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SIMPLIFIED IMPLEMENTATION COMPLETION REPORT

MADAGASCAR

FIRST POVERTY REDUCTION SUPPORT OPERATION

IDA CREDIT 3960 MAG/GRANT H116 MAG

DECEMBER 30, 2005

**Poverty Reduction and Economic Management 1
AFTP1
Africa Region**

**Simplified Implementation Completion Report
For Programmatic Development Policy Lending Operations**

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	<i>Report Date:</i> June 23, 2004

1. Program Data

<i>Name:</i>	First Poverty Reduction Support Operation	<i>L/C Number:</i>	IDA
<i>Country/Department:</i>	Republic of Madagascar/AFTP1	<i>Region:</i>	Africa
<i>Sector/subsector:</i>	Gen Pub admin (43%), Gen education (28%), Gen agr/fish/for (13%), Health (8%), Gen ind/trade (8%)		
<i>Theme:</i>	Public expenditure, financial management (P), Education for all (P), Health system performance (S), Rural services and infrastructure (S), Environmental policies and Institutions (S)		

KEY DATES

			<i>Original</i>	<i>Revised/Actual</i>
<i>PCD/PD:</i>	05/17/2004	<i>Effective:</i>	08/12/2004	08/12/2004
<i>Appraisal:</i>	06/14/2004	<i>MTR:</i>		
<i>Approval:</i>	07/20/2004	<i>Closing:</i>	06/30/2005	06/30/2005

<i>Borrower/Implementing Agency:</i>	Republic of Madagascar
<i>Other Partners:</i>	none

STAFF	Current	At Appraisal
<i>Vice President:</i>	Gobind Nankani	Callisto Madavo
<i>Country Director:</i>	James Bond	Hafez Ghanem
<i>Sector Manager:</i>	Emmanuel Akpa	Emmanuel Akpa
<i>Team Leader at ICR:</i>	Benu Bidani	Benu Bidani
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2. Principal Performance Ratings

(HS=Highly Satisfactory, S=Satisfactory, MS=Moderately Satisfactory, MU=Moderately Unsatisfactory, U=Unsatisfactory, HL=Highly Likely, L=Likely, UN=Unlikely, HUN=Highly Unlikely, HU=Highly Unsatisfactory, H=High, SU=Substantial, M=Modest, N=Negligible)

<i>Outcome:</i>	MS
<i>Sustainability:</i>	L
<i>Institutional Development Impact:</i>	S
<i>Bank Performance:</i>	S
<i>Borrower Performance:</i>	MS

	QAG (if available)	ICR
<i>Quality at Entry:</i>		
<i>Operation at Risk at Any Time:</i>		No

3. Program Description

1. A series of three Poverty Reduction Support Credits (PRSCs), provided in the form of budget support, was designed in 2004 to support the implementation of Madagascar's Poverty Reduction Strategy (PRS) over the period 2004 to 2006. The program focused explicitly on the pillars of governance and human development of the PRS, and did not include specific policy actions on broad-based growth pillar. The overarching objectives of the PRSC program were to consolidate reforms underway in the public sector, combat corruption, improve transparency and improve service delivery in education, health, water supply and nutrition. These reforms were aimed at strengthening public sector's capacity to carry out its role more effectively, enhancing Government's accountability and results focus, and reach poverty reduction goals.

2. The first operation of the series (PRSC 1), approved in July 2004 for a total amount of SDR85.5 million (25.3 million credit and 60.2 million grant), supported the implementation of policy actions in the areas of (i) good governance, and (ii) human development.

3. On governance, the PRSC 1 supported the implementation of 2004 Priority Action Plan for public expenditure management reforms, which included measures such as: the preparation and submission to Parliament of the public finance framework law; improved alignment of the 2004 budget to the priorities of the PRS, the reform of the Treasury, simplification of expenditure management process, the development and submission to Parliament of a new Procurement Code, and strengthening internal controls through the establishment of a General Inspectorate for Finances. The PRSC 1 also supported anti-corruption measures, including the establishment of an operational Anti-Corruption Commission and the development of a national anti-corruption strategy. In addition, the PRSC 1 supported the development of a judicial reform strategy.

4. In the area of human development, the PRSC 1 supported the development and implementation of Government's Education for All agenda. Key policy reforms included an increase in the education budget, measures to decrease education costs for poor households (suppression of school fees, provision of learning materials to all primary students), actions to increase access for poor students (through school construction, salary compensation for teachers paid by parents, teacher recruitment) and reinforcement of management capacity at central and decentralized levels. The PRSC 1 also

supported policy and institutional reform in the nutrition sector, including the integration of the interventions of the Community Based Nutrition Project in Government's National Nutrition Program and the establishment of the National Nutrition Office.

