

**Document of
The World Bank**

Report No. 36287

PROJECT PERFORMANCE ASSESSMENT REPORT

MADAGASCAR

**PUBLIC MANAGEMENT CAPACITY BUILDING PROJECT
(CREDIT 2911)**

**FIRST STRUCTURAL ADJUSTMENT CREDIT
(CREDIT 2937)**

**PRIVATE SECTOR DEVELOPMENT AND CAPACITY BUILDING PROJECT
(CREDIT 2956)**

**SECOND STRUCTURAL ADJUSTMENT CREDIT
(CREDIT 3218)**

June 6, 2006

*Country Evaluation and Regional Relations
Independent Evaluation Group*

Currency Equivalents (annual averages)

Currency Unit = Ariary
US\$ 1.00 = Ariary 2,000

Fiscal Year

Government: January 1 – December 31

Abbreviations and Acronyms

BFV	National Bank of Commerce	PAIGEP	Projet d'Appui Institutionnel au Secteur Public
BTM	Bank for Rural Development	PSDP-II	Second Private Sector Development Project
CAE	Country Assistance Evaluation	PASERP	Programme d'Action Sociale et Economique pour la Réinsertion Professionnelle
CAS	Country Assistance Strategy	PATESP	Projet d'Appui Technique au Secteur Privé
CIP	Commission Indépendante de Privatisation	PC	Privatization Committee
CRC	Comité de Réflexion sur la Compétitivité	PE	Public Enterprise
DCA	Development Credit Agreement	PIP	Public Investment Program
EMSAP	Economic Management and Social Action Project	PPAR	Project Performance Assessment Report
FDI	Foreign Direct Investment	PRSP	Poverty Reduction Strategy Paper
GDP	Gross Domestic Product	PSD	Private Sector Development
GOM	Government of Madagascar	QAG	Quality Assurance Group
HIPC	Heavily Indebted Poor Countries	SAC	Structural Adjustment Credit
ICR	Implementation Completion Report	SME	Small and Medium Scale Enterprises
IDA	International Development Association	SOLIMA	Petroleum Company
IEG	Independent Evaluation Group	TA	Technical Assistance
ITF	Interim Trust Fund	TELMA	Telephone Company
IVAMA	Vanilla Parastatal	TSA	Secrétariat Technique à l'Ajustement
LDP	Letter of Development Policy	VAT	Value Added Tax
MFB	Ministry of Finance and Budget		
OAG	Office of the Auditor General		
OED	Operations Evaluation Department		

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A Project Performance Assessment Report (PPAR) is based on a review of the Implementation Completion Report (a self-evaluation by the responsible Bank department) and fieldwork conducted by IEG. To prepare PPARs, IEG staff examines project files and other documents, interview operational staff, and in most cases visit the borrowing country for onsite discussions with project staff and beneficiaries. The PPAR thereby seeks to validate and augment the information provided in the ICR, as well as examine issues of special interest to broader IEG studies.

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Institutional Development Impact: The extent to which a project improves the ability of a country or region to make more efficient, equitable and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Institutional Development Impact includes both intended and unintended effects of a project. *Possible ratings:* High, Substantial, Modest, Negligible.

Outcome: The extent to which the project's major relevant objectives were achieved, or are expected to be achieved, efficiently. *Possible ratings:* Highly Satisfactory, Satisfactory, Moderately Satisfactory, Moderately Unsatisfactory, Unsatisfactory, Highly Unsatisfactory.

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Borrower Performance: The extent to which the borrower assumed ownership and responsibility to ensure quality of preparation and implementation, and complied with covenants and agreements, towards the achievement of development objectives and sustainability. *Possible ratings:* Highly Satisfactory, Satisfactory, Unsatisfactory, Highly Unsatisfactory.

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Principal Ratings

	ICR*	ICR Review	PPAR
Public Management Capacity Building (Cr. 2911)			
Outcome	Satisfactory	Unsatisfactory	Unsatisfactory
Sustainability	Likely	Likely	Likely
Institutional Development Impact	Substantial	Substantial	Modest
Bank Performance	Satisfactory	Unsatisfactory	Moderately Unsatisfactory
Borrower Performance	Satisfactory	Unsatisfactory	Unsatisfactory
First Structural Adjustment Credit (Cr. 2937)			
Outcome	Satisfactory	Satisfactory	Moderately Satisfactory
Sustainability	Likely	Uncertain	Likely
Institutional Development Impact	Negligible	Modest	Modest
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Moderately Satisfactory
Private Sector Development and Capacity Building Project(Cr. 2956)			
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Development Impact	Substantial	Substantial	Substantial
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Unsatisfactory	Unsatisfactory
Second Structural Adjustment Credit (Cr. 3218)			
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Development Impact	Substantial	Substantial	Modest
Bank Performance	Satisfactory	Satisfactory	Moderately Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Moderately Unsatisfactory

* The Implementation Completion Report (ICR) is a self-evaluation by the responsible operational division of the Bank. The ICR Review is an intermediate Independent Evaluation Group (IEG) product that seeks to independently verify the findings of the ICR.

Key Staff Responsible

<i>Project</i>	<i>Task Manager/Leader</i>	<i>Sector Manager Sector Director</i>	<i>Country Director</i>
Public Management Capacity Building (Credit 2911)			
Appraisal	Pierre J. Demangel	Luca Barbone	Michael N. Sarris
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First Structural Adjustment Credit (Credit 2937)			
Appraisal	Ali Mansoor	Emmanuel Akpa	Michael Sarris
Completion	Juan Zalduendo	Luca Barbone	Michael Sarris
Private Sector Development and Capacity (Credit 2956)			
Appraisal	Paul Ballard	Thomas Allen	Michael N. Sarris
Completion	Marie Ange Saraka-Yao	Demba Ba	Hafez M. H. Ghanem
Second Structural Adjustment Credit (Credit 3218)			
Appraisal	Juan Zalduendo	Luca Barbone	Michael N. Sarris
Completion	Jesko S. Hentschel	Philippe H. Le Houerou	Hafez M.H. Ghanem

Preface

This is the Project Performance Assessment Report (PPAR) on four lending operations to the Republic of Madagascar from 1996 to 1999, to assist in improving public management and creating a favorable environment for the private sector, with the overarching objectives of opening the economy to market forces and reducing poverty.

The Public Management Capacity Building Project (Projet d'Appui Institutionnel au Secteur Public – PAIGEP¹) (Credit 2911-MG), in the amount of SDR 9.6 million, was approved on September 3, 1996, became effective on December 18, 1996, and was closed on December 31, 2002, 18 months behind the original date. The Credit was fully disbursed.

The First Structural Adjustment Credit (SAC-I) (Credit 2937-MG and Interim Trust Fund Credit N0120-MG), in a combined amount of SDR 49 million, was approved on March 14, 1997. The ITF Credit became effective on April 1, 1997, and the IDA Credit on June 20, 1997. Both Credits closed on December 31, 1997, the original date, and were fully disbursed.

The Private Sector Development and Capacity Building Project (Projet d'Appui Technique au Secteur Privé - PATESP²) (Credit 2956-MG), in the amount of SDR 17.2 million, was approved on May 29, 1997, became effective on February 18, 1998, and was closed on December 31, 2002, the original date. Ninety-seven percent of the Credit was disbursed.

The Second Structural Adjustment Credit (SAC-II) (Credit 3218-MG), in the amount of SDR 73.5 million, was approved on May 29, 1999, became effective on June 30, 2000, and was closed on December 31, 2002, one year behind the original date. Ninety-nine percent of the Credit was disbursed, with the balance cancelled. The Credit was supplemented by two Supplemental Credits. The first (Credit 32181-MG), in the amount of SDR 15.2 million, was approved on July 20, 2000, became effective on September 20, 2000, and was closed on December 31, 2002. The second (Credit 32182-MG), in the amount of SDR 23.5 million, was approved on December 22, 2000, became effective on June 25, 2001, and was closed on December 31, 2002. Both supplemental Credits were fully disbursed.

The PPAR is based on all relevant Bank and IMF documents and on interviews with Bank and IMF staff. An Independent Evaluation Group (IEG) mission visited Madagascar in October 2005 to discuss performance with officials who implemented the projects, representatives of donors, and staff of the Bank resident mission. Basic Data sheets are in Annex A.

Comments from the Bank's Regional Management were incorporated in the report. A draft report was sent to the Government of Madagascar for comments. The Government replied that it had no comments (see Annex E).

This report was prepared by Pierre de Raet (Consultant), who assessed these projects in October 2005, under the supervision of Ms. Zeynep Taymas (Task Manager). Ms. H. Joan Mongal provided administrative support.

¹ Throughout this report, the French acronym will be used because it is the one used in all Bank documents.

² Idem.

Summary

1. This is the Project Performance Assessment Report (PPAR) on four operations, approved in the second half of the 1990s, aimed at supporting the transition of Madagascar from a largely dirigiste economy since independence in 1960 to a market economy. In 1996, a new government initiated a shift to policies based on private sector led growth and integration into the world economy, with the overarching objective of reversing a dramatic decline in income per capita over the previous decades. The Bank supported this shift by engaging into a dialogue on structural reforms articulated along two axes, a changing role of the public sector and promotion of the private sector as engine of growth, and covering four areas: broad-based growth led by foreign investment; human capital development; strengthening the public sector's ability to deliver quality services; and natural resource management. Implementation was supported by two Structural Adjustment Credits (FY97 and FY99), accompanied by two technical assistance (TA) operations meant to mitigate the implementation capacity risks associated with the reforms: the Public Management Capacity Building Project (PAIGEP) and the Private Sector Development and Capacity Building Project (PATESP), both of FY97.

2. Implementation and results were affected by three categories of factors. First, internally, a persistently fluid political situation, marked by instability, rivalries, and resistance to change, led to varying degrees of commitment to and ownership of reforms. This culminated in a deep political crisis consequent to contested presidential elections in December 2001, during which two parallel governments were established. The crisis was resolved in July 2002, when the international community recognized the Ravalomanana government of the current President. The unstable political situation was exacerbated by weak institutional and administrative capacity. Second, external shocks (three cyclones and a major increase in oil prices in 2000 - the Bank extended two Supplemental Credits to mitigate their negative impact) considerably disrupted the carrying out of reforms. Third, implementation was negatively affected by the overambitious goals and complex design of the Bank projects, notably the two TA operations. These were restructured to sharpen their focus, while SAC-II underwent a major restructuring to respond to the new priorities and revised policy choices of the government emerging from the 2002 political crisis.

3. Overall, the results were mixed, but, despite all the difficulties encountered, the main outcome is that Madagascar succeeded in moving - however imperfectly - towards a market economy and to opening its economy to the outside world. This positive outcome, however, is tempered by the little progress achieved in reducing poverty during the period. The analysis has led to the following ratings.

4. PAIGEP. Outcome is rated unsatisfactory because achievements were mixed and fragmentary due to insufficient commitment, frequent conflicts and changes in the administration, and poor coordination. Institutional development impact is rated modest because the impact on the key ministries and entities responsible for improving resource allocations and service delivery was minimal. Sustainability is rated likely based on increased capacity in macro-economic management, budget cycle, treasury operations,

and the judiciary. Bank performance is rated moderately unsatisfactory because of numerous shortcomings at entry as the Bank overestimated GOM's commitment and paid insufficient attention to institutional issues. Nevertheless, during implementation, the Bank responded flexibly to the rapidly changing situation and was able to keep the dialogue open. Borrower performance is rated unsatisfactory because commitment was weak and a lack of leadership in governance, reallocation of resources, and poverty alleviation.

5. SAC-I. Outcome is rated moderately satisfactory because progress was considerably delayed in privatization, a key reform area, and no progress was recorded in redirecting resources to the social sectors. Institutional development impact is rated modest because of increased capacity in the areas of trade, private sector development, and dialogue between the private and public sectors, but there was very little progress in the management of the public sector. Sustainability is rated likely on the basis of no reversal in policies and progress in reaching a consensus on the content of SAC-II. Bank performance is rated satisfactory because key conditions for opening the economy were well identified and prioritized, and, after disbursement of the single tranche, the Bank showed consistency in bringing the reform agenda moving towards SAC-II. Borrower performance is rated moderately satisfactory because of weak commitment to reforms and an inability to initiate a serious poverty reduction program.

6. PATESP. Outcome is rated moderately satisfactory because it helped in formulating divestiture policies and launching the first phase of the privatization program. However, the overall divestiture program remained well behind schedule. Although the project succeeded in broadening and strengthening business services to some SMEs, several broader objectives of developing the private sector were not achieved. Institutional development is rated substantial on the basis of an emerging capacity to formulate privatization strategies and manage the privatization program and the establishment of regulatory bodies in key public service sectors. Sustainability is rated likely on the grounds that some institutional structures are now in place to promote private sector development and competition. Bank performance is rated satisfactory because Bank assistance and advice were not only consistently strong but also well targeted to the priorities as they emerged from implementation of SAC-II. Borrower performance is rated unsatisfactory because commitment to reforms remained lukewarm and because some successful private sector development structures were unnecessarily dissolved.

7. SAC-II. Outcome is rated moderately satisfactory because results were mixed and uneven. While progress was made in macro-economic management, privatization, and business climate, little was achieved in public financial management and governance. Public resource management continued to be neglected, with a negative impact on poverty alleviation. Institutional development impact is rated modest because, overall, little was achieved in raising the capacity to formulate and implement policies. Sustainability is rated likely because of no reversal in policies, despite the crisis. Moreover, the risks of reversal have diminished thanks to a greater acceptance of reforms by the public opinion and the private sector. Bank performance is rated moderately satisfactory. The credit was generally well-designed, reflecting the Bank's knowledge of

country conditions that had been accumulated over several years, and it was supervised flexibly, especially in the face of shocks. However, there were shortcomings in the Bank's performance, it continued to overestimate government's commitment and underestimate institutional weaknesses. In addition, it became too absorbed by the privatization program at the expense of issues of resource allocation and poverty reduction, where virtually no progress was made as noted above. Borrower performance is rated moderately unsatisfactory because of lukewarm commitment, a reactive attitude to Bank's presence, and a lack of vision to address poverty reduction by systematic and coherent policies.

8. The following lessons emerge from the assessment.

- The record of fragile political stability in Madagascar pleads for designing policy development operations in a flexible manner based either on a menu-based approach to tranche release, or preferably, on a programmatic series of one-tranche operations with prior actions.
- Given Madagascar's relatively low absorptive capacity, TA operations for supporting reforms should be well focused and have limited objectives initially aimed at implementation bottlenecks.
- New institutions in Madagascar need continued assistance from the donor community. Establishing new institutions does not ensure their effective operations. Continued support is required, for example, to strengthen the different regulatory authorities created in the public service sectors and competition in general, as well as the business framework. Similarly, continued assistance is needed to strengthen the judiciary, which is a long-term undertaking.
- Consideration should be given to revive the Private Sector Support Fund, which proved successful prior to the 2002 crisis, or to set up a similar scheme to promote PSD.
- The domestic revenue collection in Madagascar is particularly low. Much greater attention than in the past should be given by the authorities and by the Bank to revenue mobilization and reallocation of public resources for poverty reduction, without which recent improvements in social indicators will not be sustained.

