

Project Name MADAGASCAR-MINERAL RESOURCES (@)...
GOVERNANCE PROJECT

Region Africa Regional Office

Sector Mining and other extractive (60%);
Central government administration
(40%)

Project ID P076245

Borrower(s) MINISTRY OF FINANCE

Implementing Agency
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Unité de Coordination du Projet (UCPM)
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Environment Category B

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1. Country and Sector Background

Madagascar is one of the poorest countries in the world with per capita income of US\$260 (in 2000), 70 percent of the population in poverty and half of the children malnourished. After decades of economic stagnation and downturn the country has sustained four years of positive real growth and low inflation, and the public deficit is under control. After having been one of the most rapidly growing African economies in recent years, Madagascar plunged into a deep political crisis at the beginning of 2002, following contested first-round elections in December 2001. The political crisis ended in July 2002, but the social and economic impact is extremely pronounced. The direct negative impact on national income for 2002 is estimated at half a billion dollars. The total economic cost is probably much larger, taking into account the loss of confidence, foregone direct investments, foregone exports, physical destruction. Activity in several sectors, including tourism, transport, export processing industries, and mining came to an almost complete stop.

Madagascar is very rich in minerals and precious stones and 2300 operators are active in the sector today, generating direct and stable employment for about 100,000 workers and an additional up to half a million seasonal jobs. Since 1996, official mining exports have increased from US\$16 million to US\$37 million in 2000, largely in precious stones trading. But poor governance and corruption in the sector have discouraged many formal investors and have led to a smuggling of precious stones out of Madagascar with very little value added being created in the country. Illegal exports are a multiple of official exports and estimates put the value of

trafficking in precious stones ranging from a minimum of \$200 million to the maximum of US\$500 million (or 10 percent of GDP) per year. Although severe governance problems have characterized Madagascar's mining sector for years, the crisis offers the possibility to decisively reduce illegal activities in the sector. As a result of the crisis as well as anti-corruption announcements of the Government, illegal activities have slowed down and there is now a short window of opportunity to reverse the situation and promote their integration in the formal economy. Quick action is necessary, though, before the illegal activities restart in full strength. Also, improving governance in the sector, and thereby formalizing mining operations, is one of the most important actions to improve internal revenue generation in Madagascar, much needed to extend basic services and expenditures for anti-poverty programs.

The Mining Sector Reform Project assisted Government in setting up a legal and regulatory framework conducive to private investment in the area of mineral resources, in line with its overall policy, defined in 1998 in the Document Cadre de Politique Economique (DCPE), whose key objectives are shifting the role of the State from operator to regulator and promoter of sustainable minerals development, and opening up of the sector to private investment, including foreign. Reforms, supported by the MSRP, include : (i) a new mining code and its regulations, that have established an adequate legal and regulatory framework to attract private investment into mining, including joint environmental regulations for mining, published jointly by the Ministry of Environment and the Ministry of Energy and Mines; (ii) a special law for large-scale mining investments, defining an attractive special investment regime for FDI in mining in Madagascar, and providing for a fair share of revenues between the Government and the private sector, an adequate cut for the Provincial Governments; and (iii) improved governance through the establishment of a nondiscretionary and transparent system to grant, manage and cancel mining permits, the Mining Cadastre.

Success in the implementation of these reforms - that were included as sector conditions in the Second Structural Adjustment Credit (SAC II) - triggered the scale-up of the Mining Sector Reform Project, designed as a Learning and Innovation Loan (LIL) to the current project.

In spite of the overall improvement in the legal and regulatory framework, Madagascar continues to be confronted with significant governance issues in small-scale and artisanal mining, namely as a result of the series of rushes in the gemstones area. The dynamism and complexity of informal small scale mining activities is aggravated by the deforestation and soil erosion that are a result of frequent cyclones and slash-and-burn ("tavy") practices, especially on the East coast. According to the Ministry of Environment, Madagascar has lost 80 percent of its original forest cover, more than half of this in the past 40 years alone, while deforestation is continuing at a rate of about 200,000 hectares per year. Between 1987 and 1997 the area under primary forests is reported to have shrunk by one-third. Soil erosion is estimated at 200-400 tons/ha/year. Soil erosion, associated with an increasing ability to identify gemstones by the rural population is at the origin of the intensification of the rushes on semi-precious stones that Madagascar has known over the recent years. Because of lack of institutional capacity of the mining administration, the new mining code is not being consistently enforced and, as a result,

most of the small-scale and artisanal mining is being conducted outside the formal channels, with insufficient linkages to the rest of the economy, damage to environment, social conflicts, and substantial loss of fiscal revenues.

