AFRICAN DEVELOPMENT BANK **ADB/BD/WP/2018/146/Approved**	**AFRICAN DEVELOPMENT FUND** **ADF/BD/WP/2018/102/Approved** **20 July 2018** **Prepared by: RDGS/ECGF/COMG/PGCL** Original: French

BOARD APPROVAL **Lapse-of-time Procedure** **20 July 2018**	**FOR INFORMATION**

MEMORANDUM

TO : **THE BOARDS OF DIRECTORS**

FROM : **Vincent O. NMEHIELLE**
Secretary General

SUBJECT : **MADAGASCAR : ECONOMIC COMPETITIVENESS SUPPORT PROGRAMME - PHASE II (PACE II)***

TSF GRANT OF UA 10 MILLION

The **Grant Proposal** with the draft **Resolution** related to the above-mentioned programme, were submitted for **your consideration on a Lapse-of-time Basis** on 6 July 2018.

The Secretariat General has recorded the abstention of the US Chair.

The proposal is considered as **approved** and the Resolution **adopted**.

Attach:

Cc: **The President**

***Questions on this document should be referred to:**

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AFRICAN DEVELOPMENT BANK GROUP

PROJECT : ECONOMIC COMPETITIVENESS SUPPORT PROGRAMME - PHASE II (PACE II)

COUNTRY : MADAGASCAR

APPRAISAL REPORT

Date: 18 July 2018

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AFRICAN DEVELOPMENT BANK GROUP

MADAGASCAR

ECONOMIC COMPETITIVENESS SUPPORT PROGRAMME - PHASE II (PACE II)

RDGS/ECGF/COMG/PGCL DEPARTMENTS

July 2018

Translated Document

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CURRENCY EQUIVALENTS

April 2018

Monetary Unit	=	Ariary (MGA)
UA 1	=	USD 1.45
UA 1	=	EUR 1.18
UA I	=	MGA 4,685.88

FISCAL YEAR

1 January - 31 December

WEIGHTS AND MEASURES

1 ton	=	2204 pounds (lbs)
1 kilogramme (kg)	=	2,200 lbs
1 metre (m)	=	3.28 feet (ft.)
1 millimetre (mm)	=	0.03937 inch (“)
1 kilometre (km)	=	0.62 mile
1 hectare (ha)	=	2.471 acres

ACRONYMS AND ABBREVIATIONS

ADF	:	African Development Fund
AFD	:	French Development Agency
AfDB	:	African Development Bank
AGOA	:	Africa Growth and Opportunity Act
ARMP	:	Public Procurement Regulatory Authority
BIANCO	:	Independent Anti-Corruption Bureau
CA	:	Court of Auditors
CNM	:	National Public Procurements Commission
COMESA	:	Common Market of Eastern and Southern Africa
CPIA	:	Country Policy and Institutional Assessment
CSP	:	Country Strategy Paper
DDP	:	Directorate of Public Debt
DGT	:	General Directorate of the Treasury
ECF	:	Extended Credit Facility
EU	:	European Union
FDI	:	Foreign Direct Investment
GDP	:	Gross Domestic Product
I-CSP	:	Interim Country Strategy Paper
ICT	:	Information and Communication Technologies
IDEV	:	Independent Development Evaluation
IFZ	:	Industrial Free Zone

IOC	:	Indian Ocean Commission
IMF	:	International Monetary Fund
IP	:	Implementation Plan
JIRAMA	:	*Société nationale d'électricité et d'eau de Madagascar* (National Electricity and Water Company of Madagascar)
MDG	:	Millennium Development Goals
MFB	:	Ministry of Finance and Budget
MW	:	Megawatt
NDP	:	National Development Plan
NEP	:	New Energy Policy
OCSIF	:	Investments and Financing Coordination and Monitoring Agency
PAGI	:	Institutional Governance Support Project
PAPI	:	Institutional Support Project for the Promotion of Private Investments
PARGE	:	Economic Governance Reform Support Programme
PARSE	:	Energy Sector Reform Support Programme
PCG	:	Partial Credit Guarantee
PEPBM	:	Lower Mangoky Irrigation Area Extension Project
PIP	:	Public Investment Programme
PIU	:	Project Implementation Unit
PPP	:	Public-Private Partnership
PRIASO	:	South-West Agricultural Infrastructure Rehabilitation Project
PSAEP	:	Agriculture, Livestock and Fishery Programme
PSMFP	:	Public Finance Modernization Strategic Plan
PURE	:	Emergency Economic Recovery Programme
RDGS	:	Regional Development, Integration and Business Delivery – South
SDR	:	Special Drawing Rights
SEZ	:	Special Economic Zone
TFP	:	Technical and Financial Partners
TSF	:	Transition Support Fund
UA	:	Unit of Account
USD	:	United States Dollar

PROGRAMME INFORMATION

INSTRUMENTS: General Budget Support

PBO DESIGN MODEL: Programme-Based Operation

GRANT INFORMATION

Client Information

BENEFICIARY	:	Republic of Madagascar
SECTOR	:	Multisector
EXECUTING AGENCY	:	Ministry of Finance and Budget (MFB)
TSF GRANT AMOUNT	:	UA 10 million

Financing Plan 2017-2018-2019

Source	**Amount (2017)**	**Amount (2018)**	**Amount (2019)**
TSF Grant	UA 10 million	UA 10 million	-
TSF Loan			UA 10 million
TSF PCG	USD 31 million from PCG		
IDA/World Bank Grant	USD 85 million	USD 90 million	Not stated
European Union	EUR 15 million	EUR 15 million	Not stated
France (AFD)	EUR 5 million	Not stated	Not stated

Key Information on the TSF Grant Financing

Implementation Schedule – Key Milestones (expected)

Activities	**Dates**
Appraisal	April 2018
Negotiation	May 2018
Approval	June 2018
Effectiveness date	July 2018
Disbursement Phase II	July 2018
Supervision PACE II	December 2018
Appraisal PACE III	February 2019
Disbursement Phase III	May 2019
Completion report	December 2020