Vinod Thomas
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1. Introduction

1.1 After over twenty years of dirigisme, Madagascar started in the mid-1980s to reduce the role of the state and to liberalize its economy. But the reforms were piecemeal and hesitant until the mid-1990s. In 1996, a new government presented an economic program to the National Assembly consistent with policy advice from the International Monetary Fund (IMF) and the Bank and based on private sector led growth and integration into the world economy. The Bank supported this shift in policy by deepening the dialogue with the Government of Madagascar (GOM) on structural reforms.

1.2 The four operations reviewed here find their origin in this shift. The objective of this Project Performance Assessment Report (PPAR) is to assess the extent to which they succeeded in assisting the country in its transition to a market economy open to the outside world and in reducing poverty. They were articulated along two axes: a changing role of the public sector from economic agent to public service provider, and promotion of the private sector as engine of growth. Implementation of the reforms, supported by the two SACs, was to be facilitated by two corresponding capacity building operations, one for the public sector, and the other for the private sector.

1.3 The report is structured as follows: Section 2 provides the background and the strategic context in which the four operations were prepared; Section 3 discusses the PAIGEP as setting the stage for undertaking initial reforms; Section 4 discusses the implementation and results of SAC-I; Section 5 discusses the PATESP as support for the development of the private sector; and Section 6 discusses SAC-II and its outcome. Section 7 draws conclusions and lessons.

2. Background and Context

2.1 Madagascar has a population of about 18 million, growing at 2.7 percent p.a., with three-fourths living in rural areas. It is among the poorest countries, with an income per capita of US\$290. After over two decades of state dirigisme following independence in 1960, there were some attempts at liberalization in the late 1980s leading to some improvement in the economic situation of the country. However, this was interrupted in 1991 by demonstrations and strikes in support of political liberalization. After a lengthy transition to democracy, recovery was blocked by political factionalism and policy differences on economic reform. Political instability and infighting persisted to mid-1996, when Parliament adopted a motion of no-confidence in the government (GOM), opening the way to the appointment of a non-political Prime Minister and the return of President Ratsiraka in national elections. In June 1996, the new government presented an economic program to Parliament consistent with advice from both the IMF and the Bank and, in August 1996, Parliament adopted the necessary legislation for the implementation of reforms agreed under a structural adjustment program. This is the immediate political background to the four operations reviewed here.

2.2 The more liberal policies adopted by the mid-1990s, the subject of the present PPAR, led to an average growth rate of 4.6 percent over 1997-2001, outpacing population

growth for the first time in decades. However, Madagascar's political scene continued to be marked by tensions between different factions and party rivalries, a feature of the country's political life. This erupted in the open when the December 2001 presidential elections were contested by the two main candidates, President Ratsiraka and his contender, Marc Ravalomanana, mayor of the capital. It led to a deep political and economic crisis, during which two parallel governments were established, critical infrastructure was destroyed, key social services were discontinued, and export activities virtually stopped. The crisis was resolved in July 2002, when the international community recognized the Ravalomanana government. Growth and poverty were adversely affected by the crisis with GDP falling by 13 percent in 2002. Stabilization and reform resumed after a new government was in place and the economy rebounded in 2003. Madagascar reached the decision point under the enhanced Heavily Indebted Poor Countries (HIPC) initiative in December 2000, and the completion point in 2004.

2.3 Decades of poor performance had a dramatic impact on poverty, which reached 73 percent in 1997 (76 percent in rural areas). Extreme poverty (those who cannot afford to buy a basic food basket even if they spend their total income on food items) had reached 63 percent in 1997 (66 percent in rural areas). The relatively strong growth during 1997-2001 failed to reduce poverty significantly, while the 2002 crisis wiped out whatever benefits had been gained. In 2002, poverty had reached 81 percent nationwide (62 and 86 percent in urban and rural areas, respectively). Madagascar issued its Interim Poverty Reduction Strategy Paper (I-PRSP) in November 2000 and its full PRSP in July 2003.

THE STRATEGY CONTEXT

2.4 The early attempts at reform during the late 1980s and early 1990s led GOM to take several liberalization measures in 1994, including floating the exchange rate and abolishing import prohibitions. The same year, the Bank issued a Country Assistance Strategy (CAS) focusing on promoting a private sector- and export-led growth, tackling poverty, improving natural resource management, building capacity, and improving project implementation. Underlying themes were the redefinition of the role of the state, improving the quality of public services, and expanding the role of the private sector in investment and the provision of services.

2.5 The four operations reviewed here were in gestation during this period and were identified in the 1994 CAS. At the time, there was an increasing recognition in Madagascar that increased investment was the pre-requisite to growth which would help alleviate poverty. This was seen as urgent and required a redefinition of the role of the state. Preparation of an adjustment program started in this context but progressed very slowly, over three years, 1994-96, and moving in parallel with the ups and downs in the political situation. It was not until the new leadership in place in mid-1996 was willing to undertake reforms, that a coherent program could take shape. The Bank seized this opportunity to deepen its dialogue and structure its intervention by launching a new CAS, (January 1997), a structural adjustment program (SAC-I), and two technical assistance (TA) projects to help implement the latter. The CAS concluded that poverty could only be reduced through growth and that only the private sector could deliver such a growth. Its major themes were aligned on GOM's priorities: broad-based growth led by foreign

investment; human capital development; strengthening of the public sector's ability to deliver quality services and create an enabling business environment; and natural resource management to reduce degradation and develop eco-tourism.

2.6 SAC-I was the vehicle to initiate reforms centered on opening the economy to international competition and integration into the world economy. The PAIGEP, an extension of the capacity building efforts undertaken under the FY89 Economic Management and Social Action Project (EMSAP),³ was to assist the public administration in implementing the reform program while the PATESP was to assist in moving decisively on reforming the Public Enterprise (PE) sector and promoting private sector development (PSD). SAC-II was to deepen and broaden reforms, with a particular emphasis on PSD. Both TA operations were meant to mitigate the implementation capacity risks associated with the reforms. The implementation period of the four operations ran from 1997 through 2002.

3. The Public Management Capacity Building Project (PAIGEP)

BACKGROUND

3.1 The project was a follow-up to the Economic Management and Social Action Project (EMSAP) mentioned earlier which had identified weaknesses in economic management and public finance (budget formulation, expenditure programming, PE reform) and in governance (census and management of public sector employees). Implementation had also revealed inadequate data and tools for policy formulation and a lack of capacity to provide adequate public services. Thus, the project was to support GOM in implementing the reform program by building its capacity in policy-making, in public resource management, and in governance.

OBJECTIVES AND DESIGN

3.2 The objectives were to assist in (i) improving *economic management* and (ii) addressing *governance* issues, specifically: (a) a more effective effort to identify, define, implement and monitor economic policies; (b) raising the capacity and efficiency of the civil service in a context of a redefined role of the state and an on-going decentralization process; and (c) making effective the "rule of law" and improving the security of business transactions through the independence and increased effectiveness of the judiciary. Support consisted of TA, training and equipment. There were seven components, four corresponding to the first objective, and three to the second one:

³ Economic Management and Social Action Project, Report No. 7410-MAG, October 27, 1988. Implementation Completion Report, Report No. 16272, February 6, 1997. The largest component of the EMSAP was the Social Action Program, a program of emergency actions for the disadvantaged and vulnerable groups.

Under *Economic Management*:

- Technical Secretariat for Adjustment (TSA) (created in March 1995): (i) monitoring and coordination of the reform program; and (ii) design and implementation of a public information campaign on the program;
- Statistical Office: strengthening capacity with respect to (i) national accounts; (ii) household-welfare surveys; and (iii) business-cycle surveys;
- State Secretariat for Economy and Planning: (i) studies on economic development strategy and projects' economic viability; (ii) preparation of sectoral strategies, Public Investment Programs (PIP), and Public Expenditure Programs (PEP) consistent with them and with the budget; (iii) monitoring of projects' execution and identification of obstacles to implementation; (iv) design and preparation of a publication on economic information; and (v) organizational audit of the Secretariat; and
- Ministry of Finance and Budget (MFB): (i) strengthening the effectiveness of the budget as instrument of economic policy; (ii) audit of autonomous agencies; (iii) organizational audit of the Treasury; (iv) establishment of an efficient debt management system; (v) rehabilitation of the payroll management system; and (vi) establishment of a Department of Economic Forecasting and Analysis.

Under *Governance*:

- Civil Service reform: (i) workshops to develop an action plan for reform, including a new statute; (ii) diagnostic study of four pilot ministries leading to reorganization and redeployment of staff consonant with decentralization; and (iii) financing of activities/studies resulting from the above-mentioned workshops;
- Decentralization process: (i) studies on the design and implementation of the decentralization and deconcentration process; (ii) training of officials of the central and decentralized governments; and (iii) provision of training, TA, and equipment in support of pilot implementation of decentralization in selected urban centers; and
- Legal and judicial reform: (i) compilation and publication of business laws, and publication of a legal periodical; (ii) reform of commercial and business laws; (iii) training and retraining of judges and other court personnel; (iv) streamlining of the litigation process; (v) strengthening the effectiveness of the Ministry of Justice and of the courts; and (vi) study of an arbitration mechanism for disposing of commercial disputes.

RELEVANCE OF OBJECTIVES AND DESIGN

3.3 The objectives were relevant and consistent with the Bank strategy, in that they addressed the main weaknesses in public sector management and aimed at assisting GOM's in implementing the adjustment program. However, ownership at the administrative and technical levels was marred from the beginning as a result of the

fragmented structure of the central ministries. Although this had been identified by the Bank during preparation as a source of potential conflicts and as an obstacle to effective implementation, political pressure prevented any streamlining of those ministries prior to project approval. The negative impact of this situation was underestimated at entry and assistance to policy-making was often undermined by this state of affairs during the whole period covered by the adjustment program. The matter was only solved by a ministerial reorganization after the 2002 crisis. In addition, the design of the operation was too complex with too many different types of activities dispersed over several central and technical ministries, despite the fact that the administration was known to be weak and lacking in coordination capacity.

IMPLEMENTATION AND ACHIEVEMENTS

3.4 Implementation suffered from overambitious goals, complexity in design, and lukewarm commitment to reforms. Equally important, it took place in a fluid political situation, frequent changes in appointments, restructurings of the central ministries, and uncertainties raised by a revision of the Constitution in July 1998. The project did not succeed in adapting to such important and rapid changes. Without strong leadership from GOM, repeated adjustments had to be made in project activities to match strategic realignments by the authorities. At the same time, the project management found it difficult to coordinate various sub-components.

3.5 In July 1998, QAG rated a rapid quality of supervision assessment as "marginal". It noted that: (i) the Bank team was fulfilling a management rather than a supervision role; (ii) structural reforms were severely lagging; (iii) constant political change and staff turnover were requiring continued remedial education of officials on the project and its objectives; and (iv) the project had not taken root. It recommended that, at the mid-term review, the project be more narrowly focused on key priorities of interest to GOM and consistent with structural reforms, with new indicators agreed. It concluded that the focus on development impact was marginal, that design, readiness for implementation, and borrower commitment were questionable, and that the project was too complex.

3.6 In October 1998, the mid-term review recommended a substantial restructuring to facilitate implementation, without modifying objectives. The restructuring was decided on the basis of the following: (i) the QAG assessment; (ii) the revision of the Constitution; and (iii) changes in the organization of key ministries in 1998. In addition, it was largely inspired by the need to refocus support to the implementation of SAC-II, which was under preparation.

3.7 The restructuring, effective on May 1, 1999, consisted of closing some components and streamlining others as follows: (i) the Statistical Office component was closed because 2 sub-components (national accounts and business cycles) had been completed satisfactorily; the third one (household-welfare surveys) was transferred to the MFB component; (ii) the State Secretariat for Economy and Planning component was closed (except for the study fund transferred to the TSA), because of its weaker role after the 1998 ministerial restructuring; (iii) the Civil Service reform component was to be closed by end 1999 (after a national seminar) for lack of political support; (iv) the

Decentralization reform component was closed (except for ongoing activities in the pilot urban centers), because of a change in GOM's strategy on decentralization; and (v) under the MFB component, support to the Treasury was reoriented to its computerization instead of its reorganization.

3.8 In July 1999, the Quality Assurance Group (QAG) did a new rapid quality of supervision assessment. Although it commended the Bank team for bringing the project back on track and refocusing it, it noted that intensive supervision was required, efforts needed to be maintained, and key outcome objectives were to be identified and tracked. It maintained its negative rating for design and readiness for implementation at approval, but revised its rating of GOM's commitment on the basis of its adoption of the program supported by SAC-II (approved in May 1999).

Achievements under Economic Management

3.9 Technical Secretariat for Adjustment (TSA). Assistance contributed to the formulation of the 1996-99 Policy Framework Paper (PFP) and the IMF program and was the main support for the finalization of SAC-I. The TSA carried out surveys and studies in several areas (visas, tourism, fishing licenses, and land tenure, judicial reform, and social security), some of which were eventually included into SAC-II. It also produced a monthly macro-economic indicator note and played an important role in organizing and conducting the public information campaign on the adjustment program. Starting in 2000, its capacity became over-stretched due to increased involvement in the preparation of the I-PRSP and the HIPC initiative, which prevented it from monitoring sectoral reforms and supporting the development of sectoral strategies. Similarly, it limited its ability to coordinate its activities with those of the Statistical Office and the Forecasting Unit at MFB.

3.10 *Statistical Office*. Activities were carried out as planned: (i) the national accounts for 1993-95 were revised in accordance with the 1993 UN methodology and stored on CD-ROM.⁴ Seven national account experts were trained, but five have left the Office since then; (ii) household surveys were carried out in 1997 and 1999 on the basis of an analysis of the 1993 survey to assess the evolution of poverty between these dates. This proved useful in the preparation of the I-PRSP, especially in the regional workshops. At restructuring, the responsibility for poverty monitoring was transferred to (Ministry of Finance and Budget (MFB); and (iii) six business cycle surveys were produced. Despite the satisfactory completion of the tasks planned, the capacity of the Office is still limited.

3.11 *State Secretariat for Economy and Planning*.⁵ The formulation of sectoral policies and corresponding Public Investment Programs (PIPs) and Public Enterprise Programs (PEPs) was not undertaken following the 1998 ministerial restructuring which

⁴ The Statistical Office decided to adopt a new base year, 1995, for its National Accounts, but, as of 2002, the conversion had not been done.