Government is now seeking to implement a series of measures of strong impact aimed at combating smuggling and corruption in this area, and creating an enabling environment for the production, trade, cutting and polishing of gemstones. As part of the project preparation, Government will submit to the Bank before negotiations a Letter of Sector Policy including arrangements to improve governance in small scale mining of gold and gemstones, an action plan for the decentralization of the institutional framework for the public mining institutions.

The measures to improve governance in the management of mineral resources constitute the core of the short term policy program of the Government. Among the priority measures that could be implemented over the one year period are : (i) the establishment of a one-stop shop for mineral exports; (ii) the set-up of a certification and evaluation infrastructure for gemstones; (iii) the creation of a gemstone exchange in Antananarivo; and (iv) the launching of a training program in cutting and polishing of gemstones. These measures would be complemented with agreements with the main customers of Malagasy gemstones aiming at regulating the trade of gemstones.

Over the medium term, Government's strategy for the sector is based on the recognition that the sustainable development of mining can not be achieved without a decentralized administration and a deep involvement of the affected communities. In concrete terms, this strategy calls for : (i) capacity building of the Provincial mining administration, with the establishment of a better alignment between core central public sector functions and the implementation of their mandates at the Provincial level; (ii) increase of fiscal revenues to the communes, including the decentralization of tax collection; and (iii) definition of effective ways and means for community empowerment and participation, including the establishment of public/private partnerships with responsible mining companies willing to invest part of their profits in human resources capacity building, social, and physical infrastructure. A key element of this strategy would be the provision of technical assistance to community associations and municipal governments for the integration of mineral resources management in their participatory development plans.

The Government is convinced that its central objective of reducing poverty through accelerated growth can only be accomplished through institutional and administrative reforms that refocus the role of the State, remove inefficient and discretionary regulations, and build a strong partnership between the State, the private sector, and the civil society at large. Based on international experience, the proposed project would look at relevant experiences related to partnerships between mining companies and small scale mining organizations and/or communities for the delivery of services. These experiences could be of particular interest and relevance to Madagascar as they provide an opportunity to resolve a number of existing constraints simultaneously, as mining companies typically provide technical assistance, infrastructure, and access to markets in these schemes.

In implementing its strategy, Government expects to increase the environmental and social awareness among the stakeholders involved in minerals development, and obtain a fairer distribution of revenues to the affected population. A major challenge associated with this strategy is improving good governance and transparency of revenue expenses by the communes. The focus of the actions to be supported by the project at the community level includes capacity building for decision making and planning of economic activities to be implemented with the revenues arising from mining, including conflict resolution and analysis of alternative economic opportunities, and linkages to other community-driven networks for the access to "business" services allowing them to benefit from other economic opportunities.

2. Objectives

The overall objective of the project is to assist the Government of Madagascar in implementing its strategy to accelerate sustainable development and reduce poverty in Madagascar through the strengthening of governance and transparency in the management of mineral resources, with special emphasis on small-scale and artisanal mining.

3. Rationale for Bank's Involvement

Bank's competitive advantage in mining. The Bank has been the leading provider of assistance to mining sector reform in African and Latin American countries during the last decade and in this capacity has contributed to an upsurge in mining activities in both continents. The Bank has been leading the policy dialogue in mining in Madagascar, and is the only donor capable of providing an integrated approach to the technical assistance to be given to Government for institutional development and regulatory reform designed to encourage the expansion of private investment in mining in a socially and environmentally sound way. Bank involvement will also be catalytic in attracting additional funds and support from bilateral donors particularly for the implementation of the social mitigation measures, and in providing the environment for encouraging private sector investment.