PROGRAMME EXECUTIVE SUMMARY

Programme Overview	**Programme Name:** Programme Name: Economic Competitiveness Support Programme, Phase II (PACE II) Code SAP: P-MG-KA0-011 Geographic Reach and Sector: Nationwide Schedule: 3 years, 2017 - 2019 Operational Instrument: General Budget Support Financing Phase II: TSF Grant of UA 10 million Sector: Multisector
Overview of Country Context in 2018	Economic growth is projected at 5.2% in 2018 and 5.5% in 2019, an improvement over the 4.2% of 2017. The political context remains fragile due mostly to the imminence of presidential elections scheduled for end-2018. The risks that undermine the economic prospects are external shocks and climate change, the latter of which affects agriculture. Prices are expected to be brought under control in 2018 and the inflation rate could drop to 8.1% in 2018 against 8.5% in 2017. On the social level, Madagascar is characterized by poverty and profound disparities. In 2013, the poverty rate was 73.7% at the national level. This poverty is attributable to the rapid population growth (2.8% yearly) and the uncertainty of jobs. In 2015, the country adopted a National Social Protection Policy that placed emphasis on establishing social protection nets.
Lessons Learned	Main Lessons Learned Reflected in the Programme: Lesson 1: Reform support operations that are complementary with investment projects targeting the same areas contribute to the effective implementation of reform measures. *Consideration:* PACE II reform measures are supported by ongoing investment projects in Madagascar (PAPI, PAGOSE, PRIASO and the Integrated Agro-industrial Growth Pole Project in the South) Lesson 2: Adopt priority reform measures that have an impact on inclusive economic growth and will not be affected by the approaching elections. *Consideration:* PACE II reform measures are a continuation of Phase I measures being implemented by the Government. These measures will have a positive impact on the development of job-creating sectors, thereby fostering long-term Government commitment and inclusive growth. Lesson 3: When prioritizing structuring reforms, account should be taken of the fragile situation of the country, the programme schedule and capacity of implementation structures. *Consideration*: As PACE II measures aim to consolidate the outputs of Phase I, the necessary resources for their implementation have been identified and implementation structures are supported by TFPs.
Conditions for Ongoing Support	Madagascar meets the eligibility criteria for general budget support. Government's *commitment to poverty reduction* is demonstrated by the implementation of the 2015-2019 NDP. With regard to *macroeconomic stability*, the authorities and the IMF concluded a three-year programme under the Extended Credit Facility (ECF). The third programme review conducted in March 2018 concluded that outputs were satisfactory overall. Furthermore, notwithstanding macro-economic shocks, economic growth can further accelerate to 5.2% in 2018, then 5.5% in 2019. This improvement will be driven by Industrial Free Zone enterprises, extractive industries and sectors such as agro-industry, tourism, building/construction and finance. With regard to *political stability*, recent trends are encouraging but remain fragile given the imminent holding of legislative and presidential elections. TFPs continue to hold political dialogue with the Government to emphasize the importance of political stability to protect the achievements of completed reforms. As concerns *fiduciary review*, the Bank reviewed the fiduciary framework (Technical Annexes 1 and 2) and agreed with the Government on minimum measures to improve it and strengthen PFM capacity with the support of PAGI. Lastly, *harmonization efforts* remain intact within the "Budget Support/Public Finance Partnership Framework" Group involving the Bank and other development partners, the WB, EU and AFD, which are the main donors for budget support in Madagascar.
Policy Dialogue	Dialogue with the Malagasy authorities on the programme's economic reforms was conducted in a transparent and consultative manner with the other development partners within the "Budget Support/Public Finance Partnership" Group. Dialogue on the selected reforms of this operation commenced in May 2017 and continued until end-2019, with emphasis on the following points: (i) increase public investment in the social and infrastructure sectors to better deliver inclusive growth; (ii) rationalize public expenditure by reducing non-priority expenditure and pay special attention to the financial problems of JIRAMA and the national carrier Air Madagascar; and (iii) strengthen sector governance to support the structural transformation of agro-industry for inclusive growth. In addition to strengthening dialogue, the Bank, in association with other donors, will support Government's efforts through investment projects (Technical Annex 9).

Results-Based Logical Framework

Project Country and Name: Madagascar / Economic Competitiveness Support Programme (PACE)
Project Goal: Contribute to creating favourable conditions for strong and inclusive growth by improving the economic competitiveness of Madagascar.

	RESULTS CHAIN	PERFORMANCE INDICATORS: Indicator (including CSIs)	PERFORMANCE INDICATORS: Baseline situation	PERFORMANCE INDICATORS: Target	MEANS OF VERIFICATION	RISKS/ MITIGATION MEASURES
IMPACT	Inclusive growth and improved economic competitiveness	Average GDP growth rate	2016: 4.2%	2020: 5.5%	IMF/MFB Report	
		Global Competitiveness Index (Pillar 2 Infrastructure)	2016 : 1.9 (1-7)	2020 : 2.3	Global Competi-tiveness Report	
OUTCOMES	Outcome 1. Increase of both public and private investments	Public investment rate and private investment rate (as % of GDP)	2016 : 5.3% of GDP and 10% of GDP	2019: 10.5% of GDP and 10.9% of GDP	IMF/MFB Report	***Risk of: (i) socio-political instability; and (ii) macro-economic instability.*** <u>*Mitigation Measures:*</u> (i) Partnership forged between Technical and Financial Partners around ongoing reforms and the IMF's ECF; and Government commitment to preserve the country's stability
		Number of jobs created	2014 : 80 000	2019 : 100,000 [1] (75% of them women)	EDBM	
	Outcome 2. Rationalization of public expenditure	Fewer transfers to public enterprises	2017 : MGA 750 billion	2019 : MGA 150 billion	MFB	
	Outcome 3 : Sector governance is improved to boost economic competitiveness	Increase in JIRAMA's recovery rate	2016 : 54%	2019 : 75%	JIRAMA	
		Growth of value added in the primary sectors (PS) and secondary sectors (SS)	PS - 2016: 1.6% SS -2016 : 5.5%	PS- 2019: 2.7% SS- 2019 : 7.7%	IMF/MFB Report	
OUTPUTS	**Component 1 : Improvement of the Investments Promotion Regulatory and Institutional Framework**					
	1.1. Support for the development of public-private partnerships					
	Development of capacity to prepare and manage PPP projects	National PPP Strategy	2016 : No PPP Strategy	Strategy adopted in 2018	EDBM	***Risk of limited capacity***: Inadequate institutional and technical capacity to implement reforms <u>*Mitigation Measure:*</u> All technical and financial assistance provided by TFPs to strengthen institutional capacity can mitigate this risk.
		PPP project management structure (**trigger**)	2016 : No structure	Structure put in place by decree and functional in 2018		
		Ongoing PPP projects	2016 : A list of potential project is available	At least 1 PPP project ongoing in 2019[2]		
	Development of Special Economic Zones	Law on SEZ Establishment of a SEZ	2016: Bill available 2016: No SEZ, study ongoing	Law adopted in 2017		
				Launch of tender to establish a SEZ in 2019		
	1.2. Modernization of legal and institutional frameworks to foster greater investments in agro-industry					
	Improvement of the legal framework of sanitary standards for agricultural and agro-industrial products	Implementing decree on sanitary standards for agricultural and agro-industrial products. (**trigger**)	2016 : No appropriate regulation	Implementing decree adopted and executed in 2018	MPAE	***Risk of corruption*** <u>*Mitigation Measures:*</u> Continued implementation of reforms to fight corruption, especially by gradually setting up anti-corruption units
	Establishment of an agro-industrial incubation centre for youths	Incubation centre[3]	2016 : No incubation centre	Incubation centre established in 2019		