⁵ In 1996, two ministries were responsible for budget preparation, execution and monitoring: MFB was responsible for preparing the current budget and for all budget execution, and the Secretariat for preparing the investment budget and for overall monitoring of GOM's programs. In 1998, MFB itself was divided, and in 2002, the ministries of Finance, Budget, and Economy were merged into a single ministry.

reduced considerably the role of the Secretariat. As a result, there was no solid basis for a reallocation of resources, and the 2000 performance targets with respect to reducing public expenditures, and maintaining the levels of the PIP and of social spending were not met. The component was dropped at restructuring.

3.12 *Ministry of Finance and Budget.* The budget and treasury nomenclatures were unified while budget execution was improved by making appropriations available early to line ministries, by giving spending authority for health and education to deconcentrated offices—Health and School Districts—of the ministries,⁶ and by simplifying several controls. An integrated computerized public finance management system was established as a pilot operation in Toamasina, the country's main port, and was to be installed at the national level. Payroll management was improved by the computerization of a unified data base between the Ministry of Civil Service and MFB. The Permanent Secretariat for Macro-economic Forecasting was strengthened and performed satisfactorily; producing good quality macro-economic frameworks used for the budget, the IMF programs, the PRSP, and the formulation of the HIPC triggers. It also issued an annual review of the macro-economic situation. After the 2002 crisis, it was integrated into the Economic Directorate of MFB.

3.13 An organizational audit of the Treasury was completed by consultants in 1998, but GOM considered that it was of poor quality and not responding to its needs. Its recommendations were not implemented. The remaining funds were redirected to the computerization of operations. Completed in 2000, it allows for timely information on the execution of the budget. With regard to external oversight of public accounts by the Office of the Auditor General (OAG), considerable progress was achieved. As of October 2005, final audited accounts for 1993-98 had been approved by the National Assembly and those for 1999-2001 were with the Assembly for adoption. At the same date, OAG had sent its comments on the 2002 accounts to MFB and was auditing the 2003 accounts.

Achievements under Governance

3.14 *Civil Service Reform.* A substantial amount of work, workshops, audits, and studies, led to the preparation of a new draft statute that was approved by the National Assembly but rejected by the Senate for lack of political commitment and coordination within the administration. Institutional audits were carried out for six ministries leading to reform in some of them: the disengagement from production activities in Public Works and Transport; the reduction of non-permanent staff in Agriculture; delegation of decisions to field managers at the district level in Education; and some lesser restructuring in Justice and Health. Overall, results were mixed because of unclear strategies in decentralization and deconcentration. The component was closed in late 1999.

⁶ The transfer of spending authority to deconcentrated offices was successful in increasing the amount of local control over spending and most districts function more or less. However, the districts focused primarily on infrastructure, mostly rehabilitation of facilities or new buildings. Since facilities were inadequate in any case, this was not wasted investment, but other constraints such as inadequate staffing, lack of staff training, poor teacher attendance, and inadequate teaching/health supplies, were not addressed. Another problem is that the districts remain dependent on the central government budget allocations.

3.15 *Decentralization.* Assistance was interrupted following a change in GOM's decentralization strategy, following the 1998 revision of the Constitution creating new administrative levels.⁷ Many of the revisions, particularly the transfer of competence, budgetary assignments, and the structure of inter-governmental fiscal relations, remained undefined and the nature of inter-relations between levels uncertain. As a result, the project was no longer in a position to influence core policy decisions or provide assistance and guidance in the absence of clear direction. However, the pilot programs to improve local management, establish guidelines on accounting standards, and raise revenue mobilization were successfully implemented in 12 communes and some positive experiments have since been extended to a large number communes. The component was closed at restructuring.

3.16 *Judicial Reform.* There was progress on several fronts: (i) a National School for Magistrates and Clerks was established, which still runs today with funding from the national budget and donors. It now has a section for Magistrates specializing in finance and administration; (ii) the business legislation (commercial code, companies' law, guarantees and securities, etc.) was revised; (iii) several basic laws and other legal publications were reprinted and distributed to all magistrates and other legal personnel, CD-ROMs were widely disseminated, and several secured libraries established; (iv) in 2001, an Arbitration Center was opened; and (v) the provision of materials, supplies and IT equipment permitted to reduce the backlog of cases in the capital and in three provinces.

MONITORING AND EVALUATION AND OTHER ISSUES

3.17 The project included a list of indicators to measure progress under each component, stated in terms of activities, outputs, milestones, and dates. The indicators were adequate and corresponded to the right data to be collected, given the objectives of the project. However, M&E implementation was mixed: for components not dropped after the restructuring, some outputs were produced on time, others with delay, and still others were not produced. For the components terminated at restructuring, many activities were not completed. There is insufficient information to assess – and the ICR does not discuss – the extent to which data collected or outputs produced informed directly decision-making processes and resource allocation. There were no issues with respect to compliance with safeguards and fiduciary requirements.

OUTCOME

3.18 *Unsatisfactory.* As mentioned above, there are few indicators providing quantitative results, partly because of the disruption caused by the restructuring and the numerous administrative and institutional changes. Overall, achievements were mixed and fragmentary due to insufficient commitment, frequent conflicts and changes in the administration, and poor coordination. Economic management was not strengthened as

⁷ The 1998 Constitution created Regions, as distinct from provinces and communes, but, as late as the end of 2003, they had not been established. The new Constitution also created Districts as deconcentrated units of the central government and the most important interface for public service delivery.

expected: results were poor in the management of public resources and their reallocation to the social sectors; sectoral strategies were not redefined and public expenditures and the budget not readjusted accordingly, a major shortcoming in the years leading to the preparation of a PRSP. Leadership and commitment were missing to make strides in governance, and the efficiency of state institutions in delivering public services was not improved, except for some progress under the judicial component. Most opportunities for reform were missed.

INSTITUTIONAL DEVELOPMENT

3.19 *Modest.* Impact on the different ministries and entities involved was limited. Some progress was made in the formulation of the macro-economic framework, the management of the budget cycle, the oversight of public accounts, and the judicial system, but there was no improvement in revenue mobilization (see Table 1 in Section 4). Also, there was no progress in raising GOM's capacity to manage and redirect resources in line with a program of poverty reduction. In fact, there was no attempt to formulate such a program and redesign institutional frameworks accordingly. A broad vision was missing in that respect. Finally, key reforms were abandoned in the areas most likely to raise the efficiency of public expenditure and quality in the delivery of public services, i.e., civil service and decentralization.

SUSTAINABILITY

3.20 *Likely.* The rating is justified on the basis of increased capacity in macro-economic management, budget cycle, treasury operations, and the judiciary. Also, there was no reversal in policies, even in 2002. The consolidation of policy-making and its monitoring under a single ministry after the crisis should facilitate the sustainability of whatever was achieved under the project.

BANK PERFORMANCE

3.21 *Moderately Unsatisfactory.* Quality at entry was unsatisfactory, despite the amount of work that went into project preparation. The Bank overestimated GOM's commitment and paid insufficient attention to the possible consequences of a fragile institutional set-up. The project was also overburdened by too many and too different components. Risks were well identified but insufficient care was taken to define and prepare mitigating measures. In fact, this task turned out to be done by QAG in advocating safeguards against the risk of even greater difficulties in implementation. Although the Bank team heeded QAG's recommendations and acted swiftly by streamlining the project, supervision continued to suffer from poor design at entry. However, task management in the field, permitted a constant dialogue with officials, thus minimizing the risk for negative developments.

BORROWER PERFORMANCE

3.22 *Unsatisfactory.* GOM's commitment was weak, showing no resolve in tackling the institutional problems besetting implementation. GOM was essentially passive, letting the Bank team assume decisions and tasks falling normally under its responsibility. QAG

had characterized the Bank team as “fulfilling a management rather than a supervision role”. With the arrival of SAC-II, GOM became more pro-active, notably in macro-economic management to meet the requirement of maintaining a sound framework. This helped reinforce to a certain extent the structures directly involved in this area, such as the TSA and MFB. However, GOM showed no leadership in promoting the program areas concerned with governance, reallocation of resources, and poverty alleviation.

4. The First Structural Adjustment Credit (SAC-I)

BACKGROUND

4.1 Given GOM’s poor record in tackling reforms, the Bank was very cautious in preparing the project. Active preparation did not start until the following actions had been taken: flotation of the currency in 1994; elimination of subsidies on flour and rice; appointment of independent administrators to the two state-owned commercial banks; lowering of the maximum tariff from 50 to 30 percent; reorientation of budget allocations to primary education, basic health services and social fund community projects; creation (September 1995) of a joint public/private sector group, the Committee for Reflection on Competitiveness (CRC), to develop recommendations to mobilize private investment; and appointment of the Independent Privatization Commission (CIP) (established in January 1995) to draft a new privatization law (enacted in August 1996). Preparation also moved as agreed actions were taken, with all conditions to be met prior to Board presentation. Appraisal took place after Parliament in mid-1996 had voted a motion of no confidence followed by the appointment of a non-political prime minister.

OBJECTIVES AND DESIGN

4.2 The objective was to break Madagascar out of a poverty trap by helping restore investor confidence, specifically by: (i) underpinning a fundamental relaxation of controls and restrictions facing investors and tourists; and (ii) setting the stage for a resolution of the external payment problems of Madagascar (debt rescheduling at the Paris Club and mobilizing exceptional donor support). Actions prior to Board presentation fell under the following headings: (i) *Macro-economic management*: fiscal management; monetary and financial policies; exchange rate policy; and external trade; (ii) *Incentives for private investment in exports and labor-intensive activities*: divestiture of PEs; framework for private sector incentives; tax incentives; banking; petroleum; telecommunications; vanilla; and air transport; and (iii) *Refocusing public expenditures*: restructuring of expenditures towards the social sectors. The Credit consisted of a single tranche, disbursed upon effectiveness. GOM’s program was detailed in a Letter of Development Policy (LDP). Annex B lists actions prior to preparation and prior to Board presentation.

RELEVANCE OF OBJECTIVES AND DESIGN

4.3 The objective was relevant and fully consistent with the 1997 Bank strategy in tackling the main obstacles to growth and to PSD. An implied objective was to provide credibility to the reform program vis-à-vis domestic and foreign investors, creditors, and

donors and to persuade them to extend financial assistance.⁸ By stating that the objective was to break Madagascar out of a poverty trap should be interpreted as only initiating a movement in that direction as it would be unrealistic to expect a three-year reform program to impact poverty significantly. SAC-I, prepared in parallel with the PAIGEP and the PATESP, suffered from the same shortcomings as those mentioned above for the PAIGEP, i.e., uneven commitment and fragmented structure of the central ministries. The design of the operation – a single tranche - was well advised in the circumstances. However, for the same reason, given the fragile political situation and the stop-and-go reforms of the past, there was a high risk of much reduced commitment once the tranche would be disbursed. This is in fact what happened, delaying completion of the reforms listed in the LDP by over one year.

IMPLEMENTATION AND ACHIEVEMENTS

4.4 Implementation was negatively affected by continued political instability and, after disbursement, by reduced commitment to reforms. In addition, the complexity of some components led to unexpected difficulties in execution, particularly in the privatization of PEs, which posed enormous challenges. Also, institutional weaknesses persisted with efforts under the PAIGEP insufficient to overcome them. By the end of 1997, at closing, Bank expectations had not been fulfilled and there was a fairly large unfinished agenda,⁹ most importantly the privatization of the two state-owned banks (BTM and BFV) and of the oil company, SOLIMA. This PPAR assesses implementation and achievements on the basis of actions taken prior to Board presentation and progress made over 1997-98, i.e., until preparation of SAC-II started in earnest in November 1998.

Achievements under Economic Management

4.5 Macro-economic stability was maintained and GDP growth reached 3.7 and 3.9 percent in 1997 and 1998, against targets of 3.0 and 3.5 percent. Growth performance was mainly due to an increase in investment, from 10.9 percent of GDP in 1995 to 14.8 percent in 1998. But there was no progress in revenue mobilization with tax revenues stagnating at 9-10 percent of GDP, a very low level by Sub-Sahara Africa standards. The overall fiscal deficit deteriorated further due to a lower than expected reduction in expenditures. Overall, performance was good in stabilizing the economy, mainly due to the monetary and financial policies pursued (Table 4.1).

⁸ At appraisal in 1996, debt servicing absorbed 45 percent of exports of goods and services starving the country of foreign exchange. In the best scenario calculated at the time, debt rescheduling and exceptional donor financing were expected to cover only half of the gross financing requirements to reach and sustain a reasonable rate of growth, the other half having to be mobilized from foreign direct investment.

⁹ An internal Bank document of January 1998 expresses concern at progress and lists: (i) the actions remaining to be taken prior to engaging the dialogue on SAC-II (sale of the two state-owned banks; completion of the regulatory framework in the petroleum sector and sale of SOLIMA; increased flexibility in issuing visas; reduction in the discrepancy between budgetary allocations and actual expenditures, etc.); and (ii) the proposed measures that would be required for the release of tranches under a second operation (privatization of Air Madagascar and airport infrastructure; further liberalization of the telecom sector; audit of insurance companies and their privatization; audit of pension funds; liberalization of land tenure; effective implementation of liberalization in mining; greater progress in revenue mobilization and expenditures restructuring, etc.).

4.6 Inflation and credit to GOM were kept under control thanks to the Central Bank's tight monetary stance following measures adopted in 1994 (increases in interest rates; increased reserve requirements; and limits to credit to the Treasury). Inflation fell from 49 percent in 1995 to 6.2 percent in 1998, almost on target. The tight monetary policy was also dictated by the need to absorb excess liquidity caused by the indiscriminate lending of the two state-owned banks, which had resulted in large monetary expansion in 1994 and 1995. The exchange rate remained determined by market forces since its flotation in May 1994. A harmonized tariff with three rates (a top rate of 20-25 percent and an average rate of 15 percent) was to be introduced by 1998, but, by the end of the year, only equipment, primary imports and basic consumption items benefited from a 5-15-25 percent rate structure, with a weighted average rate still above 15 percent.

Table 4.1: Selected Economic Indicators, 1995-2002

	1995	1996	1997	1998	1999	2000	2001	2002
Real GDP growth	1.7	2.1	3.7	3.9	4.7	4.8	6.0	-12.7
Inflation, consumer prices	49.1	19.8	4.5	6.2	9.9	11.9	7.4	15.8
Total investment (% GDP)	10.9	12.2	12.8	14.8	14.9	15.0	18.5	14.3
Of which private	4.9	5.0	6.3	6.9	8.0	8.3	11.2	9.5
Of which FDI	0.3	0.3	0.4	0.4	1.6	1.8	2.0	0.2
Tax revenue (% GDP)	8.8	8.8	9.7	10.2	11.0	11.3	9.7	7.7
Fiscal deficit (% GDP)	-4.3	-4.8	-5.6	-6.4	-5.5	-5.3	-8.1	-7.7

Source: IMF, World Bank.