4. Description

The project which would be implemented over a period of five years and consists of four components:

Component 1 - Strengthening transparency and governance in mining. This component would support quick measures with great impact aimed at improving governance in the management of mineral resources and reducing the smuggling of gemstones, and more specifically: (i) adjustment of the sector's legal and regulatory framework; (ii) support for the establishment of mining administration offices close to exploitation sites, the Bureaus de l'Administration Minière (BAM); (iii) establishment of a certification program for gemstones; the creation of a one-stop shop for gemstone exports, and a gemstones exchange; and (iv) strengthening of private sector associations.

Component 2 - Key institutional reforms for the decentralized management of mineral resources. This component would support Government's decentralization strategy for transfer of competences to the provincial and municipal levels and empowerment of local communities. Community level effort would include extending access to Cadastre information on the

municipal levels, streamlining of tax collection, and of Directorate of Mines and Geology operations. The project would form six provincial-level offices in cooperation with the Ministry of Environment to oversee environmental management on the provincial level. Also, ten communes would be selected for implementation of decentralized management of mineral resources, and especially tax collection on the provincial levels. Four studies in the pilot regions, focusing on strategic impact of mining activities will be sponsored in order to build capacity in the mining sector and to define sector strategy. A key aspect of this component is a training program aimed to raise human resource capacity in the sector. The component would also sponsor a communication campaign geared to raise awareness of mining sector reform in local communities. The set-up of an Intranet and Internet network within the mining administration is another part of this component, which would facilitate communication with all stakeholders, private and public.

Component 3 - Promoting private investments and value-added in the sector. Madagascar's geological potential is little known, and small scale mining methods widely employed in the country lead to a waste of resources and damage to the environment. A large portion of the minerals production is smuggled out of the country with little fiscal and economic impact. This component would address the current situation by (i) establishing the Mining Sector Promotion Agency and (ii) strengthening the Geo-scientific Information Infrastructure. Creation of the Mining Sector Promotion Agency would improve the Government's capacity to attract private sector investment by coordinating certification procedures, administering a Small Grants program, establishing a database of geological and geophysical information on the country's mineral resources, and designing and implementing environmental awareness campaigns. The project would also work in coordination with the ongoing Multisectoral STI/HIV/AIDS Prevention Project to undertake pilot activities for HIV/AIDS prevention on the commune level. The second sub-component would finance the geo-physics campaign and conduct geological and geochemical mapping. Both of these activities would increase the availability of mineral resources information to investors by creating a Mineral Resources Governance Database and thus facilitate private sector investment in the long-run.

Component 4 - Project coordination and management. Project management would build upon the existing Project Implementation Unit (UCPM) that has shown proven skills in project procurement, financial management and reporting. The UCPM would be responsible for a monitoring and evaluation program for the activities of the project and coordinate its efforts with a Steering Committee, composed of representatives from various ministries and charged with strategic and financial management.

Strengthening transparency and governance in mining

Key institutional reforms for decentralized management of mineral resources

Promoting private investments and value-added in the sector

Project coordination and management

PPF

Contingencies

5. Financing

Total (US\$m)

BORROWER \$5.40

IBRD

IDA \$32.00

US: AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID) \$3.00

FRANCE: FRENCH AGENCY FOR DEVELOPMENT \$1.20

Total Project Cost \$41.60

6. Implementation

Project Implementation Period

The proposed project would be implemented over a period of 5 years.

Project completion date would be June 30, 2008 and the Credit closing date would be December 31, 2008.

Executing agency

The Ministry of Energy and Mines (MEM) will be responsible for the implementation of the project.

Project management

The Ministry of Energy and Mines (MEM), through the existing UCPM (Mining Project Coordination Unit) will be responsible for the overall implementation of the project. The UCPM will continue to operate and will (i) be responsible for the execution of the Project Implementation Plan (PIP); (ii) manage (a) procurement - including all contracting for works and purchases of goods - and the hiring of consultants, (b) Project monitoring, reporting and evaluation, (c) the contractual relationship with the Bank, and (d), financial record keeping, the Special Account and disbursements; and (iii), establish communication and/or coordination links between MEM and the different sectors involved in the Project. The Project will also establish a Steering Committee, composed of representatives from MEM, Ministry of the Environment, DMG, BCMM, CNM. The Steering Committee will be chaired by the Director General of MEM and will oversee financial, management, and strategic issues.