[1] Programme's combined three years
[2] The list of potential PPP projects is attached as Technical Annex 11
[3] Benchmark incubation centre with intake capacity of at least 100 youths per year

	Establishment of a legal and institutional framework for the promotion of agropoles	Law governing agropoles	2016: No law	The bill is submitted to Parliament in 2019	MPAE	in ministries and institutions. ***Fiduciary Risk:*** The risks identified by CFRA can negatively affect the programme implementation and the achievement of its objectives. *Mitigation Measures:* Strengthen MFB's institutional and human capacity through PAGI; monitor the implementation of PSMFP (2017-2026); implement technical assistance and projects financed by TFPs
		Decree instituting an agropoles promotion and management structure	2016 : No structure	Structure created by decree in 2019		
		Decree instituting the land management and allocation mechanism	2016 : No mechanism	Mechanism defined by decree in 2019		
OUTPUTS	**Component 2 : Strengthening of Sector Governance in Support of Economic Competitiveness**					
	2.4. Strengthening of electricity sub-sector performance					
	Establishment of an energy development master plan (production, transmission and distribution)	Electricity sub-sector development master plan	2016 : No master plan	Development master plan adopted by the JIRAMA Board of Directors in 2018	Progress reports of MEEH and JIRAMA	
	Promotion of results-based management through the deployment of cost plus incentive fee contracts[4]	Performance contract between GM JIRAMA and directors ***(trigger)***	2016 : No performance contract	Performance contract between GM JIRAMA and directors signed in 2018		
	Improvement of JIRAMA's financial and commercial performance	Settlement of arrears the State owes JIRAMA **(trigger)**	2016 : Arrears payable stand at MGA 19.5 billion	Gradual settlement: 2018: MGA 7.8 billion 2019: MGA 7.8 billion		
		Audit of JIRAMA's assets and liabilities	2016 : Financial situation is not clear	2018: Audit finalized and a plan prepared to implement recommendations		
		Installation of prepaid metres in Government departments	2016: Prepaid metres are not installed on a widespread basis	2019: Prepaid metres are installed in all Government departments		
	2.4. Improvement of air transport sector performance					
	Improvement of the national carrier AIR MADAGASCAR's management	Audit of accumulated liabilities of AIR MADAGASCAR	2016 : Accumulated debts stand at USD 88 million	2018 : Audit of liabilities of USD 88 million	Progress report of MFB/ AIR MADAGASCAR	
	Gradual reduction of State transfers to AIR MADAGASCAR	State transfers to AIR MADAGASCAR	2017: MGA 303 billion	2019 : MGA 0		
KEY ACTIVITIES	**COMPONENTS**				**RESOURCES**	
	Component 1: Improvement of the regulatory and institutional framework for the promotion of investments Component 2 : Strengthening of sector governance in support of economic competitiveness				TSF Grant: UA 10 million	

[4] Contracts will clearly specify commitments binding the State and JIRAMA, based on the business plan for achieving the company's financial balance by 2020

I. INTRODUCTION: THE PROPOSAL

1.1 This proposal submitted for the Board's approval concerns a one-year Transition Support Facility (TSF) grant of UA 10 million to finance the second phase of the Economic Competitiveness Support Programme (PACE II). PACE is a three-year programme-based operation covering the 2017, 2018 and 2019 financial years. The first phase approved in November 2017 provided a list of reform measures indicatively considered as conditions precedent to the second phase, which have all been fulfilled.

1.2. The outcomes of the first phase (PACE I) were deemed highly satisfactory (see IPO attached as Technical Annex 3). All planned measures to establish a suitable regulatory and institutional framework for the promotion of investments, including: (i) the design of the PPP strategy; (ii) the adoption of the law on SEZs; and (iii) the adoption of the law on industries, have been completed. Measures aimed at boosting electricity subsector performance such as: (a) the promotion of results-based management through the signing of cost plus incentive fee contracts between the State and JIRAMA; and (b) higher recovery of unpaid bills, were carried through. Furthermore, the planned measure to boost air sector performance through a strategic partnership between the national carrier Air Madagascar and a private reference company was implemented. This partnership aimed to improve Air Madagascar's management and to enable it to achieve positive results. This will lead to the elimination of State transfers to Air Madagascar by end-2019. These results require sustained Bank intervention to consolidate the gains of the first phase and to continue supporting the Malagasy authorities' efforts to move to a more competitive economy and improve governance in key sectors (energy, agriculture) to support economic competitiveness.

1.3. As a follow-up to the first phase, PACE II continues the reforms jointly identified in 2017 by the African Development Bank Group and the Malagasy authorities. The continuity sought in this second phase also stems from the programme-based nature of the operation. This approach will help to establish a medium-term dialogue platform with the authorities and improve aid predictability in order to facilitate alignment with the country's development policies. It will provide part of the country's funding needs for the 2018 financial year.

1.4. PACE II reforms aim to consolidate the achievements of previous programmes and support Government's efforts to implement the reforms listed in the National Development Plan (NDP) 2015-2019. PACE II will place emphasis on improving Madagascar's competitiveness, to attract more public and private investments in job-creating sectors like agro-industry. Furthermore, improving the performance of public enterprises (JIRAMA and Air Madagascar) will help to reduce State subsidies and transfers to these companies, and redirect resources towards investments in public infrastructure and social sectors capable of generating inclusive and sustainable economic growth.

II. POINTS ON THE COUNTRY'S ELIGIBILITY

Madagascar meets the eligibility criteria for general budget support operations defined by the Bank's Policy on Programme-Based Operations approved in March 2012 (ADF/BD/WP/2011/38). Since a detailed analysis of these criteria was presented in the PACE I Appraisal Report, the following sections only give an update of the criteria.

2.1. Criterion 1- Government's Commitment to Poverty Reduction

PACE is in line with the 2015-2019 National Development Plan (NDP). Its accompanying Implementation Plan (IP, 2015-2019) charts the direction of the country's new inclusive and sustainable development policy. These instruments aim to implement the Madagascar Vision, presented in the general State policy paper, "Madagascar: a Modern Prosperous Nation". Both documents seek mainly to create the right conditions for sustainable and inclusive economic growth through five strategic priorities: (i) Governance, rule of law, security, decentralisation, democracy and national solidarity; (ii) Preservation of macroeconomic stability and development support ; (iii) Shared growth and territorial anchoring of development; (iv) Appropriate human capital to contribute to the development process; and (v) Development of natural capital and building of resilience to disaster risks. The 2015- 2019 NDP was the subject of a Donors and Investors Conference held in Paris in December 2016. During the event, USD 10.6 billion was pledged as commitments to support the implementation of this plan, including USD 6.4 billion as financing from development partners and USD 4.2 billion from private sector partners. The progress the country has made so far is reflected in: (a) the upturn of economic growth marked by the return of commercial benefits, the development of tourism, the resumption of infrastructure projects, and higher private investments in major mining projects; (b) the strengthening of the legal framework to further stimulate private investment, economic diversification and job creation (see §3.2); (c) the adoption in 2015 of a National Social Protection Policy (PNPS), which places emphasis on the establishment of social protection nets; and (d) the implementation of the National Employment Policy covering the 2015-2019 period.