Achievements under Incentives for Private Investment in Exports and Labor-Intensive Activities

4.7 *Framework for Private Sector Incentives and Tax Incentives.* Conditions prior to Board presentation relating to entry and exit visas, work permits, and other restrictions on foreign investment were sustained, while legal monopolies in power, petroleum, telecom, and air transport were lifted. The fiscal incentives formerly provided by the investment code and incorporated into the tax code prior to Board approval were maintained. In addition, taxation of imports designated for the production of exports was reduced; a special service was created to monitor the large taxpayers; the Value Added Tax (VAT) was extended to all activities above a threshold with a zero rate limited to exports; and most exemptions to the VAT were eliminated.

4.8 *Divestiture of Public Enterprises.* The 1996 Privatization Law defined the privatization program and established a legal and institutional framework consisting of: (i) a Privatization Committee (PC) composed of representatives from the private and public sectors and assisted by a Technical Secretariat responsible for coordinating the preparation and execution of privatization transactions; (ii) a Privatization Trust Fund responsible for establishing a share warehousing scheme to hold minority shares in privatized PEs pending their sale to employees of the privatized PEs and the public at large; and (iii) a Social and Regional Development Support Fund responsible for ensuring that benefits of the privatization program would accrue to the less privileged in society. In application of the new law, a decree, issued in May 1997, listed 45 PEs (to which was added the public telephone company, TELMA, in early 1999) slated for privatization. A concomitant law

relating to the settlement of disputes arising out of privatization established an Arbitration Commission. None of these entities, however, was operational at project inception.

4.9 Progress was very slow because of political infighting and strong resistance. By the end of 1998, only a handful of small PEs had been sold or liquidated and the bulk of the privatization agenda was in fact pushed to SAC-II. Specific Board conditions applied to some of the large PEs, but, here also, progress was slow. The sale of Bank for rural Development (BTM) and National Bank of Commerce (BFV), expected by the end 1997, was delayed due to political interference. BFV was sold only in December 1998, and a sale protocol for BTM signed only in April 1999. In petroleum, although the sector had been liberalized in 1995, the legal instruments required to render the decisions effective were issued only before Board presentation. Another Board condition was to allow at least one other oil company to enter the market and compete with SOLIMA, but the very existence of Petroleum Company (SOLIMA) proved to be a deterrent and the condition was modified to the sale of a controlling interest under SAC-II. In telecom, the sector had been liberalized *de jure* prior to Board, but competition became effective only after four mobile phone operators, selected on the basis of competitive bidding, entered the market in 1998. In air transport, the market had also been liberalized, but there was no progress in the sale of Air Madagascar. In sum, by end 1998, little progress had been achieved in privatizing SOLIMA, Telephone Company (TELMA), and Air Madagascar. Different transactions were under discussion but with new conditionality planned for SAC-II.¹⁰

Achievements under Public Expenditures Restructuring

4.10 The objectives of restructuring expenditures in favor of the social sectors were not achieved. Between 1989 and 1994, expenditures on primary and secondary education were generally between 1.6 to 1.8 percent of Gross Domestic Product (GDP) and on health about 1 percent.¹¹ Table 2 shows that minimal progress was achieved in raising allocations for education (total sector) over 1997-98, while allocations for health decreased. Actual expenditures were even lower.¹² Also, monitoring of and reporting on expenditures for the sectors were expected to be strengthened, but little was achieved, and institutional strengthening in that area was incorporated into SAC-II.

¹⁰ Although there was no SAC conditionality for the vanilla sector, GOM withdrew its support to IVAMA, the trading parastatal, and, in 1997, the export tax on vanilla was abolished. At end 1998, IVAMA was under liquidation.

¹¹ As a condition of Board presentation, the 1996 budget allocations for education and health were increased by 0.1 percent of GDP. Neither the Government's Medium-Term Adjustment Program for FY1996-99 nor SAC-I contained specific targets for further years for expenditures in the social sectors. GOM's program referred only to "Increase social spending, in particular on basic health care and primary education".

¹² The breakdown of allocations to the education sector by level and actual expenditures is not available.

Table 4.2: Budget Allocations to Social Sectors, 1995-2002

	1997	1998	1999	2000	2001	2002
Education						
In % of total expenditures	10.5	12.7	11.8	12.8	12.2	14.0
In % of GDP	1.9	2.3	2.5	2.9	2.8	3.4
Health						
In % of total expenditures	7.8	6.6	6.7	8.1	7.3	8.0
In % of GDP	1.4	1.2	1.4	1.8	1.7	1.9

Source: Loi de Finances

MONITORING AND EVALUATION AND OTHER ISSUES

4.11 SAC-I did not contain any specific monitoring indicators or milestones to assess progress after disbursement of the tranche at effectiveness. Progress was monitored by reference to GOM's commitments under its FY96-99 reform program. There were no issues with respect to fiduciary safeguards.

OUTCOME

4.12 *Moderately Satisfactory.* Some objectives were met, others only partially, and still others were not. Macro-economic stability was maintained, inflation declined substantially, and prior achievements in exchange rate and trade policies were sustained. The business climate was somewhat improved with better incentives for PSD, but effective implementation left much to be desired. In three important areas, progress was very limited: (i) the privatization of BTM was considerably delayed; (ii) although the legal monopolies in telecom, petroleum, and air transport were abolished, no progress was achieved in privatizing the incumbent companies or in attracting competition, except for mobile phone operators; and (iii) expenditures were not redirected to the social sectors. Despite the numerous shortcomings, the rating is justified on the basis that SAC-I was the first - and important - step to opening the economy to market forces and to the outside world. Changing the climate was a valuable outcome, given the isolation of the country since independence.

INSTITUTIONAL DEVELOPMENT

4.13 *Modest.* Institutional capacity was somewhat strengthened in the areas of trade and PSD and the public and private sectors entered into a dialogue on incentives for investment. However, there was little progress in the management of the public sector, either in the PE divestiture program, where vested interests and opposition remained strong, or in the ability to redirect resources to poverty reduction. There was definitely less GOM's ownership in those areas with a corresponding lesser interest in strengthening the responsible ministries and entities.

SUSTAINABILITY

4.14 *Likely*. There was no reversal in policies. Moreover, the initial steps taken under SAC-I permitted to arrive at a consensus on the content of SAC-II. From then on, it became clear that it would have been very difficult for any government to backtrack on reforms.

BANK PERFORMANCE

4.15 *Satisfactory*. The key conditions for opening the economy were well identified and prioritized. In that sense, quality at entry was satisfactory, but, at preparation, the Bank overestimated GOM's commitment, a shortcoming which affected also the PAIGEP and the PATESP. The Bank correctly made the processing of the project conditional on actual progress, given the country's prior record. It was also right, after disbursement, to insist on pursuing the agenda before launching the appraisal of SAC-II. This period provided the Bank with the necessary insight into GOM's priorities and constraints and thus helped clarify the content of SAC-II. However, the Bank did not seize the opportunity to deepen the dialogue on the conditions amenable to widening the tax base, raising revenue, and redirecting resources to the social sectors. It became too absorbed by the privatization of the large PEs.

BORROWER PERFORMANCE

4.16 *Moderately Satisfactory*. Performance varied according to components and degrees of commitment and ownership. Discipline was demonstrated in macro-economic management and in curbing inflation and there was some commitment to liberalize the PSD framework. But GOM was unable to overcome the obstacles to privatization and to initiate a program to improve public services and start tackling poverty reduction.

5. The Private Sector Development and Capacity Building Project (PATESP)

BACKGROUND

5.1 The project had its origin in the economic and sector work by the Bank and IFC in the early 1990s,¹³ which had identified the obstacles to private sector-led growth and highlighted the need to improve the general business environment and strengthen the managerial, technical, and financial capacity of existing enterprises. Also, in 1994-95, the private sector had become increasingly vocal in demanding reforms and progress in privatization. With the new leadership in place in mid-1996, the stage was set to design a project aimed at supporting the PSD components of the reform program. The new climate had allowed setting clearer objectives for PSD under SAC-I.¹⁴

¹³ Madagascar: New horizons – Building a Strategy for Private Sector, Export-led Growth. A Private Sector Assessment, Report No. 14385-MAG, May 31, 1995.

¹⁴ SAC-I and the PATESP were approved by the Bank Board two months apart in March and May 1997.

OBJECTIVES AND DESIGN

5.2 The objective was to support accelerated export-led growth, specifically by: (i) designing and implementing reforms in market deregulation, de-monopolization and competition, PE divestiture, and the tax system to address major constraints to increased private investment, efficiency, exports, and job creation; (ii) fostering an improved government-private sector dialogue; and (iii) strengthening capacities and skills of private firms and associations. The Credit supported two reform programs:

5.3 The *Economic Policy Reform Program*, consisting of: (i) design and implementation of reforms in the business environment and private sector incentives; (ii) support to privatization, including the establishment of the PC and its Technical Secretariat, the Privatization Trust Fund, the Social and Regional Development Support Fund, a Retraining Fund to finance the training and redeployment of employees affected privatization (later institutionalized under the name Programme d'Action Sociale et Economique pour la Réinsertion Professionnelle - PASERP),¹⁵ and the Arbitration Commission; and (iii) tax reform (modernization of the VAT and strengthening of the fiscal and customs administrations - component to be monitored by the Fiscal Affairs Department of the IMF).

5.4 The *Private Sector Capacity Building Program*, consisting of: (i) establishment of a Private Sector Support Fund (PSSF) to provide private firms and business associations access to support services, international data, and market sources; (ii) TA and other support to the CRC; (iii) establishment of a Seminars Fund to finance seminars between GOM and the private sector on competitiveness; and (iv) establishment and operation of a FDI match-making scheme through the creation of a Match-making Fund.

RELEVANCE OF OBJECTIVES AND DESIGN

5.5 The objective was highly relevant and consistent with Bank strategy. In addition to strengthening GOM's capacity to carry out the reforms, the project aimed at raising the capacity of domestic firms by exposing them to foreign operators and world markets. However, it attempted to tackle too many different aspects of privatization and PSD, and, as a result, its design was overly complex: activities were spread over several entities, some functioning, others existing on paper only, and still others to be created; conventions were required to make some proposed funds operational; procedure manuals and implementation plans were to be drafted, etc. All these proved to be a constraint to a rapid start of the project.

IMPLEMENTATION AND ACHIEVEMENTS

5.6 Effectiveness of the Credit was delayed by 9 months, from May 1997 to February 1998 (against one month expected at appraisal), to satisfy the several conditions relating

¹⁵ The inclusion of a Retraining Fund, with SDR2.3 million, was decided at negotiations, without a precise institutional set-up. It was institutionalized in October 1997 as Programme d'Action Sociale et Economique pour la Réinsertion Professionnelle (PASERP), effectively established in October 1998, and became operational only in April 1999. It was a follow-up to the Programme de Réinsertion Professionnelle (PRP) established under EMSAP.

to the complex institutional set-up mentioned above. In this context, pressure from vested interests and political interference became additional causes of delay. Before effectiveness, QAG had conducted a quality at entry assessment, rated as marginal. It had noted the over-complexity of the project, the questionable commitment of the authorities, the lack of readiness for implementation, the inadequate risk assessment, and the mismatch between the capacity of the entities responsible for implementation and the tasks expected from them. The assessment had concluded by recommending to reduce the number of components and to sharpen the focus of intervention.

5.7 The project was restructured in July 1998, without changes in objectives. Three components were dropped, none of them having started by then: (i) the tax reform on the basis of an improved dialogue in preparation of SAC-II (which by then had an increased focus on liberalization and privatization);¹⁶ (ii) the Match-making Fund on the basis of negligible success and impact;¹⁷ and (iii) the Seminars Fund on the basis of the need for a sharper focus. The ICR notes that, in retrospect, quality at entry was indeed marginally satisfactory. IEG concurs with this assessment. The restructuring led to a much leaner project, and, as preparation of SAC-II progressed, its focus improved and narrowed. It became the main vehicle to provide support to PSD and to the privatization of the incumbent companies in telecom, air transport, and petroleum. The PATESP agenda was increasingly driven by the requirements to meet the conditions for tranche release under SAC-II.

Achievements under the Economic Policy Reform Program

5.8 *Market Liberalization and Private Sector Incentives.* A Facilitation Center was created to facilitate access to information and simplify business creation and registration procedures, but remained largely non-operational.¹⁸ Procedures for obtaining work permits and visas were simplified. In the mining, telecom, air transport, and petroleum sectors, the primary and secondary legislation was completed (competitive licensing award, technical standards, price adjustment mechanisms) and the capacity of the regulatory bodies was strengthened in licensing procedures, compliance with international standards, and monitoring.

5.9 *Public Enterprise Divestiture.* The privatization program was to be implemented in three phases over five years (1997-2002), covering 120 PEs. In phase I (1997-98), 46 PEs would be privatized or liquidated.¹⁹ Assistance consisted mainly of financing international experts to the PC and its Technical Secretariat to design privatization strategies and prepare transactions. From the onset, Bank missions also played a significant role in advising on the structure and sharing of responsibilities between the PC and its Secretariat, since these were the key actors in the divestiture process. During

¹⁶ There had also been a disagreement on the modalities of a bonus incentive scheme linked to tax collection, which were a condition of disbursement under that component.

¹⁷ Despite a pilot phase prior to appraisal which had been characterized by the Bank team as a complete success.

¹⁸ A fully functioning "one stop shop" was established only in 2003 under the successor project, the Private Sector Development Project-II (PSDP-II), approved by the Board in August 2001, (Cr. 3567-MAG).

¹⁹ Out of these, there were 11 large companies dominating major sectors, 30 smaller ones slated for divestiture, and 5 slated for liquidation.

supervision, the Bank advised on procurement procedures, proper sequencing in the privatization process, active communication campaigns, and timely preparation and implementation of social safety net measures. By Credit closing, the divestiture program was not completed due to resistance from vested interests, the complexity of some transactions, and the inordinate amount of time and energy spent on the large PEs in support of SAC-II.²⁰ GOM was supposed to set-up a tracking system to monitor fiscal transfers to PEs but it failed to do so. A Country Financial Accountability Assessment conducted in 2003 concluded that few transfers had been abolished and that the Treasury did not have the capacity to monitor the financial situation of PEs. Under the scheme to promote local ownership, a strategy for the distribution of shares in privatized companies (criteria, mechanisms, etc.) was developed, but the fund was not operational by Credit closing.

5.10 The PASERP was meant to mitigate the social costs of the program. However, after becoming operational in April 1999, its mandate was substantially broadened from financing severance payments to becoming the main body responsible for all social aspects of privatization. It thus became overwhelmed by activities incommensurate with its capacity and staff, all the more so that it had been assigned responsibility also for the Social and Regional Development Support Fund. This created considerable confusion in the execution of the program. For the three years 1999-2001, only 821 employees benefited from the program out of 2,256 eligible beneficiaries.