Accounting, financial reporting and audits

A financial management assessment has been carried out during pre-appraisal (see Annex 6), and procedure adjustments to comply with Bank norms have been agreed with MEM. A computerized financial management system will be set up. The UCPM will maintain accounts and payments. A summary financial report will be included in the quarterly progress reports. Project accounts, the Special Account, all procurement and compliance with the financial and legal covenants of the Credit Agreement and all procurement, including Statements of Expenditure will be audited annually by independent auditors satisfactory to the Bank. The terms of reference of the audit have been reviewed by the financial management specialist of the Bank/IDA. The auditors should be recruited prior to negotiations. The auditors will be also required to carry out a comprehensive review of the internal control procedures and provide a management report outlining any recommendations for their improvement. The audit report will be submitted to IDA not later than 6 months after the end of each fiscal year.

Monitoring and evaluation

The UCPM will be responsible for monitoring and evaluation of the Project, according to the indicators and benchmarks included in the PIP and the Credit agreement. Not later than 45 days after each quarter, the UCPM will submit to the Bank quarterly progress reports covering all Project activities, including procurement and a financial summary report.

Bi-annual reviews, the first one to take place 6 months after effectiveness, would provide detailed analysis of implementation progress towards development objectives, and include an evaluation of financial

management as well a post-review of procurement matters.

7. Sustainability

Madagascar has good geological potential as evidenced by the interest major international mining companies are showing in the country. However, the Government will encounter difficulty in sustaining this interest and in ensuring the maximum contribution to economic development unless the major governance issues are addressed and reforms to decentralize the mineral resources management that have already begun are deepened and completed. If transparent management, proper regulations and enforcement mechanisms as well as a competitive environment are put into place, minerals exploration and development of mines will become self-sustaining to provide a continual revenue stream and other economic benefits to the country. Without substantial improvement of governance in the sector, the continuation of rushes on gemstones could destroy the social and environmental tissue in huge extension of the East coast without material contribution to the region's development. The project will contribute to the institutional strengthening of the Government of Madagascar in key areas of the mining sector (policy, institutional, environmental, social), through a set of prerequisite steps that will lay the foundation for future private investment. Project implementation will provide a sound basis for Madagascar in exploiting, over the long term and in a developmentally sound manner, the significant potential of its natural resources. Sustainability will be enhanced through the project's strong emphasis on institutional capacity building, training, human capital development and environmental awareness in the public as well as private sectors.

8. Lessons learned from past operations in the country/sector

Lessons have been learned from the Mining Sector Reform Project and other ongoing projects being implemented in Madagascar, from other countries where the Bank has financed similar capacity building operations for mining (e.g., Algeria, Burkina Faso, Ghana, Guinea, Mali, Mauritania, Mozambique and Tanzania), as well as from a Bank review on mining sector reform in Latin America (A Mining Strategy for Latin America and the Caribbean, 1996).

Experience in Madagascar shows that although Government is committed to policy reform and to improvements in the legal and regulatory framework, enforcement of the new regulations can be blocked by governance issues and institutional shortcomings. In addition, the general trend towards a state that withdraws from direct participation in economic activities and the operational aspects of implementing public policy requires systematic thinking on how to improve the interface between the public and private sector for the purpose of generating a more dynamic mining sector, in such a way that will allow the affected communities to benefit directly from the surge in activities.

Lack of detailed baseline information and adequate institutional capacity make improving governance in the small-scale mining area through technical assistance a particularly difficult task. Experience with capacity building and public sector reform under the MSRP and economic and sector work conducted under the project show that learning through the implementation of pilot projects is crucial to achieve results on the ground. In addition, giving the generalized level of poverty and the

shortfalls in institutional capacity, public/private partnerships are particularly adapted to the situation of Madagascar. The counterpart, at the policy level, of this strategic choice, is that policy implementation has to stress incentives to private economic activity rather than indiscriminate economic repression.