2.2. Criterion 2 – Political Stability

After exiting the political crisis in 2014, Madagascar made progress in establishing the legitimate institutions arising from democratic elections. The renewal of key State institutions begun with the swearing-in of the President of the Republic in January 2014, continued in 2015 with the establishment of the National Assembly, the organisation of municipal and senatorial elections, and the passing of an amnesty law by Parliament making it possible to free political prisoners. Meanwhile, although positive overall, the trend of the political situation remains challenging in terms of political, economic and social fragility. Political instability, coupled with weak governance and recurrent climatic shocks, contribute to maintaining poverty and deep-seated inequalities. With the approach of legislative and presidential elections at end-2018, political tensions have resurfaced, provoked by the controversial adoption of new electoral laws. Therefore, prospects at the political level depend on the public authorities' ability to maintain an appeased political environment.

2.3. Criterion 3 – Macroeconomic Stability

Over the last few years, economic growth has picked up again in Madagascar. In 2017, the country registered a real GDP growth of 4.2%, the same as in 2016. This performance is expected to improve to 5.2% in 2018. The main drivers of growth in 2017 were Industrial Free Zone (IFZ) enterprises, tourism, extractive industries and agro-industry. The primary sector declined in 2017, posting a negative growth of -1.8% due mostly to agriculture that was affected by the effects of Cyclone Enawo and drought in the upper plateaus. The negative impact of climate change led to a sharp fall in agricultural production (-5.9%). For its part, the secondary sector continued expanding in 2017, with a growth of 7.7% against 4.8% in 2016, driven by the Industrial Free Zone enterprises whose value added grew to 13.6% in 2017. Extractive industries also grew by 9.5% against a -1.6% decline in 2016. This good performance is attributable to the upturn in nickel and cobalt prices in 2017. The tertiary sector also remained dynamic, registering growth of 5.9% in 2017, against 4.8% in 2016 thanks to the expansion of the tourism sector.

The monetary policy implemented by Government in 2017 sought to contain the increase in money supply to ensure financial stability and keep prices under control. The inflation rate reached 8.5% in 2017 against 7% in 2016. This increase is due to the effects of the climatic shocks of early 2017, which made it difficult to supply products to the country, and the gradual increase in the prices of petroleum products.

Table 1. Main Economic Indicators 2015 – 2019 (% GDP)					
	2015	**2016**	**2017**	**2018p**	**2019p**
Real GDP growth (%)	3.1	4.2	4.2	5.2	5.5
Inflation, CPI (end of period as %)	7.6	7	8.5	8.1	7.2
Credit to the private sector (annual variation as %)	16.5	8.2	12.9	16.9	15.2
Total receipts including grants	10.4	15.4	15.2	15.1	15.3
Tax receipts	10.1	11.5	11.5	11.8	12
Grants	1.5	3.5	3.3	3	3
Total expenditure and net loans	15.1	15.5	18.1	19.1	20.1
Recurrent expenditure	11.7	12.2	12.1	11.8	11.4
Capital expenditure	3.5	5.3	6	7.4	8.7
Budgetary balance (commitment basis)	-3.3	-2.1	-2.9	-4	-4.7
Money in a broad sense (M2 annual variation %)	15.8	21.4	18.5	13.1	15.3
Gross reserves (months of imports)	2.9	3.9	3.7	4	4.2
External debt	28.4	26.7	24.4	25.9	27.8
Internal debt	12.9	11.7	11.8	10.3	9.3
Current account transactions balance	-1.9	0.6	-4.1	-3.4	-3.1

Source : AfDB, African Economic Outlook 2018 and IMF Report of 17 November 2017 (for monetary and debt data)

The public finance situation is gradually improving despite challenges in public enterprise governance. According to the results of the third review of the reform programme backed by the IMF's Extended Credit Facility (ECF) conducted in March 2018, the authorities made satisfactory progress since all quantitative benchmarks for end-December 2017 were achieved. Some of the programme targets were even exceeded, such as accumulation of reserves and budgetary balance. Tax revenue mobilization accounted for 11.5% of GDP, the same level as in 2016. The higher recurrent expenditure in 2017 was partly linked to the difficulties of JIRAMA and the effects of drought and Cyclone Enawo, the budgetary cost of which is estimated at USD 71 million, or 0.6% of GDP.

According to the IMF's Debt Sustainability Analysis in its July 2017 Article 4 Consultations Report and the first Extended Credit Facility (ECF) review, the risk of debt overhang for Madagascar's public debt was assessed as moderate. Therefore, the debt contracted and guaranteed by the Malagasy State is sustainable, but with potential risks of vulnerability. The main vulnerability risks are weak budget resource mobilisation, exchange rate shocks and conditional commitments linked to public enterprises. Madagascar's total debt was estimated at 36.2% of GDP in 2017, against 38.4% of GDP the previous year, corresponding to a drop of 2.2 percentage points of GDP. This total debt in 2017 is composed of 24.4% and 11.8% of GDP in external and domestic debt, respectively.

The economic prospects for 2018-2019 are favourable for strong growth. Projections are based on a GDP growth of 5.2% in 2018, then 5.5% in 2019. Monetary policy will also help to ensure stable prices with an inflation rate of 8.1% between 2017 and 2018, before dropping to 7.2% in 2019. Sectors that drive economic growth in the secondary and tertiary sectors will remain the same as in 2017. The implementation of Madagascar's medium-term budgetary policy, which mainly targets a regular rise in revenue, gradual reduction of transfers to JIRAMA and higher public investment while limiting risks that can hurt macroeconomic stability and debt sustainability, will translate into higher tax receipts at 11.8% of GDP in 2018, greater investment expenditure in 2018 to reach 7.4% of GDP and lower recurrent expenditure to 11.8% of GDP in 2018.