Achievements under the Private Sector Capacity Building Program

5.11 *Private Sector Support Fund.* The Fund was established successfully and acted as intermediary between recipient firms, mostly SMEs and business associations, and local and international suppliers of business services. It received 1,532 requests, of which 809 were approved for a total amount of US\$5.9 million, of which 66 percent were financed by the Fund. According to a November 2002 survey, 83 percent of beneficiaries were satisfied of the support provided. The Fund also played an important role in facilitating accreditation of ISO norms in quality, environment, and accounting, and in supporting the launching of the African Growth Opportunity Act and the US-Madagascar Business Council. These latter initiatives led to a substantial increase in trade and investment between the US and Madagascar. Despite its success, the Fund was closed after the 2002 crisis because it was deemed by GOM to have too much autonomy in managing its budget.

5.12 *Government/Private Sector Dialogue.* The CRC was very active in debating issues and in airing them in the media and it contributed to launching a consultative process involving the private sector, civil society and public/private partnerships. However, its impact remained limited in terms of influencing GOM decisions in policy making. It was dissolved after the crisis and replaced by a much less independent entity composed in part of ministers.

²⁰ By December 2002, strategies were completed for 35 companies and transactions for 17, including 10 that were liquidated.

MONITORING AND EVALUATION AND OTHER ISSUES

5.13 The project document contained a matrix of performance indicators per component, stated in terms of units (e.g., number of firms, values, percentages, etc.) and sources of measurement by the end of the project (i.e., by PY5). While the nature of the indicators was adequate, the measurement units and the targets by PY5 implied in many cases the existence of data (from the statistical office, reports, surveys, etc.) unlikely to be readily available. There is insufficient information about whether data were actually collected during implementation and, if so, how they were utilized. The ICR limits itself to record achievements under each component. There were no issues with respect to compliance with fiduciary safeguards.

OUTCOME

5.14 *Moderately Satisfactory.* The project contributed indirectly to the growth performance of the second half of the 1990s by helping GOM implement - with reasonable success - its PSD and divestiture policies, despite the difficulties encountered. This positive outcome is due to the refocused objectives after restructuring, reducing the risks of dispersion. The fact that the privatization program was not completed does not alter fundamentally this assessment, as the priority given to the large PEs was deliberate to have a demonstration effect of the role of the private sector, as illustrated by the surge in FDI over 1999-01 (Table 1 in Section 4). It remains however that a very large portion of the privatization program was postponed (as of end 2005, it was still not completed). The activities directed at SMEs also contributed to reaching the objective. Unfortunately, this component was not carried over under the successor project (Private Sector Development Project-II (PSDP-II), approved by the Board in August 2001), following the decision of the post-crisis government to discontinue the scheme. In sum, the PATESP led to much progress considering the situation from which the reform process started, and, without it and the advisory role of the Bank, results under the program would have been very different. However, as early as 2000-01, it was clear that a successor project would be needed to complete the agenda. This proved to be a sound decision, as the PSDP-II, effective since November 2002, became the main vehicle to consolidate the still fragile achievements of the PATESP.

INSTITUTIONAL DEVELOPMENT

5.15 *Substantial.* The project succeeded in strengthening some institutions, not least by making them operational to carry out their mandate. The main beneficiaries were the Technical Secretariat of the PC and the regulatory authorities. However, after closing, these were still weak and in need of further support to build their staff and expertise – a serious challenge given the complexity of the tasks involved. Thus, continued support was provided under PSDP-II. On the other hand, the project had no impact on the two funds aimed at disseminating ownership in privatized PEs and it is questionable whether they were a priority in the circumstances. Similarly, there was little impact on the PASERP due to its change in mandate that blurred its original objective. In contrast, a serious loss was caused by the decision to dismantle the Private Sector Support Fund.

SUSTAINABILITY

5.16 *Likely*. There was no major reversal in policies that might have affected negatively the support provided by the project, even during the 2002 crisis. Most of the benefits were sustained even though further strengthening under PSDP-II was needed. The extent to which the benefits gained under the PASERP are sustainable is not known (it was also extended under PSDP-II). But the benefits associated to the activities under the CRC and Private Sector Support Fund components are unlikely to be sustained since their activities were discontinued. Overall, the benefits generated were resilient to the effects of the crisis and mitigated its adverse impact on economic performance.

BANK PERFORMANCE

5.17 *Satisfactory*. Although quality at entry with respect to design was unsatisfactory, the analytical work carried out by the Bank during preparation was a solid basis for defining the content of reforms. Bank performance during supervision was satisfactory, with consistency in support and staffing. Of particular importance, the Bank reacted positively to QAG assessment by narrowing the scope of the project while preserving its key objective. The alignment of assistance with the SAC-II agenda was also well advised, since this was the cornerstone of the adjustment program. Finally, the decision to launch a successor project was timely.

BORROWER PERFORMANCE

5.18 *Unsatisfactory*. GOM's commitment to reforms was lukewarm well into project implementation. Resistance from vested interests and from political quarters responsible for key sectors, as well as poor coordination and poor governance within the administration, interfered with and delayed the implementation of the privatization program.²¹ In addition, GOM showed no coherent vision for the role of PASERP and underestimated the potential role of the Private Sector Capacity Building component as an indispensable complement to public policies. It erred in dissolving the successful Private Sector Support Fund and in undermining the independence of the CRC, two structures that could have strengthened PSD further. These shortcomings showed the continued skepticism of GOM vis-à-vis the role of the private sector.

²¹ The divestiture of SOLIMA was tainted by a transparency issue in the award of bids, with the authorization of the PC.

6. The Second Structural Adjustment Credit (SAC-II)

BACKGROUND

6.1 The President's Report of SAC-II stressed the continued validity of the 1997 CAS and noted that progress under SAC-I had been slower than expected, particularly because of inadequate ownership of specific reforms, such as in privatization. In addition, it argued that, with a single tranche under SAC-I, the Bank had not had the leverage to push the reform agenda forward. Eighteen months had been spent in completing the SAC-I agenda after its disbursement. Only then did the Bank feel that preparation of a second operation could be launched. This had created a dilemma, however, because, in the absence of Bank involvement and sustained reforms, donors had been reluctant to provide budget support. Indeed, a major concern of the Bank since early 1998 had been to press for the adoption of highly visible measures as a justification to start actively preparing a second operation, and thus send a strong signal to the donor community to extend budget support in 1998.

OBJECTIVES AND DESIGN

6.2 The objective was to achieve higher growth and reduce poverty by: (i) consolidation of macro-economic stability; (ii) privatization and introduction of competitive regulatory frameworks; (iii) improvement in the business environment by targeting promising sectors and promoting transparency in licensing for the exploitation of natural resources; and (iv) strengthening of public finance by expanding the tax base, increasing non-tax revenues, and ensuring that resources allocated to the social sectors were effectively used for the poor. The design reflected the lessons from SAC-I. The issue of leverage was addressed by adopting a multi-tranche "menu-based" approach recognizing that implementation evolved over time and that flexibility was needed. The Credit had three tranches, with amounts increasing in steps. Excluding the general condition of maintenance of macro-economic stability and including those prior to Board presentation, there were four sets of conditions (see Annex C).

- First, conditions prior to Board presentation covered the completion of SAC-I measures and some additional ones: (i) reforms in the telecom, mining, fisheries, and exemption regime; (ii) adoption of an Arbitration Law; (iii) reconciliation of the budget and treasury classifications; and (iv) signing of a sale protocol for BTM.
- Second, effectiveness of the Credit and disbursement of the first tranche were subject to conditions ensuring progress before disbursement and a greater chance of success in implementation, especially of the privatization program. They included: (i) submission of a detailed action plan for the implementation of the PASERP;²² (ii) establishment and registration of joint ventures relating to the sale of SOLIMA's oil operations and conclusion of contractual arrangements relating to the transfer of

²² Even though this provision was specified in the Development Credit Agreement (DCA) as condition of effectiveness, it applied to the release of each tranche, as a Supplemental Letter stated that it was to be read as part of the general condition of "satisfactory progress in the carrying out of the program".

ownership of its non-oil operations; and (iii) establishment of a legal and regulatory framework, including the regulatory body, for the petroleum sector.

- Third and fourth, each of the second and third “menu-based” tranches would comprise a core measure and additional measures in PSD and/or in public finance reform. Each core measure would involve the sale of either TELMA or Air Madagascar (including the establishment of a fully operational regulatory framework and body). The additional measures were to be selected from a total of four PSD areas and four public finance areas.²³

PSD areas:

- *Measure 1: Mining:* enactment of a revised Mining Code, including implementation decrees; and action plan to expedite the processing of mining permit applications;
- *Measure 2: Land tenure:* facilitation of access to land; and invitation to investors to submit bids for five tourism and five industrial zones;
- *Measure 3: Business environment and judicial processes:* (a) action plan to improve caseload management and substantive progress in the same; and (b) action plan for the purpose of streamlining formalities/procedures required to carry out economic activities, and substantive progress in the same; and
- *Measure 4: Sector liberalization and additional sector reforms:* (a) granting at least two airport concessions to qualified and experienced private operators; (b) invitation to telecom operators to bid for a national license; and (c) enactment of a law and issuance of decrees governing the fiscal regime of large mining projects.

Public finance areas:

- *Measure 5: Revenue policies and monitoring:* establishment of a unit within the Ministry of Budget to monitor public revenues and to review medium and long-term tax policy and tax administration reforms;
- *Measure 6: Expenditure monitoring in social sectors:* (a) establishment of a monitoring system to capture the implementation of social policies and expenditures actually incurred for primary education and basic health; and (b) carrying out of a survey to assess performance in the delivery of primary education and basic health services;
- *Measure 7: Fishing licenses:* (a) establishment of a system to allocate shrimp fishing licenses in a non-discretionary, competitive and transparent manner; (b) annual adjustment of shrimp fishing fees in accordance with the new allocation system; and (c) carrying out the recommendations of the audits of the Fonds de Développement Halieutique et Aquicole (FDHA); and
- *Measure 8: Financial sector reforms:* (a) carrying out the financial, organizational and actuarial audits for two insurance companies and three social security funds; and (b) adoption of action plans to improve their performance.

²³ The exact language of the additional measures is in Annex C.

6.3 Thus, the second tranche would be released after one core measure and at least four out of eight additional measures were completed, the choice being left to GOM. In addition, it was subject to either completing the sale of BTM as per the April 1999 protocol or, in case of unsuccessful negotiations, proceeding with divestiture. The third tranche would be released after the remaining core and additional measures were completed.

6.4 The Bank's Regional Operation Committee agreed to raise the amount of the Credit from US\$75 to US\$100 million to cover the social cost of the privatization program. However, there was no provision, either in the DCA or in GOM's legislation, specifying such an allocation to the PASERP and no such allocation were made. The two-year reform program, detailed in a LDP, was to be completed by December 31, 2001.

RELEVANCE OF OBJECTIVES AND DESIGN

6.5 The objective was highly relevant and consistent with Bank strategy, with emphasis rightly placed on: (i) completing the privatization of the large PEs (indeed, in hindsight, this proved to be the centerpiece of SAC-II); (ii) promoting the liberalization of sectors with a good potential for growth; and (iii) strengthening the management of public resources to widen the tax base and redirect expenditure to the social sectors. Since there had been no budget support from the Bank in 1998, the project highlighted the need for Madagascar to obtain external support to sustain macro-economic stability and expenditures on basic services. The design was also relevant in that it responded to the situation faced after the disbursement of SAC-I, when it had become clear that reforms had lost their momentum and commitment had subsided. The "menu-based" approach was realistic and the inclusion of a program to mitigate the social impact of privatization was well advised.

IMPLEMENTATION AND ACHIEVEMENTS

6.6 Implementation was much slower than expected and was directly and negatively affected by two external shocks (three cyclones and the sharp increase in oil prices in 2000) and by the political crisis of the first half of 2002. These led to sudden shifts in priorities. To start, there was a delay of 13 months between approval (May 1999) and effectiveness (June 2000) due to the complex negotiations and unforeseen complications in the privatization of several lots of SOLIMA (see para.6.2), that were exacerbated by the increase in oil prices. The first tranche was disbursed in July 2000.

6.7 Between February and April 2000, Madagascar was hit by three cyclones with considerable damages in parts of the country. The Bank approved a Supplemental Credit of US\$20 million in July 2000 to provide: (i) fast-disbursing foreign exchange to compensate partially for lower export earnings and higher import needs in 2000 and 2001; and (ii) counterpart funding for the reconstruction of health and education facilities, roads, bridges, etc. GOM took upon itself to monitor and evaluate reconstruction and decided, despite the absence of conditions prior to disbursement, to withdraw funds from the Credit in two installments, the first upon effectiveness, and the

second after completion of 50 percent of reconstruction in the most affected areas.²⁴ The first installment was disbursed in September 2000. Reconstruction took much longer than planned and the second installment was disbursed only in July 2002.

6.8 The doubling of oil prices between 1998 and 2000 to more than US\$30 per barrel put heavy pressure on foreign exchange and the stabilization program, with additional financing requirements for 2001 estimated at US\$80 million. The Bank approved a second Supplemental Credit of US\$30 million in December 2000 to cushion the impact of the oil shock and avoid disruption in program implementation. The counterpart funds were to reduce the specific taxes on petroleum products and/or maintain existing rebates to mitigate the impact on the poor. The balance of the financing gap was expected to be filled by extraordinary donor contributions and higher export growth. The Credit was disbursed in June 2001, without conditions.

6.9 Although implementation continued to be slow and uneven during 2001, the Bank was of the opinion that, overall, the program was achieving its objectives, given the maintenance of a relatively strong macro-economic performance in a stable price and deficit environment. For second tranche release, GOM had chosen, by mid-2001, the privatization of TELMA over Air Madagascar.²⁵ It had planned to send an invitation to negotiate to the winning bidder, upon receiving the bids in December 2001. However, with the conditions relating to the regulatory framework already fulfilled and four of the eight additional conditions also met (1: mining; 3: business environment and judicial processes; 5: revenue policies and monitoring; and 6: expenditure monitoring in social sectors - see para. 6.2), the Board approved in December 2001 a waiver to the requirement of a sale of 34 percent of TELMA's voting stock to avoid undue pressure on GOM during negotiations. Instead, issuance of the invitation to negotiate was considered as meeting the core condition. At the same time, the closing date was extended from December 2001 to December 2002, and the second tranche was released in January 2002.

6.10 Following the crisis of 2002, consultations between GOM and the Bank were held in July/August 2002 to take stock of progress achieved and to review the priorities of the new government to readjust the program accordingly. The review concluded as follows: (i) since December 2001, no progress had been made in financial sector reforms (audit of pension and savings funds), in facilitating access to land, and no invitation had been sent to investors for the development of tourism and industrial zones; (ii) there had been progress in the mining sector (adoption of a law on large mining projects) and in air transport (in May 2002, GOM had signed a two-year management contract with Lufthansa Consulting to operate Air Madagascar); (iii) during the crisis, illegal licenses had been issued in the fishery, mining, and forestry sectors by various officials; and

²⁴ GOM planned to withdraw the second installment after 350 primary schools in the 10 most heavily damaged school districts and 33 out of 82 primary health centers destroyed had been rehabilitated, reequipped, and staffed.