Similar experience in other World Bank projects in the country suggests that emphasis on beneficiary participation in project preparation and supervision, organization and coordination in the field are critical for timely and effective implementation. Given the limited availability of highly skilled staff, ownership and political commitment to project objectives are key to ensuring strong local leadership, and clear delineation of ministerial authority and responsibilities.

Experience in other countries indicates that improving the enabling environment increases the ability of a country to attract and retain appropriate private investment. The last 25 years have seen significant changes in the international mining industry, in large measure because of the liberalization of economic and mining policies of previously restrictive governments in mining countries. These reforms have had three broad objectives, to improve sector performance and growth and the contribution of mining to the national economies, to ensure the sustainability of the mining industries in the developing countries, and to ensure that the host countries and local populations get a fair share from the benefits of growth of the sector.

World Bank involvement in the reform process of successful mining countries shows that, for this to happen, the enactment of the necessary legal, fiscal and environmental policies and the establishment of strong mining institutions to implement and administer them have proven to be the keys to success. This includes: (i) a background of sensible economic policies and a coherent general legal framework; (ii) a mining law providing security of tenure, clarity and transparency and access to land (including the release of reserved areas held up by the State and full transferability of concessions to remove all barriers to the entry of investors) , and an investment framework providing access to foreign exchange and a stable and equitable fiscal regime; (iii) public mining institutions that apply properly the sector policies; (iv) a sensible environmental management system; and (v) clear incentives and mechanisms to associate the local communities to the management of mineral resources and to make them benefit of the revenues arising from the mining activity.

9. Environment Aspects (including any public consultation)

Issues : There are no investments in mining operations under the Project. However, the Project would stimulate private investment in mining, and identified environmental issues regarding environmental management and control by public mining authorities include:

- (i) Government is having problems in the implementation of the environmental regulations applicable to mining, especially with regards to small scale and artisanal activities;
- (ii) the Minister of Energy and Mines has yet to fully staff and provide adequate budget to the existing Environmental Unit of the Mining Directorate and the skills have to be decentralized at the provincial level;
- (iii) environmental baseline data for key mining areas has started to be developed under the MSRP but is still inadequate to monitor the

development impact of mining activities or to provide adequate information to the private sector for the preparation of environmental assessment (EA) studies;

(iv) public participation in mining projects is embryonic;

(v) there is little experience in evaluating socio-economic impacts of mining projects.

In order to address these issues, an update of the Sector Environmental and Social Assessment (SESA) will be carried out as part of the project, focusing on the:

(i) review of the present status of the environmental legal, regulatory and institutional frameworks;

(ii) evolution of the mining sector, including a description of most of the mining projects in operation or under development;

(iii) potential physical and socio-economic impacts of sector activities on the environment and on the communities, including indigenous populations;

(iv) identification of protected areas and areas of high value biodiversity restricted to mining activities, and prospective areas for mining development where environmental baseline studies will be prepared, in order to assess natural, social and sector background data;

(v) preparation of pilot socio-economic baseline studies aiming at the definition and implementation of consultation procedures, training requirements and programs, ad hoc institutional strengthening, alternatives for revenue sharing with local communities, and other related measures.

The project is categorized as "B" without a separate EA, but a separate EMP will be prepared and disclosed at the World Bank Infoshop and in the country before appraisal. Measures taken in the previous mining capacity building projects and the environmental management projects will be spelt out. The annex will outline the capacity building initiatives being taken to ensure that the regulatory framework that has been put in place is enforced, and how the proposed project intends on bringing small scale and artisanal miners into the economic mainstream as a way of applying the rules of the game for environmental management among other management issues. The Terms of reference for the EMP will be prepared by the ASPEN team and the study will be carried out preferably by a national consultant. More conceptual work also needs to be done on revenue management, building on the current thinking being developed in the Mining Department. The meeting recalled that USA Government requires environmental disclosure at least 120 days before Board approval, and this needs to be taken into consideration in terms of the preparation schedule, since USAID is a potential co-financer of the proposed operation .

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Note: This is information on an evolving project. Certain components may not be necessarily included in the final project.