2.4. Criterion 4 – Fiduciary Risk Review

Since it exited the crisis in 2013, Madagascar embarked on reforms to improve its public finance management (PFM) system. As per the results of the last PEFA 2017 on 2016 outputs, the main legal bases are robust, but the PFM system has two main weaknesses: low budgetary credibility due to limited supervision and insufficient control of public enterprises, whose imbalances cause unforeseeable subsidies and Parliament's marginal influence over the budgetary process. Based on the Country Fiduciary Risk Assessment (CFRA) prepared by the Bank, fiduciary risk was deemed substantial in 2017.

To mitigate this risk and address the country's weak PFM, risk mitigation measures were defined in the CFRA matrix. The authorities committed to improve the country's PFM performance through the implementation of these measures. Achievements in that regard include: (i) the design of a strategic public finance modernisation plan (PSMFP) over a ten-year period (2017-2026) and implementation of its action plan ; (ii) submission of the Draft Appropriations Act within the statutory timeframes; (iii) tighter *ex-ante* control and service rendered (DGCF); (iv) operationalisation of the Budget and Financial Disciplinary Board (CDBF); (iv) institutional and technical capacity-building for key oversight bodies including the General State Inspectorate (IGE), DGCF and the Treasury Inspectorate; and (v) institutional and technical capacity-building for agencies responsible for external audit and corruption control, including CdC, BIANCO and CSI.Given the political commitment to continue rolling out the PSMFP actions and measures listed in the Bank's CFRA matrix, the country's fiduciary risk will reduce to a moderate level in the medium term. The detailed analysis is attached to this report as Technical Annex 1.

2.5. Criterion 5 - Harmonisation

Development partners in Madagascar coordinate their activities through sector and thematic groups, to strengthen political and strategic dialogue, align and harmonise their interventions. The Bank actively participates in this process within the Public Finance/Budget Support Group along with the World Bank, the European Union and the French Development Agency. The International Monetary Fund (IMF) also participates in the process as observer. For 2018, the World Bank and the European Union plan to disburse USD 90 million and EUR 15 million, respectively. For its part, the IMF plans to disburse support for the third review of Madagascar's economic reform programme backed by a third ECF agreement in July 2018. The PACE II reforms were discussed in advance with the above partners and selected based on each institution's comparative advantage and value added, in a logic of harmonisation and complementarity.

III. 2018 PROGRAMME – PACE II

3.1 Programme Goal and Objective

3.1.1. PACE will contribute to creating favourable conditions for strong inclusive economic growth by improving economic competitiveness in Madagascar. In this regard, PACE will help to remedy the investment deficit in Madagascar and improve governance in the energy, transport and agro-industry sectors.

3.1.2. The programme's expected impact will be to raise the GDP growth rate from 4.2% (2016) to 5.5% (2020), and improve Pillar 2 (infrastructure) of the Global Competitiveness Index from 1.9 (2016) to 2.3 (2020).

3.2 Programme Components

3.2.1 As a follow-up to Phase I, this PACE Phase II has two components. The first component: "Strengthen the regulatory and institutional framework for the promotion of public and private investments" will help to create a favourable environment for the promotion of public-private partnerships (PPP) to develop anchor infrastructure projects. This component will also help to modernize legal and institutional frameworks to promote investments in agro-industry. The second component "Improve sector governance to support economic competitiveness" will place emphasis on enhancing energy and transport sector performance. These two components are complementary and mutually reinforcing and, if satisfactorily implemented, will attract private sector PPP-based financing in the energy, transport and agro-industry sectors to stimulate economic growth and create very high value-added jobs.

Component I: Strengthen the regulatory framework to promote public and private investments: This component will create a favourable regulatory and institutional framework for the promotion of

PPP investments in high value-added job-creating sectors (including agro-industry) and infrastructure projects. It will focus on the two sub-components presented below.

Sub-component 1.1 – Improve the regulatory and institutional framework to promote investments

3.2.2 Context

Madagascar's private sector is still undeveloped and characterised by very small informal enterprises with minimal involvement in very high value-added processing activities. Nevertheless, Madagascar has strong assets to create a conducive environment for a more competitive private sector. In fact, the country has abundant and cheap labour. The country made some progress in 2017 with regard to the business climate. According to the World Bank's Doing Business 2018 Report, Madagascar is ranked 162nd out of 190 economies under "Ease of doing business", against 167th in the 2017 classification, thereby gaining 5 places. This improvement is especially at the level of loan and business-creation procedures. Points of weakness where reforms are still needed mainly concern the costs and time needed to obtain construction permits, the electricity connection costs/time, registering property and enforcing contracts.To attract private investment, the country endowed itself with an Industrial Development Policy in 2015. The proposed model is based on export-oriented industries (textiles, processed agricultural products). In 2016, a Law on Public-Private Partnerships (PPP) was adopted. In 2017, the authorities revised the institutional and legal framework governing Special Economic Zones (SEZ) to promote industrialisation, economic diversification and job creation. The sectors identified for SEZ development are textile/dress-making, agro-industry and tourism.

3.2.3 PACE I Achievements

Measures planned under this sub-component to create favourable regulatory and institutional frameworks for investment promotion were all implemented. They are: (i) operationalization of the projects selection criteria manual to be financed under PIP; (ii) design of a PPP strategy; and (iii) adoption of the law on SEZs.

3.2.4 Measures Supported by PACE II

To consolidate the above-mentioned Phase I measures, the following measures will be implemented in Phase II: (i) adoption of the PPP strategy to guide the selection, sustainable and efficient management of PPP projects; (ii) establishment of a PPP projects management structure in the Ministry at the Presidency in charge of Presidential Projects and Equipment (*preliminary action*); and (ii) preparation of a feasibility study on the establishment of a SEZ in Madagascar.

Sub-component 1.2. Modernisation of legal and institutional frameworks conducive to the expansion of agro-industry

3.2.5 Sector Context

Madagascar exploits agricultural land estimated at about 2 million hectares out of the 35 million potential hectares favourable for intensification of the food crop cultivation, field crops and other major productions. Since Madagascar's climate is favourable for tropical and temperate farming, intensification is an alternative to accelerate agricultural growth and boost productivity. The country also has a significant work force and pro-production skills. Rice-based agriculture is the largest sub-sector in Madagascar since it engages over 85% of households while commercial agriculture is mostly practiced along the East coast and in the North where coffee, vanilla, wallflowers and lychee are the main cash crops.

Sector constraints: Madagascar still practices traditional, non-intensive low-yield agriculture. The proportion of cash and export crops, meant for sale, is low. These products must comply with phyto-sanitary standards, which most fail. On that score, they are not accepted on international markets. The agricultural sector is also characterized by its vulnerability to climatic conditions such as cyclones, drought (in the South), locusts and caterpillars, which often destroy the crops.

Distribution systems are poorly developed and the high cost of transporting inputs have led to lower productivity. Added to that, production infrastructure (e.g. irrigation) is insufficient and several irrigation schemes have deteriorated due to lack of maintenance (estimated at about 1.2 million irrigated hectares).