²⁵ A tender to sell a majority stake in Air Madagascar had been launched in 1999 but had not been brought to closure.

(iv) after the crisis, the new government had launched a series of emergency measures to tackle corruption and strengthen public financial management (see para. 6.22 below).²⁶

6.11 Upon completing the review, the Credit was restructured and the conditions for third tranche release revised, with a notable shift in favor of governance and financial management. Some conditions were amended, others deleted, and still others added. The core measure relating to air transport was amended from the sale of a majority of shares in Air Madagascar to the signing of a management contract. The additional measures 2, 4, 7 and 8 were modified as discussed below. Annex D lists the changes in detail. On the whole, the conditions were substantially diluted: not only were they less constraining, but they essentially confirmed measures taken since the end of the crisis in June/July 2002, thus ratifying a de facto situation. GOM and the Bank agreed on a supplement to the original LDP and on amendments to the DCA. The Board approved the restructuring in September 2002 and the tranche was released in October 2002.

Achievements under Economic Management

6.12 Up to the end of 2001, macro-economic stability was maintained. Growth reached an average of 5.2 percent over 1999-2001 due to the good performance of private investment, in particular of foreign direct investment (FDI) in textiles, petroleum, and mobile telephony, with a large spillover effect on small businesses and employment. There was also a substantial increase in tourism. Inflation remained contained, hovering just below 10 percent per year. But tax revenues continued to perform poorly, stagnating at an average of 10.6 percent of GDP over 1999-01 as a result of tax exemptions, weak tax administration, and widespread fraud in the run-up to the presidential elections of 2001. The fiscal deficit rose from an average of 5.6 percent of GDP over 1996-98 to an average of 6.3 percent over 1999-01 (Table 1 in Section 4). The crisis led to a dramatic reversal in performance, with GDP falling by 12.7 percent in 2002, and investment from 18.5 percent of GDP in 2001 to 14.3 percent.²⁷ After the crisis, the economy rebounded with a cumulative growth rate of about 15 percent over 2003-04.

Achievements under Privatization and Competitive Regulatory Frameworks

6.13 The LDP specified that the state had total or partial ownership of about 136 enterprises and that, by June 30, 2000, it would sell its controlling interests in—or proceed with liquidations of—46 of these, i.e., the list of May 1997 plus TELMA. However, SAC-II included specific conditions only for BTM, SOLIMA, TELMA, and Air Madagascar. As a result, and as noted earlier, SAC-II focused on these latter three and on concluding BTM's transaction, which was a condition of second tranche release. Divestiture of the other PEs continued to be carried out under the PATESP.

6.14 The sale of BTM was completed in November 1999. In the petroleum sector, the regulatory framework and regulatory body became operational in September 1999, but

²⁶ During the crisis, corruption had flourished, public resources squandered, and the President' Special Funds overspent to the tune of US\$25 million vs. a budgeted amount of US\$400,000.

²⁷ The largest drop was in FDI, falling from US\$93 million in 2001 to US\$8.5 million in 2002 and, in the textile sector where foreign investment dominated, output fell by 81.1 percent.

the sale of SOLIMA and of its subsidiaries proved to be a long and arduous process. The division of the assets into lots raised difficult issues of property rights and land tenure, and required the creation of several joint ventures. The complexity of the operation was exacerbated by the increase in oil prices as GOM and the new owners had to agree on a timetable and a formula to align domestic and world prices. The transaction was deemed completed in June 2000, with the sale of the refinery and the oil terminal at Taomasina, thus clearing the way for Credit effectiveness. However, the transactions of the other lots (logistics, distribution, etc.) were concluded much later, the last one in March 2005.

6.15 The privatization of TELMA was considerably delayed due to contested property rights, litigation over bidding procedures, and the political crisis. The transaction was finally closed in June 2004, with DISTACOM, a Hong Kong group, holding 68 percent of the shares (34 percent from the state and 34 percent from France Telecom for a total of US\$25.2 million).²⁸ The objective of inviting a second fixed line operator was abandoned at restructuring, although GOM reserved the right to launch a bid to that effect. In air transport, the regulatory authority was established in 1999, but the privatization of Air Madagascar was abandoned. After a bid was launched in February 1999, the process stalled due to an unsettled claim of the US Exim Bank on the airline's largest asset, its Boeing 747. In addition, the events of September 2001 and the crisis led to a sharp deterioration in the financial situation of the company making its sale unattractive. This led GOM to revise its strategy in favor of a management contract with Lufthansa Consulting, signed in May 2002 and renewed in May 2004. In this climate, the twin objective of privatizing airport infrastructure was temporarily abandoned.

6.16 To sum up, achievements were mixed and considerably delayed. The number of issues encountered in the privatization of the large PEs, together with resistance from some political quarters and labor unions, absorbed an enormous amount of time and energy for both GOM and the Bank. By project closing, none of the three major privatizations had been completed by the original deadline. Moreover, there were many shortcomings, such as incomplete adherence to procedures, lack of clarity in the functions of the PC vs. the secretariat, and lack of expertise in the latter. Finally, IEG notes that the ICR is silent on the divestiture of the remaining 43 PEs, an indication of the overwhelming attention accorded to the three major companies. After December 2002, the privatization program was carried over under PSDP-II.²⁹

Achievements under Improvement in the Business Environment

6.17 The project aimed at improving the business environment by targeting promising sectors and promoting transparency in licensing for the exploitation of natural resources. Three sectors were targeted as initial engines of growth: mining, fisheries, and tourism.

²⁸ The state currently holds 22 percent; TELMA's personnel holds 4 percent; and 6 percent are to be transferred by the state to the Privatization Trust Fund.

²⁹ As of end May 2005, of the 43 remaining PEs, 24 had been sold and 5 liquidated; bidding documents were under preparation or sent for 4 companies; consultants were being recruited to prepare the bidding documents for 6 companies; and bidding was suspended for 2 companies. The Northern Railway Company was operating under concession and a concession agreement was under preparation for the Southern Railway Company (Source: Internal Bank document of August 2005).

In mining, a new transparent and non-discriminatory regulatory framework (additional measure 1)³⁰ was put in place with the enactment of a new Code in 1999, a new cadastre in May 2000, and the enactment of a law governing the fiscal regime of large mining projects (at restructuring, additional measure 4 was limited to the enactment of that law, while the conditions relating to airport concessions and a second telecom company were dropped).

6.18 In fisheries (measure 7), license fees for shrimp fishing were raised by 100 percent in 1999 and, in June 2000, GOM adopted an allocation system based on transparent, competitive, and non-discretionary delivery of licenses. The system functioned for the 2000 season, but failed already in 2001, as operators entered into informal cartel agreements in submitting their renewal bids. At restructuring, the requirements of adjusting annual fees in accordance with the new system and of carrying out the recommendations of the audit of the Fonds de Développement Halieutique et Aquicole were removed (the audit had not been done). A new requirement was added, i.e., that the forestry sector be subject to a similar licensing system as for fisheries, and this was adopted in August 2002. In addition, the revised measure 7 required a review of all licenses granted in the two sectors and the withdrawal of those issued illegally. During the crisis, illegal licenses had been widely issued by local authorities. As noted above, no progress was achieved in developing tourism and industrial zones (this was dropped under measure 2 and replaced by actions pertaining to governance - see below).

6.19 In the area of judicial processes, an action plan to improve caseload management was prepared and approved by the Bank in 2001, but was not implemented pending the findings and recommendations of a forum tasked to expedite judicial proceedings.³¹ However, before approval of the plan, the Ministry of Justice had already adopted a number of measures with some success. In the area of business environment, an Arbitration Law was adopted and a Center for Arbitration and Mediation set up before Board presentation, but recourse to arbitration is limited because of the high costs. On the basis of consultations with the private sector, measures aimed at streamlining the formalities for enterprise creation and for environmental appraisals were adopted but they were hardly implemented (see additional measure 3 para. 6.2).³²

Achievements under Public Resource Management

6.20 A Technical Unit on Revenue Monitoring was created in the Budget Ministry in March 2000 to collect, analyze, and disseminate data relating to public revenues and a group was made responsible for formulating medium and long-term fiscal policy (see measure 5 para.6.2). In December 2001, the Unit issued a report on revenues at the central and decentralized levels and on trends in tax collection over five years. However, it did not succeed in analyzing the determinants of revenue, closing tax loopholes, and

³⁰ In September 1999, as condition to Board presentation, the permit allowing a military entity, the Office Militaire National des Industries Stratégiques (OMNIS), to engage in mining activities had been withdrawn.

³¹ A revised action plan was to be prepared on the basis of the conclusions of the forum, but had not been done by the time the ICR was written (June 2003).

³² As noted above, an effective “one stop shop”, under the acronym of GUIDE, was created only in October 2003 under PSDP-II.

identifying weaknesses in tax administration or ways to broaden the tax base. Nonetheless, the creation of the Unit, the submission of its report, and the prospect of a conference on tax policy in 2002 were considered as meeting the condition for second tranche release. During the crisis, the Unit was dissolved.

6.21 In 2000, GOM established a system by which spending decisions for education and health were delegated to deconcentrated offices to speed up the use of budget allocations in outlying areas (see measure 6 para. 6.2). A Technical Monitoring Unit of Social Expenditures was created to monitor social policies and expenditures actually incurred, including performance under the new deconcentrated system. It carried out a tracking survey to analyze the proportion of budget flows actually reaching primary education and health centers and produced quarterly reports on expenditures based on budget items and functions. However, it failed to produce recommendations on policies and action plans on how to increase social expenditures or to improve execution rates.

Achievements under Governance and Public Financial Management

6.22 The original conditionality did not address specifically governance and financial management, although these were underlying concerns. During the July/August 2002 consultations, GOM and the Bank agreed that actions taken by GOM in the aftermath of the crisis in the areas of anti-corruption and financial management would be substituted to actions not taken in land tenure (measure 2) and financial sector reforms (measure 8) as conditions for third tranche release. Accordingly, the following replaced measure 2: creation of a task force responsible for proposing a national anti-corruption strategy and adoption of a decree requiring ministers, senior officials, and judges to declare their assets and those of their close relatives. Measure 8 was modified to cover actions taken to strengthen financial management: tighter control over the use of the Special Funds, including sanctions against officials involved in their misuse, and adoption of a decree mandating OAG to carry out semi-annual audits of the Special Funds; completion of an audit of the HIPC funds for 2001; and merger of the Ministries of Finance and of Budget, thereby bringing to closure a long-standing obstacle to improving fiscal policy and public financial management. The new conditionality was in fact nothing more than a rubber stamp of the urgent measures taken to address the unique situation that had developed during the crisis, and with no provision or requirement for further reforms. Actual implementation and/or institutionalization of most of these measures were in fact undertaken under subsequent programs or operations.

MONITORING AND EVALUATION AND OTHER ISSUES

6.23 In addition to the series of conditions referred to above, SAC-II contained three simple outcome/impact indicators at project end (originally December 31, 2001), compared to end 1998: increase in FDI as a share of GDP (from 0.4 to 1.7 percent); increase in the share of private investment (the public investment/private investment ratio declining from 1.2 to 0.9); and an increase in the growth rate (above 5 percent). The three targets were met by end 2001 (see Table 1 in Section 4). SAC-II also listed intermediate/output indicators with targets set for the closing date. There is no information whether data were collected to verify these targets or whether they were

utilized. The ICR discusses compliance with the tranches conditions only. There were no issues regarding compliance with fiduciary safeguards.

OUTCOME

6.24 *Moderately Satisfactory.* Achievements were mixed: satisfactory in macro-economic management until the political crisis, moderately satisfactory in privatization, business climate, and public financial management, and unsatisfactory in public resource management. In governance, the measures taken after the crisis could not have any measurable impact by Credit closing and corruption remains pervasive, especially in the judiciary.³³ The progress recorded in growth was wiped out in 2002, revealing the fact that reforms remained hostage to the fragile political and social environment. Poverty was slightly reduced in urban areas thanks to the increase in FDI but the situation stagnated or worsened in rural areas. Here again, the crisis of 2002 wiped out whatever benefits had been gained. However, the budgetary support provided by the Credit prevented the crisis from having worse consequences on poverty.

6.25 Despite the disappointing results, achievements under SAC-II consolidated the transition to a market economy initiated under SAC-I, by laying the foundations for a PSD-driven growth. The main achievement of the SAC-I/SAC-II program may be characterized as having arrested the “dirigisme” of the previous decades, with little risk of reversal. In sum, the two SACs set the stage – but not much more - for the government, after the 2002 crisis, to embark on a more resolute policy of growth *cum* poverty reduction.³⁴ The rating is justified on the basis of this conclusion.

INSTITUTIONAL DEVELOPMENT

6.26 *Modest.* Little was achieved in raising the capacity to formulate and implement policies. Some of the units created were dissolved or were largely ineffective, such as in public resources management. In PSD and privatization, GOM remains dependent on external assistance, and the regulatory authorities remain weak and reportedly receive technical support from the enterprises under their oversight. In the fisheries sector, there is no effective competition and, in the area of facilitating the creation of business enterprises and judicial processes, institutional capacity was only slightly improved. In governance and financial management, a new institutional set-up was in place only after Credit closing. Only in two areas was capacity strengthened: in mining, with the establishment of a fully functioning cadastre and in public finance, with the long-awaited merger of the ministries of finance and budget. Overall, institutional capacity remains very weak.

SUSTAINABILITY

6.27 *Likely.* There was no reversal in policies, despite the crisis. Several positive factors concurred to reduce the risk of reversal: the government emerging from the crisis

³³ Under the decree requiring high officials to declare their assets, there are important remaining exceptions.

³⁴ In parallel to this PPAR, IEG-CR undertook a Country Assistance Evaluation (CAE) covering Bank assistance to Madagascar over 1994-2004.

showed commitment to pursuing reforms and did so starting in 2003, although at a slower pace than anticipated; public opinion has come to accept the reforms, particularly a greater role for the private sector, although there is a growing impatience to see concrete results in terms of employment opportunities and reduction in inequality; and the private operators who have invested in the privatization program have now vested interests in maintaining and strengthening the reforms. However, the remaining challenge for any government is to deliver benefits rapidly and more widely, especially to the rural populations.