4. Achievement of Objectives and Outputs

5. The overall outcome is rated as moderately satisfactory. The Government has made good progress in implementing the policy and institutional program supported by the PRSC, albeit these efforts were hampered by (i) the adverse macro-economic environment; (ii) capacity constraints for budget execution; and (iii) unanticipated implementation delays (cf. section below).

6. The key actions taken between June 2004 and June 2005 in the area of Governance are summarized in Table 1. Salient features include the overall satisfactory implementation of the 2004 Priority Action Plan and the establishment of an independent anti-corruption agency. Some measures for strengthening budget execution and accountability were delayed, though, including the development of an integrated financial management system, the preparation of implementation rules for the new Procurement Code, and the examination of the accounts for 2002 and 2003 by the Auditor General. Reasons advanced for the delays include problems with the equipment to be installed, difficulties in recruiting the suitable consultant, and the presence of important backlog at the level of the Auditor General. As a result, some indicative triggers for PRSC 2 were adjusted or dropped (Table 2).

7. The Government has also made good progress with the implementation of the human development program. A major achievement was the increase of budget allocation in the 2005 Finance Law for key PRSP priorities - including education, health, nutrition, transport and water supply. All triggers for the PRSC 2 in that area were met but for the one on water supply, where adequate staffing and equipment of the Directorate of Water and Sanitation and the six regional branches were delayed. In the area of education, the enrollment increase at the primary stage exceeded expectations, reaching a rate of over 90. Key measures taken by the Government included free supply of textbooks and pupils material, provision of funds to schools and higher subsidies for community teachers. Significant progress was also made in expanding schooling facilities. In the area of nutrition, the PRSC gave the Government the opportunity to reassert its commitment to fight malnutrition through the adoption of the first National Nutrition Program and the establishment of the National Nutrition Office. Despite these important achievements, implementation of the program was significantly constrained due mostly to difficulties with budget execution.

8. The second operation of the PRSC was approved in July 2005 for a total credit amount of SDR53.9 million. It will consolidate and deepen the support for policy and institutional reforms commenced under PRSC 1. The monitoring indicators for measuring the outcome of the program in 2006 remained unchanged, but for two minor adjustments.¹ More significant changes were introduced, though, in the Policy and Institutional reform matrix for the PRSC. These changes, drawing on lessons from the first year of execution, resulted in a streamlined set of reforms and the extension of the implementation period for an additional year. In addition, given that the PRSC focuses explicitly on the pillars of governance and human development, all the measures related to the second axis of the PRS, namely Broad Based Growth, were dropped from the matrix.

¹ The expected outcomes for primary enrollment and completion rates were revised upwards (indeed enrollment rates achieved in 2004 were already higher than the expected output for 2006). The level of indicators and objectives for two health indicators were also adjusted on the basis of new data produced in May 2005.

5. Major Factors Affecting Implementation and Outcome

9. The three major factors which affected the implementation of the program during the first year were: (i) the adverse macro-economic environment for 2004; (ii) capacity constraints for budget execution, notably with respect to procurement and financial management in the sector ministries; and (iii) unanticipated delays in the implementation of some reforms.

10. The adverse macro-economic situation - marked by exogenous shocks, a strong depreciation of the exchange rate and a surge in inflation - seriously hampered the execution of 2004 budget.² Expenditure needs, notably for imported goods, increased sharply owing to cyclone reconstruction needs and the sharp depreciation of the exchange rate. On the resources side, the revenue collection was below expectation and donor flow aid was delayed. The Government had to adjust through a curtailment of expenditures, with a freeze of commitments in March 2004, a reduction in expenditures mid-year, and a shortened expenditure cycle. Although the Government attempted to limit the cuts for priority sectors, the unpredictability and stop-and-go cycles affected delivery in all sectors.

11. In addition to this overall budgetary constraint, limited capacity for budget execution within the sector ministries - notably with respect to procurement procedures and financial management - was manifest and contributed to the execution delays observed in most sectors. This situation has been exacerbated by the lack of understanding of the PRSC instrument in sectors which were used to investment projects. This is unlikely to improve for 2005, as the decision of the Government to introduce budget programs a year ahead of schedule has added significant challenges for administration. Indeed, preliminary data indicates that lack of familiarity with the new procedures is hampering budget execution for 2005, notably in peripheral administrations in the education and health sectors.