To remedy the poor management of irrigation schemes, the Government adopted a law governing scheme management. Further, in a bid to develop the cash-crop sectors and improve product quality, the Government identified certain laboratories (*Institut Pasteur*, for example) to analyse the sanitary standards of agricultural produce.

3.2.6 PACE I Achievements

Measures adopted for the first phase to create favourable conditions for the upsurge of agro-industry, enhance the sector's competitiveness and conquer local and regional markets, were successfully implemented. These include: (i) the adoption of the implementing decree on the management, maintenance and preservation of irrigation schemes. This instrument distributes tasks between Government and exploiters, with Government taking charge of "strategic" infrastructure like dams, intake structures and main canals, while farmers will take care of secondary, tertiary and quaternary canals, drying, processing and storage; and (ii) the adoption of the law on industries.

3.2.7 Measures supported by PACE II

To consolidate Phase I measures, PACE II will continue to support reform measures aimed at modernising the legal and institutional framework for the development of agro-industrial growth poles. These include: (i) the adoption of the implementing decree on sanitary standards of agricultural and agro-industrial products to promote exports; (ii) definition of the legal framework governing agropoles; (iii) preparation of the decree defining a transparent land allocation mechanism in agropoles, and contract specifications for private investors and the local population.

Component II- Improvement of Sector Governance to Support Economic Competitiveness: This second component aims to improve governance in growth-bearing sectors, namely energy and transport. The aim of this component is to improve the management of these sectors to attract more private investments. This component has two sub-components: (i) improve energy sector management; and (ii) improve air transport sector performance.

<u>Sub-component 2.1: Improve Energy Sector Management</u>

3.2.8 Sector Context

The national electricity access rate was 15.25% in 2016 (57.59% in urban areas and 6.10% in rural areas) and remains among the lowest in Africa. Electricity in Madagascar is distributed by the State-owned company, JIRAMA. JIRAMA's own production is supported by many private producers using mainly diesel-powered generators.

In recent years, the company experienced a series of financial difficulties and is unable to meet new connection demands. JIRAMA's network is obsolete for want of preventative maintenance. The thermal equipment seriously over-stretches JIRAMA's finances, which had to pay an enormous oil bill estimated at MGA 636 billion (USD 215 million) in 2016. To cushion the impact on consumers, the State grants operating subsidy every year to contribute to fuel and energy purchases and the lease of generators to private individuals. This subsidy stood at MGA 450 billion in 2017. JIRAMA has been in financial deficit for a decade now due to: (i) very high technical and non-technical losses (33%); (ii) electricity selling prices that are far below the cost price (on average MGA 275/kWh in 2016, against a cost price of MGA 765/kWh); and (iii) a very low bills recovery rate (54% in 2016). Tariff increases were applied to the tune of 15% in 2016, then 7.5% on average in July 2017, and lastly 10% on average in January 2018. The Electricity Code adopted in April 2018 replaces Law No. 98-032 to include provisions related to the exploitation of renewable energy sources.

3.2.9 PACE I Achievements

The measures selected under this sub-component will contribute to better electricity sub-sector performance. These include: (i) the signing of the performance contract between the JIRAMA General Manager and the State. The objectives of the contract were drawn from the "Letter of Madagascar's Energy Policy 2015-2030", which summarises the main guidelines, objectives and strategies adopted to increase the household access rate to modern electricity from 15 to 70% by 2030; (ii) the improvement of JIRIMA's financial and commercial performance through the signing of a plan to settle State arrears owed the company and the payment by the State of MGA 3.9 billion; (iii) the reinforcement of transparency through the award of management concession contracts on a competitive basis; and (iv) the design of JIRIMA's draft masterplan. The masterplan is being finalised and will be approved in August 2018.

3.2.10 Measures Supported by PACE II

To continue and consolidate Phase I reforms, the second phase supports the following measures: (i) adoption of JIRAMA's masterplan that will guide efforts to achieve the objectives of Madagascar's Energy Policy 2015-2030; (ii) the promotion of results-based management through the signing of target-type contracts between JIRAMA's General Manager and Directors; (iii) the improvement of the financial and commercial performance through the State's payment of MGA 7.8 billion of consumption arrears to JIRAMA (*preliminary action)* and the recovery of at least 65% of 2018 bills of all categories; and (iv) the audit of JIRAMA's assets and liabilities, with a view to taking measures to sanitise the company's financial situation.

Sub-component 2.2 Improvement of Air Transport Sector Performance

3.2.11 Sector Context

The restructuring of Air Madagascar is a major challenge for improving the country's economic competitiveness. This company remains strategic in terms of allowing access to the most remote economic zones of the country and connecting the country to the rest of the world. Furthermore, the company plays a key economic role. According to a World Bank study in July 2017, its direct impact on the travel and tourism sector in 2016 accounted for over 5% of GDP. Considering both the indirect and induced effects, Air Madagascar accounted for nearly 14% of GDP in 2016. Besides, its total contribution to employment (including the widest impacts of investment, logistics chain and impacts of induced income) was estimated at 641,500 jobs in 2016, or 11.4% of total employment in the country. Its disappearance could deal a serious blow to the already fragile economy.

Considering the company's technical and financial difficulties, the Government set up a new Board of Directors in August 2015. Its main mission was to prepare Air Madagascar for a strategic partnership with a leading private carrier. In March 2017, after a competitive Call for Proposals, Air Austral was selected by the Air Madagascar Board of Directors as the technical and financial partner. In November 2017, Air Madagascar signed a strategic partnership with Air Austral. Under this partnership, Air Austral acquired 49% of Air Madagascar's shares worth about USD 40 million, and the State took charge of all the company's accumulated debts as at end-October 2017, estimated at USD 88 million. To improve the company's performance, Air Austral will operationalize Air Madagascar's medium- and long-term development plan 2017-2020, which contains actions to enable the company which registered losses of nearly USD 20 million in 2016, to attain balance and achieve growing returns as from 2021.

3.2.12 PACE I Achievements

PACE I was expected to support the conclusion of a strategic partnership between the national carrier Air Madagascar and a standard private carrier to help boost air transport sector performance. This measure was achieved especially with the signing of a strategic partnership with Air Austral. The aim of this partnership with a private carrier was to strengthen Air Madagascar's management and enable it to achieve positive results. This will also lead to a gradual reduction of State transfers to Air Madagascar until total phase-out at end-2019.

3.2.13 Measures Supported by PACE II

To consolidate PACE I measures, the second phase will support: (i) the settlement of Air Madagascar's liabilities. So far, the Government has already reimbursed USD 55.7 million (MGA 179 billion). The USD 38.6 million (MGA 124 billion) balance will be settled by end-2018; and (ii) the implementation of Air Madagascar's medium-term business plan in which financial balance is expected to be attained as from 2021.