BANK PERFORMANCE

6.28 *Moderately Satisfactory.* The agenda of SAC-II was well identified and its design appropriate. Indeed, by appraisal, the Bank had a good knowledge of the political uncertainties and of the economic challenges. It was particularly concerned about the long implementing delays. However, despite the precautions taken (menu-based tranches), there were weaknesses at entry, notably the overestimation of the commitment to some reforms and of the institutional capacity to carry out several reforms simultaneously. In particular, the Bank underestimated the complexity inherent to the privatization of large and powerful PEs, notably the multitude of legal issues involved. In that sense, the component was not ready for implementation. During supervision, the Bank demonstrated realism and flexibility, viz., it reacted quickly and positively to the cyclones and the oil shock. Unfortunately, the dominance of the privatization agenda considerably reduced the attention given to other components. This was eventually reflected in two ways, the absence of any progress under some "additional measures" and the "formal" fulfillment of tranche release conditions under others, notably in public resource management (measures 5 and 6).

6.29 After the crisis, the Bank played an important role in helping GOM select key areas demanding urgent attention, but endorsed revisions in the third tranche conditions that were nothing more than a rubber stamp of actions taken. This was understandable in the circumstances but meant little in terms of building a solid basis for future reform. At the time, the Bank was driven by the willingness to transfer funds rapidly to the new government to mitigate the effects of the crisis. Finally, it failed to monitor adequately performance under the Cyclone Supplemental Credit. Despite the many shortcomings on the part of the Bank, its very presence and involvement were critical to the turnaround in economic policy after decades of mismanagement.

BORROWER PERFORMANCE

6.30 *Moderately Unsatisfactory.* The commitment to reforms was lukewarm throughout and opposition to some of them was strong, in particular to the privatization of the large PEs, symbols of autonomy. For historical reasons, the mentality is strongly nationalistic and isolationist – still an obstacle to attracting FDI. In areas less contentious than privatization, GOM did not have the will or the capacity to translate decisions into permanent and workable mechanisms or to create institutions capable of applying and enforcing policies in a consistent and systematic manner. This was particularly the case in resource management. To a large extent, it was a passive actor, reacting to external

events and to the recommendations of Bank missions. Also, it was not capable to neutralize abuses that undermined the implementation or the success of some components. Finally - and most importantly – it failed to take advantage of the program to formulate and develop pro-poor policies and build effective mechanisms to reduce poverty and inequality as well as the urban-rural disparity.

7. Lessons

7.1 The following lessons emerge from the assessment.

- The record of fragile political stability in Madagascar pleads for designing policy development operations in a flexible manner based either on a menu-based approach to tranche release, or preferably, or on a programmatic series of one-tranche operations with prior actions.
- Given Madagascar's relatively low absorptive capacity, TA operations for supporting reforms should be well focused and have limited objectives initially aimed at implementation bottlenecks.
- New institutions in Madagascar need continued assistance from the donor community. Establishing new institutions does not ensure their effective operations. Continued support is required, for example, to strengthen the different regulatory authorities created in the public service sectors and competition in general, as well as the business framework. Similarly, continued assistance is needed to strengthen the judiciary, which is a long term undertaking.
- Consideration should be given to revive the Private Sector Support Fund, which proved successful, or to set up a similar scheme to promote PSD.
- The tax effort in Madagascar is particularly low. Much greater attention than in the past should be given by the authorities and by the Bank to revenue mobilization and reallocation of public resources for poverty reduction, without which recent improvements in social indicators will not be sustained.

Annex A. Basic Data Sheet

PUBLIC MANAGEMENT CAPACITY BUILDING PROJECT (CREDIT 2911-MG)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Original commitment	13.83	12.99	93.9
Total cancellation	n/a	0.84	n/a
Total project cost	15.09	15.52	102.8
Cofinancing	1.26	2.53	2.00

Project Dates

	<i>Original</i>	<i>Actual</i>
Departure of Appraisal Mission	06/06/1995	06/06/1995
Board approval	09/03/1996	09/03/1996
Signing	09/26/1996	09/26/1996
Effectiveness	12/24/1996	12/18/1996
Closing date	06/30/2001	12/31/2002

Staff Inputs (staff weeks)

	<i>Actual/Latest Estimate</i>	
	<i>N° Staff weeks</i>	<i>US\$US\$('000)</i>
Preappraisal	n/a	n/a
Appraisal/Negotiation	73.0	249.4
Supervision	168.67	221.7
Completion	10.00	7.0
Total	241.67	478.1

Mission Data

	<i>Date (month/year)</i>	<i>No. of persons</i>	<i>Staff days in field</i>	<i>Specializations represented</i>	<i>Performance rating</i>	<i>Rating trend</i>
Identification/ Preparation	03/95	1		Team Leader,	S	S
	06/95	3		Members	S	S
Appraisal	10/95	1		Team Leader	S	S
	07/96	6		Members	S	S
Supervision	11/97	1		Team Leader	S	S
	10/98	4		Team members	S	S
	07/99	3		Country Economist (2) Team Member (1)	S	S
	03/00	4		Team Leader (1)	S	S
				Country Economist (2)		
	02/01	4		Team member (1)	S	S
				Country Economist (2)		
12/02	4		Team member (1)	S	S	
			Country Economist (2)			
Completion	n/a	n/a	n/a	n/a	n/a	n/a

FIRST STRUCTURAL ADJUSTMENT CREDIT (CREDIT 2937-MG)

Key Project Data (amounts in US\$ million)

	<i>Appraisal estimate</i>	<i>Actual or current estimate</i>	<i>Actual as % of appraisal estimate</i>
Original commitment	70.6	70.6	100
Total project cost	70.6	70.6	100

Project Dates

	<i>Original</i>	<i>Actual</i>
Departure of Appraisal Mission	10/03/1996	10/03/1996
Board approval	03/14/1997	03/14/1997
Signing	03/14/1997	03/14/1997
Effectiveness	06/13/1997	04/01/1997
Closing date	12/31/1997	12/31/1997

Staff Inputs (staff weeks)

	<i>Actual/Latest Estimate</i>	
	<i>N° Staff weeks</i>	<i>US\$US\$('000)</i>
Preappraisal	173	623
Appraisal	3	60
Negotiations	12	38
Supervision	10	28
Completion	11	20
Total	209	769

Mission Data

	<i>Date (month/year)</i>	<i>No. of persons</i>	<i>Staff days in field</i>	<i>Specializations represented</i>	<i>Performance rating</i>	<i>Rating trend</i>
Identification/ Preparation	05/94-07/96	35	n/a	Economist Principal Economist Private Sector Dev. Spslt. Division Chief Manager and Resp. Rep. Country Officer Procurement Specialist Public Sector Mgt. Spslt. Rural Development Social Scientist	n/a	n/a
Appraisal/Board Approval	07/96-03/97	0	n/a	n/a	n/a	n/a
Board/Effectiveness	03/97-04/97	n/a	n/a	n/a	n/a	n/a
Completion	11/98-04/99	2	n/a	Economist Principal Economist Public Sector Mgt. Spslt.	n/a	n/a

**PRIVATE SECTOR DEVELOPMENT AND CAPACITY BUILDING PROJECT
(CREDIT 2956-MG)**

Key Project Data (*amounts in US\$ million*)

	Appraisal estimate	Actual or current estimate	Actual as % of appraisal estimate
Original commitment	23.8	23.1	97.0
Total cancellation	-	0.7	n/a
Total project cost	35.5	n.a.	-
Cofinancing	11.7	n/a	n/a

Project Dates

	Original	Actual
Departure of Appraisal Mission	09/14/1996	09/14/1996
Board approval	05/29/1997	05/29/1997
Signing	07/14/1997	07/14/1997
Effectiveness	10/13/1997	02/18/1998
Closing date	12/31/2002	12/31/2002

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	N° Staff weeks	US\$US\$('000)
Preappraisal	112	226.4
Appraisal/Negotiations	20	66.0
Supervision	93	220.6
Completion	4.5	5.3
Total	229.5	518.3

Mission Data

	<i>Date (month/year)</i>	<i>No. of persons</i>	<i>Staff days in field</i>	<i>Specializations represented</i>	<i>Performance rating</i>	<i>Rating trend</i>	
Identification/ Preparation	5/95	8	n/a	A	n/a	n/a	
	7/95	10	n/a	S-1	n/a	n/a	
	9/95	5	n/a	S-1	n/a	n/a	
	12/95	6	n/a	S-1	n/a	n/a	
	2/96	4	n/a	S-1	n/a	n/a	
	(Pre-appraisal)						
Appraisal/Negotiation	7/96	4	n/a	S-1	n/a	n/a	
	(Pre-appraisal)						
	10/96	5	n/a	S-2	n/a	n/a	
	(appraisal)						
	4/97	8	n/a	S-2	n/a	n/a	
Supervision	(negotiations)						
	7/98	3	n/a	S-3	U	U	
	9/98	4	n/a	S-3	S	U	
	12/98	3	n/a	S-3	n/a	n/a	
	4/99	3	n/a	S-3	S	S	
	7/99	2	n/a	S-3	S	S	
	12/99	3	n/a	S-3	S	S	
	3/00	1	n/a	S-3	S	S	
	7/00	2	n/a	S-3	HS	HS	
	3/01	7	n/a	S-3	S	HS	
	6/01	4	n/a	S-3	S	HS	
	9/01	1	n/a	S-3	S	HS	
					No mission due to Political crisis	U	S
		7/02	5	n/a	S-3	S	S
Completion	4/03	1	n/a	S-4	S	S	

Specialized staff skills represented

A = Specialist, business law, PSD, tax policy, trade and Export, regulatory policy

S-1 = Team leader, Economist, Financial Analyst, Industrial Economist, PSD Spec. Regulatory Policy Spec., Operations Analyst, FDI Promotion Specialist, Fiscal Economist, Export Promotion Specialist.

S-2 = Team leader, PSD Spec., Export Promotion Spec., Country Director, Lawyer, Economist, Country Manager, Portfolio Manager

S-3 = Team Leader, PSD Spec. Information Analyst, Privatization, Civil Aviation, Air Transport, Infrastructure, Telecom.,

Environment, Energy, Lawyer, Operations, Economist, Sector Manager, Project Finance

S-4 = Consultant

SECOND STRUCTURAL ADJUSTMENT CREDIT (CREDIT 3218-MG)

Key Project Data (amounts in US\$ million)

	Appraisal estimate	Actual or current estimate	Actual as % of appraisal estimate
Original commitment	100	100	100
Total project cost	100	100	

Project Dates

	Original	Actual
Departure of Appraisal Mission	03/15/1999	03/15/1999
Board approval	05/20/1999	05/29/1999
Signing	06/10/1999	06/10/1999
Effectiveness	09/08/1999	06/30/2000
Closing date	12/31/2001	12/31/2002

Staff Inputs (staff weeks)

	Actual/Latest Estimate	
	N° Staff weeks	US\$US\$('000)
Preappraisal	n/a	181.08
Supervision	101	350.51
Completion	32	45
Total	133	576.59

Mission Data

	Date (month/year)	No. of persons	Staff days in field	Specializations represented	Performance rating	Rating trend
Identification/ Preparation	12/98	7	n/a	A	S	S
Supervision	7/99	2	n/a	S-1	S	S
	11/99	3	n/a	S-1	S	S
	03/00	6	n/a	S-1	S	S
	03/01	10	n/a	S-1	S	S
	06/01	9	n/a	S-1	S	S
	09/01	4	n/a	S-1	S	S
	11/01	6	n/a	S-1	S	S
Completion	12/02	3	n/a	S-2	S	S

A = Country Director, Resident Rep. Sector Manager, Task Manager, Mining, Fisheries, Public Sector Reform

S-1= Task Manager, Team Leader, Economist, Fisheries Procurement, Operations, Privatization, Cyclone Reconstruction

Sr. Counsel Lawyer, Public Sector Reform, Mining, Judicial Sector Reform, Social Expenditures

S-2 =Team Leader, Economist, Consultant

Annex B: Actions Prior to SAC-I (Credit No. 2937)

Actions taken for Project Preparation.

1. The Government took key actions prior to discussions on the adjustment operation:
 - flotation of the FMG in 1994;
 - elimination of subsidies on flour and rice;
 - appointment of independent administrators to the two state-owned banks;
 - lowering the maximum tariff from 50 percent to 30 percent;
 - (reorienting expenditures to primary education, basic health services, and social fund community projects;
 - inviting a formally-constituted private sector group to participate in policy discussions and draft an incentives framework for private sector development; and;
 - appointing an Independent Commission for Privatization to draft the privatization law.

Conditions of Presentation of the Credit for Approval and Tranche Release

2. The following conditions were met prior to Board presentation:
 - liberalizing entry, work permit and residence requirements for investors, and visas for tourists and abolishing exit visas for nationals and foreign residents;
 - granting foreign managerial and technical staff automatic work permits and rights of residence for their families subject only to a valid employment contract;
 - allowing foreign investors access to land tenure through 99-year mortgageable leases to be approved within 2 months of application;
 - removing the requirement for prior authorization to invest and integrating the fiscal incentives of the investment code into the tax code;
 - abolishing prior approval for equity capital contributions by foreign investors (above a threshold of 20 percent of a company's authorized capital);
 - appointing experienced negotiators to design and carry out the divestiture of the two state owned commercial banks;
 - ending the monopoly in telecoms and selecting at least one company based on an international competitive bid for cellular operation;
 - liberalizing air access by allowing regional airlines from Eastern and Southern Africa and the Indian Ocean access to all Malagasy airports, allowing new airlines to operate on other international routes, canceling the designation of Air Madagascar as the sole

beneficiary of Malagasy air traffic rights and opening ground handling facilities for airlines to competition;

- opening the petroleum sector to competition and taking the necessary steps to allow at least one oil company to compete with SOLIMA; issuing the legal instruments to give effect to the decree liberalizing the import, transformation, storage, transport and distribution of all petroleum products and setting up an entity to be jointly managed by all oil companies to control storage, pipelines and unloading of oil;
- adopting the legal framework for the divestiture of the hundred or so remaining public enterprises;
- reorienting the 1996 budget and the 1996-99 PIP to strengthen the contribution of Government expenditure to poverty reduction;
- completion of an independent audit on the satisfactory implementation of the social safety net; and
- submission of a signed Letter of Development Policy.

Annex C: Measures Supported By SAC II (Credit No. 3218)

MEASURES TAKEN PRIOR TO BOARD PRESENTATION

- BTM: Signing a sales protocole for BTM.
- Public Finance: Complete changes in budget nomenclature to match Budget Law and Treasury accounting.
- Arbitration: Adoption of an Arbitration Law by the National Assembly.
- Telecommunications: Publication of inter-connection decree between fixed and cellular operators.
- Mining: Mining Code, agreeable to IDA, approved by the Council of Ministers and submitted to the National Assembly. Re-definition by law of the role of OMNIS, in practice precluding the State from participating in commercialization and/or production of mining products and limiting its role to promotional activities.
- Fisheries: Increase license fees by 100 percent (on average) in 1999 relative to 1998, and prepare report on actual and potential payments per firm. Commit to the introduction of a transparent, non-discretionary, and competitive mechanism for the allocation of fishing licenses before the fishing campaign of the year 2000 (e.g., bidding mechanism that takes into consideration Madagascar's own features, and following terms of reference already agreed with IDA). Limit the number of licenses in the west coast to a total of 69 industrial and 36 artisanal, and to 6 industrial licenses in the east coast (freeze to remain until completion of sustainability study), and respecting the 1998 distribution of authorizations per zone and boat for each firm.