12. The Government made good progress in implementing the policy and institutional program, though reforms took in general longer to accomplish than originally anticipated. The main reasons included over-optimism at the design stage, insufficient prioritization of actions, and under-estimation of the capacity constraints and implementation lead times. This was particularly true for measures aimed at strengthening the procurement framework and the accountability and transparency of budget execution, some of which required amendments to the regulatory framework and the establishment of new institutions (e.g. the General Inspectorate for Finance).

6. Bank and Borrower Performance

13. Overall Bank performance was moderately satisfactory. The objectives of the PRSC were well aligned with Government's PRS and the program was underpinned by solid analytical work. The PRSC 1 document rightly identified difficulties with the implementation of budgetary and governance reforms as a serious risk for the program. To mitigate this risk parallel support was provided through the governance project and WBI capacity building support.

14. Similarly, the overall Borrower performance was moderately satisfactory. The Government has made good progress in implementing the policy and institutional program supported by the PRSC. It has also made commendable efforts to prioritize and sequence the actions and has succeeded in rallying the donors around the Priority Action Plan. However, the continued difficulties with respect to

² The depreciation was due mainly to a surge in imports during the first half of 2004 - owing to increased government capital expenditure, an acceleration of private imports in response to tax and tariff exemptions granted in 2003, and higher oil prices - and weak exports, as the vanilla and shell industries were damaged by two successive cyclones.

budget preparation and execution have somehow hampered the overall outcome of the program. In that respect, continued and unwavering efforts to monitor and coordinate the reform program will remain critical.

7. Findings and Implications for Subsequent Operation(s) in Series

15. The first year of implementation evidenced the need for continued and increased support for public and financial management reforms. In particular, efforts to strengthen and build capacity in the sector ministries for budget formulation, procurement and financial management should be furthered.

16. The need for greater realism in setting the targets and the timeframe was also manifest. Further work with the Government would be needed to prioritize and scale up reform process in congruence with existing capacities.

17. The unpredictability of flows of resources seriously hampered budget execution during 2004. Predictability could be improved through better revenue forecasting. A better alignment of donor disbursements with the budget cycle might also contribute to improve predictability. The actual firmness of the commitment is actually more relevant than the timing of the disbursement, however in the case of Madagascar the availability of resources upfront could be critical in providing the level of confidence and certainty needed to execute the budget and avoid stop-and-go cycles.

Table 1: Key Policy and Institutional Reforms in Governance since July 2004

<i>Area</i>	<i>Actions taken by the Government since July 2004</i>
Public Financial Management	
Overall implementation	<ul style="list-style-type: none"> • Satisfactorily implemented 2004 Priority Action Plan for public finance reforms. • Developed 2005 Priority Action Plan for public finance reforms. • Strengthened reform coordination in MEFB.
Budget Formulation	<ul style="list-style-type: none"> • Allocated greater share of resources to PRSP priority sectors in 2005 budget relative to 2004. • Introduced program budgets in 2005 with a medium-term perspective and better link between sector priorities and budgets. • Strengthened capacity of sector ministries.
Budget Execution	<ul style="list-style-type: none"> • Simplified expenditure management process and strengthened budget execution capacity of key spending ministries. • Made fully operational the transitional integrated financial management system in Tamatave; and expected to be operational in Antananarivo and four additional provincial treasuries shortly.
Procurement	<ul style="list-style-type: none"> • Prepared implementing rules and regulations for new Procurement Code. • Prepared standard bidding documents. • Established Procurement Oversight Institution.
Accountability	<ul style="list-style-type: none"> • Submitted final accounts for 2000 and 2002 to the <i>Chambre des Comptes</i>. • <i>Loi de Règlement</i> for 1998 voted by Parliament • <i>Loi de Règlement</i> for 1999 sent to MEFB by <i>Chambre des Comptes</i> for onward transmission to Parliament. • <i>Loi de Règlement</i> for 2000 examined by <i>Chambre des Comptes</i> and sent to MEFB for onward transmission to Parliament.
Results-focus/Monitoring	<ul style="list-style-type: none"> • Established results framework (as outlined in <i>Politique Générale de l'Etat</i>) for the Administration and for each ministry. • Conducted indicative PEFA of public financial management system in 2005.
Other Governance Areas	
Anti-Corruption	<ul style="list-style-type: none"> • Made operational independent Anti-Corruption Agency (BIANCO) in October 2004. • Prepared and passed Anti-corruption law, including key implementation decrees. • New regulation for declaration of assets to improve compliance rate (as of mid-May 2005, 60% of public and elected officials required to fill declarations had done so). • Prepared and passed anti-money laundering legislation. • Submitted to Parliament law regulating political parties and their financing. • Conducted independent audit of land titling system.
Justice	<ul style="list-style-type: none"> • Prepared and passed law regulating commercial enterprises. • Prepared and passed law rationalizing civil and commercial court procedures. • Set up two model courts (TPI Antananarivo and Ambatolampy). • Reduced backlog of cases in Antananarivo from 22,000 in 2002 to almost zero.
Customs	<ul style="list-style-type: none"> • Prepared customs strategy and action plan. • Merged customs tax and import duty into single customs duty. • Eliminated customs duty credit (<i>crédit de droit</i>). • Mandated payment of customs duty through banking system. • Abolished immunity of customs agents from enquiries and prosecution. • Rotated 430 customs agents in 2004/2005. • Made operational automated data processing system (SYDONIA++) in Tamatave. • Improved customs clearance procedures.