3.3 Programme Outputs and Expected Outcomes

3.3.1. Progress Towards Achieving PACE I Output Targets (2017)

The PACE I output targets described in the logical framework were achieved as follows:

Table 2: Progress Towards Achieving PACE I Output Targets

Action	Implementation Progress
Component 1 : Improve the regulatory and institutional framework to promote investments	
1.1 Support the development of public-private partnership	
Adoption of the manual on selection criteria of PPP projects to be financed	**Done** : The manual is available and used to select PPP projects to be financed
Transmission of bill on special economic zones (SEZ) to Parliament	**Done:** Parliament passed the Law on SEZs in March 2018
1.2 Modernisation of legal and institutional framework to foster the expansion of investments in agro-industry	
Adoption of the implementing decree on the management, maintenance and preservation of irrigation schemes.	**Done :** Decree to implement Law No. 2014-042 of 9 January 2015 governing the rehabilitation, maintenance, management, preservation and policing of irrigation areas was adopted
Adoption of the law on industries	**Done:** Law was adopted by Parliament in 2017
Component 2 : Strengthen sector governance to support economic competitiveness	
2.1. Improve electricity sub-sector performance	
Preparation of the JIRAMA masterplan	**Ongoing**: The masterplan will be finalised and approved in August 2018
Promotion of results-based management through the deployment of target-type contracts	**Done:** Performance contract signed between the State and JIRAMA
Improvement of JIRAMA's financial and commercial performance	**Done:** Plan to settle arrears that the State owes JIRAMA signed by the two parties, indicating the amount owed and the modalities for settlement in 2018 and 2019. Payment of MGA 3.9 billion by the State into JIRAMA's account
Strengthening of transparency in granting management concession	**Done:** Management concessions are granted on a competitive basis and the standard contract for concessions is available
Increase of tariffs	**Done:** An increase of 10% on average was applied in 2018
2.2. Improve air transport sector performance	
Improvement of Air Madagascar's performance	**Done:** The strategic partnership contract has been signed between Air Madagascar and a leading private carrier (Air Austral)

3.3.2 Progress Towards Achieving the Outcome Indicators and Programme Impact

The achievement of Phase 1 outcome targets was deemed satisfactory (see Table 2) and the implementation of outputs for the second phase is well underway (see Annex 3). In this regard, the expected outcomes are on track as presented in Table 3 below:

Table 3: Progress Towards Achieving the Outcome Targets Announced in the Logical Framework

Outcome Indicator	Target	Achievements/Observations
Outcome 1: Increase of public and private investments		
Public investment rate and private investment rate (% of GDP)	2019: 10.5% of GDP and 10.9% of GDP	Ongoing: The economic upturn, the strengthening of the legal framework for the promotion of investments, the return of mining projects and the promises made at the 2016 Paris Donor Conference will contribute to achieving the 2019 target. In 2018, the public investment rate is projected at 8.1% of GDP and the private investment rate at 9.3% of GDP.
Number of jobs created (three-year total of the 2017-2019 programme)	2019: 100,000	Ongoing: The IFZ textile sector and the service sector (tourism, construction) contributed to the creation of new jobs estimated at 45,589 in 2017. With the establishment of SEZs and the promotion of agropoles, there are more job opportunities, especially for women. Thus, the target set for 2019 will be achieved.
Outcome 2: Streamlining of public expenditure		
Reduction of transfers to public enterprises	2019: MGA 150 billion	Ongoing: In 2018, subsidies to JIRAMA are estimated at MGA 450 billion. However, the authorities committed to gradually reduce subsidies through actions that will help to improve the company's governance and fiscal consolidation. These measures to strengthen JIRAMA are supported by donors through ongoing investment projects
Outcome 3: Improve sector governance to boost economic competitiveness		
JIRIMA's increased recovery rate	2019: 75%	Ongoing: JIRAMA Management undertook in its target-type contract to recover over 65% of bills consumed in 2018, with 75% as the 2019 objective.
Growth of the value-added of primary sectors (PS) and secondary sectors (SS)	PS- 2019: 2.7% SS- 2019: 7.7%	Ongoing: Implementing reforms to expand agro-business will make it possible to achieve the 2019 target. In 2017, growth was 0.8% (PS) and 5.7% (SS). This low performance stems from the negative effects of climate change, which led to the sharp fall in agricultural production.

3.4. Progress Towards Achieving the PACE II Indicative Triggers

3.4.1 PACE II indicative triggers as defined at the outset during PACE I appraisal were achieved satisfactorily. The implementation progress of each trigger is presented in paragraph 3.6.1.

3.5. Policy Dialogue

3.5.1 PACE is a three-year programme-based operation aimed at supporting the authorities in implementing structural reforms. Dialogue on selected reforms started in May 2017 and will continue to end-2019 with emphasis on the following points: (i) strengthen public investment in the social sectors and infrastructure to better ensure inclusive growth; (ii) rationalise public expenditure by reducing non-priority spending, and pay special attention to JIRAMA and Air Madagascar's financial problems; (iii) improve public finance management especially to better mobilise tax revenue and build the capacity of internal/external control bodies, via PAGI; and (iv) strengthen sector governance to support the structural transformation of agro-industry and the economy in general, to achieve inclusive growth. To strengthen dialogue, the Bank in collaboration with other donors, will support Government's efforts through investment projects.

3.6. Grant Conditions

3.6.1 Preliminary Actions (triggers)

All actions precedent (triggers) to the submission of PACE II to the Bank Board of Directors, which were defined during Phase I appraisal, are presented in Table 4 below:

Table 4: Actions Precedent (triggers) and Required Evidence for PACE II (2018)

Preliminary Measures – 2018	State of Progress/ Proof of Implementation
Component 1 : Improve the Regulatory and Institutional Framework to Promote Investments	
Precedent Measure 1: Adoption of the decree establishing a PPP project management structure	*Implementation progress:* Done **Proof 1** : Decree establishing the PPP project management structure
Precedent Measure 2: Signing of contract for the conduct of the study on the establishment of a SEZ in Madagascar and transmission of the validated study inception report	*Implementation progress:* Done **Proof 2:** (i) Contract signed between EDBM and the consulting firm responsible for the study (ii) Report of commencement of the study to establish a SEZ (iii) Report of EDBM's approval of the study inception report
Component 2 : ***Strengthen Sector Governance to Support Economic Competitiveness***	
Precedent Measure 3: Signature of performance contract between the JIRAMA General Manager and Directors	*Implementation progress:* Done **Proof 3: P**erformance contracts signed between the JIRAMA General Manager and Directors (directorates attached to the Directorate-General and Operational Directorates)
Precedent Measure 4: Settlement of MGA 7.8 billion of State arrears owed JIRAMA	*Implementation progress:* Done **Proof 4:** (i) Statement from the Antananarivo General Revenue Department dated and signed attesting the payment of MGA 7.8 billion into the JIRAMA account opened in the Treasury (ii) JIRAMA's letter acknowledging the State's transfer of MGA 7.8 billion into its account in the Treasury