MEASURES FOR CREDIT EFFECTIVENESS (1ST TRANCHE)

- The Borrower has: (a) a macroeconomic framework consistent with the objectives of the Program, this includes securing the international financial support necessary for the sustainability of this framework; (b) adopted an action plan (including an implementation schedule) describing the methodology to be followed to compute severance payments; (c) furnished evidence that: (i) with respect to the privatization of SOLIMA's oil operations, each of the joint-venture companies referred to under paragraph 17 of the LDP has been established (in particular with respect to the relevant share of the capital stock to be held by the Borrower), and duly registered; and (ii) with respect to SOLIMA's non-oil operations, the Borrower has concluded contractual arrangements aimed at transferring the ownership/use of the said operations to private sector entities; and (d) the Borrower has established a legal and regulatory framework and a regulatory authority for the petroleum sector with functions, membership, budgetary resources and adequate staffing, all satisfactory to the Association and in accordance with paragraph 19 of the LDP.

**GENERAL CONDITIONS AND DESIGN OF 2ND AND 3RD
"MENU- BASED" TRANCHES**

- The Borrower has achieved satisfactory progress in the carrying out of the Program, including: (i) BTM privatization process has been settled prior to the release of the second tranche through the completion of the existing sales protocol or, if the deal unravels, already agreed steps for full State disengagement from BTM are put in place; (ii) social programs have been implemented as agreed with IDA; and (iii) a macroeconomic framework consistent with the Program has been maintained. In addition, each of the "menu-based" tranches requires a CORE MEASURE (one sales contract, and fully operational regulatory framework and body), and ADDITIONAL MEASURES (fully complied a total of 4 out of the 8 reform areas listed below).

MEASURES FOR 2ND AND 3RD "MENU-BASED" TRANCHES

CORE MEASURES

Air Transport: The Borrower shall have: (a) sold at least 65 percent of Air Madagascar's voting stock; (b) established an adequate legal and regulatory framework and a regulatory authority with functions, membership, budgetary resources, and adequate staffing (all in accordance to paragraph 19 of the LDP); and (c) invited airport operators to bid for the concessioning of at least two main lots of airport infrastructure.

OR

Telecommunications: The Borrower shall have: (a) sold at least 34% of TELMA's voting stock; and (b) established an adequate legal and regulatory framework and a regulatory authority with functions, membership, budgetary resources, and adequate staffing (all in accordance to paragraph 19 of the LDP).

ADDITIONAL MEASURES

Private Sector Development

1. Mining Sector. The Borrower shall have enacted a revised Mining Code, including implementation decrees; and adopted an action plan aimed at expediting the processing of mining permit applications.
2. Land Tenure. The Borrower shall have taken all the measures referred to in paragraph 12 of the LDP to facilitate access to land; and invited investors to submit bids for five tourism and five industrial zones.
3. Business Environment and Judicial Processes. The Borrower shall have: (a) on the basis of the results and recommendations of its ongoing study (Etude sur les lenteurs de la procédure judiciaire), adopted an action plan to improve caseload management within the judicial system; and achieved substantive progress in the execution of the said action plan; and (b) on the basis of a consultative process involving all interested parties, adopted an action plan for the purposes of streamlining formalities and procedures required to carry out economic activities, and achieved substantive progress in the execution of the said action plan.

4. Sector Liberalization and Additional Sector Reforms. The Borrower shall have: (a) granted at least two airport concessions to qualified and experienced private operators; (b) invited telecommunications operators to bid for a national license to provide telecom services; and (c) enacted a law governing the fiscal regime of mining projects whose investment costs exceed about US\$200 million, including implementation decrees.

Public Finance Reform

5. Revenue Policies and Monitoring. The Borrower shall have established a unit within the Ministry of Budget with terms of reference satisfactory to IDA to monitor public revenues and to review medium and long-term tax policy and tax administration reforms.
6. Expenditure Monitoring in Social Sectors. The Borrower shall have: (a) established an appropriate monitoring system to capture the implementation of the Borrower's social policies and expenditures actually incurred for primary education and basic health with respect to the specific budget items and sectoral policies specified in paragraph 24 of the LDP; and (b) carried out a survey based on a methodology aimed at assessing the Borrower's performance in the delivery of primary education and basic health services.
7. Fishing Licenses. The Borrower shall have: (a) established an appropriate system, satisfactory to the Association, to allocate shrimp fishing licenses in a non-discretionary, competitive and transparent manner, (b) adjusted annual shrimp fishing fees for licenses granted for the 1999 fishing campaign in accordance with the methodology adopted as a result of the revamped licensing system referred to above; and (c) carried out the recommendations resulting from the technical and financial audits of the FDHA.
8. Financial Sector Reforms. The Borrower shall have: (a) carried out the financial, organizational and actuarial audits through independent consultants for the insurance companies Ny Havana and Aro, and the social security funds CNAPS, CRCM and CPR; and (b) adopted action plans to improve their performance.

RESTRUCTURING OF SEPTEMBER 2002 CORE MEASURE

The Core Measure with respect to Air Transport was modified as follows:

- **With respect to air transport** operations, the Borrower shall have concluded a performance-based management contract with a reputable operator for the management and restructuring of Air Madagascar, on terms and conditions acceptable to the Association and in accordance with paragraph 18 of the Supplement to the Letter of Development Policy;

ADDITIONAL MEASURES

Additional measures 2, 4, 7 and 8 were modified as follows:

2. With respect to its anti-corruption program of activities, the Borrower shall have:
 - established a national anti-corruption task force, whose mandate, composition and terms of reference shall be acceptable to the Association, to be responsible for provision of advice on the development of a national anti-corruption strategy, provision of general policy guidance on the practical application and implementation of the anti-corruption strategy, and regular monitoring of the impact and achievements of the anti-corruption program, in accordance with para. 33 of the Supplement to the Letter of Development Policy;
 - adopted a decree requiring ministers, senior officials and judges to issue annual declarations of their assets and those of their close relatives, in accordance with paragraph 34 of the Supplement to the Letter of Development Policy.
4. With respect to the mining sector, the Borrower shall have enacted a law governing the fiscal regime of mining projects whose investment costs are estimated to exceed FMG 1 trillion, along with all necessary implementation decrees required to give full effect to the law, all in form and substance satisfactory to the Association.
7. With respect to the fisheries and forestry sectors, the Borrower shall have:
 - established an appropriate regulatory framework, acceptable to the Association, to allocate shrimp fishing licenses in a non-discretionary, competitive and transparent manner;
 - developed an action plan and schedule for such a regulatory framework to be similarly established and applied in the forestry sector;
 - in the case of both the fisheries and forestry sectors, completed a status review of all licenses issued to date and taken appropriate steps to withdraw all licenses which have been issued in contravention of, or without due regard to, the relevant legislation.
8. With respect to financial management, the Borrower shall have taken appropriate measures to strengthen its organs of budgetary control, including:
 - completion of a detailed report of the operation and use of Special Funds during FY 2001 and the first half of FY 2002, and adoption of a full and comprehensive list of corrective measures, acceptable to the Association, designed to strengthen the management of such Special Funds, including: (i) measures to prevent any possibility of misuse of funds allocated to, or on account of, such Special Funds; and (ii) sanctions, as appropriate, against officials involved in incidences of misuse of such funds;
 - adoption of a decree mandating the *Chambre des Comptes* to conduct semi-annual audits of Special Funds;
 - completion of the audit of HIPC funds for FY01;
 - merger of the Ministries of Finance and Budget.

Annex D: List Of Persons Met

Public Sector

Mr. Radavidson Andriamparany, Ministre de l'Economie, des Finances et du Budget (MEFB)

Mr. Refeno Fanjava, Président de la Commission des Finances, Assemblée Nationale

Mr. Noël Rakotondramboa, Secrétaire Général de la Présidence

Mr. Favjama, Président de la Commission des Finances et de l'Economie, Assemblée Nationale

Mr. Jeannot Célestin Tatagera, Rapporteur Général de la Commission des Finances et de l'Economie, Assemblée Nationale

Ms. Anjaratiana Antsaseheno Rasoloalino, Responsable du Suivi des Marchés Publics, Sservice du Budget, de la Comptabilité Financière et Approvisionnement, Assemblée Nationale

Mr. Louis Maxence Randriantoetra, Directeur Général du Trésor, MEFB

Mr. Honoré Parfait Razafinjatovo, Magistrat, Directeur de l'Appui aux Programmes, Ministère de la Justice.

Mr. Philibert Ratsimbazafy, Directeur Général, Direction Générale de l'Audit Interne, MEFB.

Mr. Guy Gabriel Razafinony, Secrétaire Général, Secrétariat Technique de l'Ajustement, MEFB

Mr. James Andriamatemaima, Secrétariat Technique de l'Ajustement, MEFB

Mr. Claude Rakotoarivao, Secrétariat Technique de l'Ajustement, MEFB

Me. Martine Masoafora, Secrétariat Technique de l'Ajustement, MEFB

Mr. Boanary Raveloarijaona, Président de la Chambre des Comptes, Cour Suprême

Private Sector

Mr. Constant Horace, Cabinet Concept Gestion (formerly Ministre du Développement du Secteur Privé et de la Privatisation - MDSPP)

Ms. Amélie Voninirina, Consultant (formerly PAIGEP)

Mr. Zaza Ramandimbarison, Consultant (formerly Vice Prime Minister and Director of AGETIPA)

Mr. Patrice Pezat, Directeur, ORANGE

Mr. Eugène Beckers, Directeur Général, TELMA

Mr. Léon Rajaobelina, Vice-Président Régional, Conservation International

Mr. Aimé Harivelo, Consultant (formerly Coordonnateur PAIGEP)

Mr. Herintsalama A. Rajaonarivelo, Président, Groupement du Patronat Malgache

Me. Hanta Rakotovao, Secrétaire Exécutif, Groupement du Patronat Malgache

Mr. Rasata Rainiketamanga, Professeur, CEDS (formerly Directeur de Cabinet, Ministry of Finance)

Mr. Pierre-Aimé Clerc, Directeur Général, TOTAL

Mr. Michel Rambelo, Directeur de Programme, Programme d'Action Sociale et Economique pour la Réinsertion Professionnelle (PASERP)

Mr. Berend Bruns, Directeur Général, Air Madagascar.

Dr. Florette Andriamiarisatrana, P.C.A. SagediProma (formerly President, CRC)

Mr. Charles Andrianaivojaona, Coordonnateur, Projet Zones d'Aménagement Concerté (formerly SG, Ministère des Pêches et des Ressources Halieutiques)

Mr. Alain Rasolofondrainibe, Directeur Général, SILAC (formerly Président du Bureau Permanent du FASP, PATESP)

Mr. Jaona Randrianarisoa, (formerly Directeur, Appui au Secteur Privé, MDSPP)

Labor Unions

Mr. José Bertin Randrianasolo, Secrétaire Général, Confédération Générale des Syndicats des Travailleurs de Madagascar - FISEMA.

World Bank

Mr. James Bond, Country Director

Mr. Dieudonné Randriamanampisoa

Mr. Jocelyn Rafidinarivo

Mr. Guenter Heidenhof

Ms. Josiane Raveloarison

Ms. Benu Bidani

Mr. Hafez Ghanem

Mr. Philippe Le Houerou

Mr. Ali Mansoor

Mr. Jesko Hentschel

Mr. Simon Gray

Ms. Marie-Ange Saraka-Yao

Mr. Laurent Besançon

IFC

Mr. Henri E. Rabarijohn, Country Manager

Me. Johane Rajaobelina, Program Manager, SSC (SME Solutions Center)

IMF

Mr. Ræz-Væz Zadeh

Mr. Juan Zalduendo

Mr. Marc G. Quintyn

Others

Mr. Michael Sarris, formerly Country Director, World Bank

Mr. Jan-Hendrik van Leeuwen, Consultant

REPOBLIKANI MAIM (IASIKA RA
Tanindrazana-Fahafahana-Fandrosoana

MINISTRE DE L'ECONOMIE, DES FINANCES
ET DU BUDGET
Sous-CRÉDIT GÉNÉRAL
DIRECTION GÉNÉRALE DU TRÉSOR
Direction de la Dette Publique

Anuanao le 24 MAI 2006

Lh: MINISTRE DE L'ECONOMIE,
DES FINANCES ET DU BUDGET

N° ~~57~~ - MI FU/SGIDG/njDI>rRC:

Monsieur R. KVIEFTERS
CHIEF EVALUATION PAYS ET RELATIONS
REGIONALES
GROUPE INDEPENDANT D'EVALUATION

BANQUE MONDIALE

WASHINGTON D.C.

FAX N° 202-522-3124

OJJJE11: Rapport d'évaluation rétrospective de performance des projets

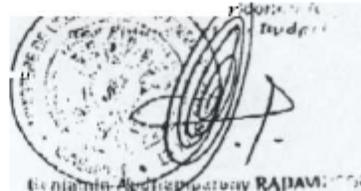
- PAIGEP (Cr. 2911-MAG)
- CAS 1 (Cr.2937- MAG)
- PATESP (Cr. 2956- MAG)
- CASH (Cr. 3218- MAG)

RF-F1:RE14CE : Votre lettre en date du 20/04/06

Monsieur le Chef d'Evaluation,

Faisant suite à votre correspondance sus-citée, je l'honneur de vous faire connaître que la version préliminaire du Rapport d'évaluation rétrospective de performance des projets en objet n'appelle de notre part aucune observation particulière.

Veuillez agréer, Monsieur le Chef d'Evaluation, l'assurance de ma considération distinguée.



Benjamin Ratsirison

Comments from the Government (English Translation)

**Republic of Madagascar
Ministry of Finance, Economy and Budget
Secretary General
Director General of Treasury
Director of Public Debt**

The Minister of Finance, Economy and Budget

No. 363

05/24/2006

To: Mr. R. Kyle Peters
Senior Manager
Country Evaluation and Regional Relations
Independent Evaluation Group
The World Bank, Washington

Re: Project Performance Assessment Report
Madagascar Public Capacity Building Project (Credit 2911); First Structural Adjustment
Credit (Credit 2937); Private Sector Development and Capacity Building Project (Credit
2956) and Second Structural Adjustment Credit (Credit 3218)

Reference: Your letter of 04/20/2006

Dear Sir,

In response to your letter referenced above, I have the honor to inform you that we have no particular observation on the draft Project Assessment Report for the subject projects.

Please accept, Mr. Division Chief, the expression of my distinguished consideration.

**Benjamin Radavidson Andriamparany
Minister of Finance, Economy and Budget**