Source: PRSC2 program document (WB Report No. 32516-MG, June 9, 2005).

Table 2: Indicative Triggers for PRSC 2

	Indicative PRSC 2 trigger in PRSC1 Board Document	Final PRSC 2 Prior Actions	Comments
Governance			
Public Financial Management	Satisfactory implementation of Priority Action Plan for 2004,	Unchanged	Trigger fulfilled
<i>Budget Formulation</i>	in particular: <ul style="list-style-type: none"> Budget for 2005 allocates greater share of resources to PRSP priority sectors relative to 2004, with adequate funding allocated to key priorities (such as education, health, nutrition). 	Unchanged	Trigger fulfilled
<i>Budget Execution</i>	<ul style="list-style-type: none"> Progressive implementation of the recommendations of the audit of the treasury in particular: <ol style="list-style-type: none"> monthly accounts produced until the 15th of the following month <u>in the treasuries</u> that installed the transitional financial management system final accounts for 2003 prepared by the Treasury. <ul style="list-style-type: none"> Transitional financial management system installed in four sites. 	<p>Adjusted: monthly accounts produced until the 15th of the following month <u>in Toamasina</u>, where the transitional financial management system is operational.</p> <p>Unchanged</p>	<p>Adjusted trigger fulfilled: there are delays in the effective functioning of the system in Antananarivo and four additional provincial treasuries. Original trigger proposed as prior action for PRSC 3.</p> <p>Trigger fulfilled</p>
<i>Procurement</i>	<ul style="list-style-type: none"> Implementing rules and regulations for the new Procurement code issued by Government 	Dropped	See above.
	<ul style="list-style-type: none"> Establish the new procurement oversight institution (“<i>Autorité de Régulation des Marchés Publics</i>”) 	Unchanged	Trigger fulfilled
<i>Accountability</i>	<ul style="list-style-type: none"> <i>Projet de loi de règlement</i> for 2002 and 2003 <u>examined</u> by the Auditor General 	Changed: <i>Projet de loi de Règlement</i> for 2002 and 2003 <u>sent</u> to the Auditor General.	Adjusted trigger not met, though expected by December 2005
Customs	Adopt a time-bound action plan for 2005 for customs reform and start implementation.	Unchanged	Trigger fulfilled
Human and Material Security			
Education	Implementation of the National Education for All (EFA) on track.	Unchanged	Trigger fulfilled
	MENRS will prepare and submit a sustainable Human Resources (HR) rationalization plan.	Unchanged	Trigger fulfilled

	Indicative PRSC 2 trigger in PRSC1 Board Document	Final PRSC 2 Prior Actions	Comments
Nutrition	Creation of National Council for Nutrition and establishment of the secretariat (<i>Office National de Nutrition</i>) and appointment of its coordinator.	Unchanged	Trigger fulfilled
Health	Update health sector strategy.	Unchanged	Trigger fulfilled
	Introduction of Medium Term Expenditure Framework for the health sector commencing in CY 2005.	Unchanged	Trigger fulfilled
Water Supply	The Directorate of Water and Sanitation in Antananarivo and the six Faritany RWSS units <u>are adequately staffed and equipped</u> to implement successfully the proposed RWSS national program "Water and Sanitation for All" endorsed by GOM and donors in October 2004	Changed: The Directorate of Water and Sanitation in Antananarivo and the six decentralized departments in the provinces <u>have started to adequately staff and equip</u> themselves to implement successfully the "Water and Sanitation for All" program.	Adjusted trigger fulfilled