieur) N. 007-MFB/SG/DGB du 30 Juin 2017* that improves the selection process of domestically-financed investment projects through standardizing selection criteria and the screening of all project proposals with pre-defined parameters in line with the National Development Plan.		Yes, positive. Projects should be selected that support the NDP, and therefore address economic, poverty and social challenges.
Pillar B: Improve the Environment for Investment		
PA#7. The Recipient has caused JIRAMA to adopt standard contracts for all new Power Generation Agreements.	No. This is an institutional reform that is not expected to have environmental impact.	Yes. Improvement in the operational result of Jirama is expected to lead to lower subsidy and free up resources for pro-poor spending.
PA#8. The Recipient has adopted *Loi No. 2016-039 du 15 decembre 2016 modifiant et complétant certaines dispositions du Code de Procedure Civile Malagasy* to integrate commercial justice reforms in the legal framework and reduce the number of postponements of commercial cases.	No. This is an institutional reform that is not expected to have environmental impact.	Yes, as a quicker and more efficient commercial justice system can reduce uncertainty and improve the business climate, which could incentivize new enterprises to establish and create jobs, or existing businesses to expand.
PA#9. The Recipient has submitted to Parliament the *Projet de Loi No. 025/2017 du 27 septembre 2017 sur la microfinance,* the draft law on microfinance, including resolution schemes for microfinance	No. This is an institutional reform that is not expected to have environmental impact.	Yes, positive. A more stable and better-supervised MFI system is expected to benefit the population at large.