3.6.2. PACE III Triggers (2019)

Following dialogue, the Government undertook to put a set of measures in place prior to submission of the programme to the Bank Group's Board of Directors. The following table shows the indicative measures to serve as triggers for the programme's third phase in 2019. These indicative measures, drawn from the matrix discussed between the Government and the Bank, can be modified during preparation of the Phase III simplified appraisal report in 2019. The measures are as follows:

Table 5: Triggers for 2019

Indicative Preliminary Measures – 2019	Evidence of Implementation
Component 1 : Improve the regulatory and institutional framework to promote investments	
Precedent measure 1/ Phase 3: Final report on study to establish a SEZ approved	Report approved by EDBM
Precedent measure 2/ Phase 3: Draft decree instituting agropoles is submitted to the Council of Ministers	Draft decree submitted at the Council of Ministers
Component 2 : Strengthen sector governance to support economic competitiveness	
Precedent measure 3/ Phase 3: Audit JIRAMA's assets and liabilities	Audit report on JIRAMA's assets and liabilities
Precedent measure 4/ Phase 3: Ministerial order on the installation of smart prepaid meters in all Government departments	Ministerial order

3.7. Good Practice Principles for the Application of Conditionality

Pursuant to the Bank policy on programme-based support operations (*ADF/BD/WP/2011/38/Rev.3/Approval dated 29 February 2012*), the programme design reflected the four good practice principles for the application of conditionality**.** These four principles are justified by the following developments: (i) Government took ownership of the programme since it was designed with the active collaboration of State structures involved in reform implementation. The programme matrix was reflected in Government's policy reform programme (Letter of Development Policy attached as Annex 1); (ii) TFP coordination was ensured for better complementarity of policy support interventions; (iii) the programme is fully aligned on the National Development Plan (NDP) priorities and supports the country's efforts to create conditions for accelerating economic growth and high value-added job creation; and (iv) conditions precedent to Board presentation are realistic and achievable. They were confirmed with the authorities during programme appraisal in April 2018.

3.8. Financing Needs and Arrangements

According to projections, Madagascar's budget financing needs for FY 2018 stand at about MGA 1,421 billion. This budget support operation is an integral part of external financing sources that will contribute to fill the budget deficit for the 2017-2019 period (Table 6). This gap will be bridged with external financing including budget support packages amounting to MGA 1,251 billion in 2018 and MGA 1,895 billion in 2019, on the one hand, and internal financing of MGA 170 billion in 2018 and MGA 171 billion in 2019, on the other. The Bank Group's budget support represents 7%, 2.1% and 1.4% of the financing needs of 2017, 2018 and 2019, respectively, and accounts for 35% of the programmed budget support operations for the 2017-2019 period.

Table 6 : Financing Needs and Sources (projections in MGA billion)

	Period	2017	2018	2019	2020
A	Total receipts and grants	5398	6322	7051	7554
	including: grants (excluding budget support)	1240	847	1515	1165
B	Total expenditure and net loans	7233	7519	9093	9476
	including: interest payments	339	392	462	502
	including: capital expenditure	2961	3286	4776	4721
C	**Global balance (commitment basis)** (A - B)	**-1835**	**-1197**	**-2042**	**-1922**
D	Arrears accumulation	-306	-225	-113	-94
E	**Global balance (commitment basis)** (C + D)	**-2141**	**-1421**	**-2155**	**-2015**
F	Internal financing	715	170	117	342
G	External financing including:	1426	1251	1895	1478
	All budget support packages	475	50	51	
	AfDB budget support	*147*	*30*	*30*	
H	**Financing (F + G)**	**2141**	**1421**	**2012**	**1820**
J	**Financing gap**	**0**	**0**	**-143**	**-195**

Source : Malagasy authorities, MFB and IMF

3.9. Application of Bank Group Policy on Debt Accumulation

The principles governing the Bank's Policy on Non-concessional Debts are applied and respected under PACE. The latest WB and IMF DSA (July 2017) concluded that the risk of a debt overhang in Madagascar is moderate. During the 2009-2013 crisis, the authorities did not contract external loans at non-concessional terms, thereby preserving debt sustainability. Nevertheless, to address the many development challenges of the post-crisis context and finance the major promising projects identified in the NDP, the authorities could, while consulting development partners like IMF, resort to non-concessional loans for up to USD 100 million (commitment basis) during the ECF 2016-2019 period.

IV. IMPLEMENTATION, MONITORING AND EVALUATION

4.1 Programme Beneficiaries

4.1.1. PACE will benefit the entire population of Madagascar. An improved regulatory framework for the promotion of investments and better sector governance (energy, transport and agriculture) will help to improve the business climate and attract more investments in higher value-added job-creating sectors for the Malagasy people. Improved governance of State-owned enterprises (JIRAMA and Air Madagascar) will also benefit the population through better performance of these companies. Furthermore, the private sector will take advantage of the enhanced economic competitiveness arising from the delivery of programme-supported reforms. The programme will benefit JIRAMA and Air Madagascar by improving their performance.

All PACE beneficiaries were met and their key concerns were reflected in the design of programme reforms.

4.1.2. Impact on Gender, the Poor and Vulnerable Groups:

Impact on Gender

Context: The Government of Madagascar is determined to bridge gender inequalities and eliminate all forms of discrimination. The Government ratified most international gender-related conventions and has recently (2017) adopted the National Strategy to Fight Gender-Based Violence (SNLVBG) 2017-2021 and its corresponding Action Plan. In education, there is virtually girl-boy parity in the primary and secondary cycle: 49.7% of girls against 50.3% of boys in 2016. However, improvements are still needed in terms of empowerment. Women do not have equal access to jobs, land and credit. With regard to entrepreneurship, women are concentrated in the informal sector and head small-size enterprises in agriculture and commerce.

Programme Impact: Enhancing Madagascar's economic competitiveness will make job-creating sectors more attractive to the private sector. Private investments in special zones (SEZ, agropoles) will create jobs for women who constitute a significant labour pool in these zones (62.4%). These reform measures will also be supported by the Bank's ongoing PAPI Project, which targets the establishment of a textile SEZ that will employ mostly women. Moreover, the improvement of power supply will benefit vulnerable groups, especially women who lack financial capacity to acquire back-up generators to supply electricity during power outages. The improved access to electricity will enable women to further engage in income-generating activities and lighten their domestic chores. (Technical Annex 9 gives more details on the gender context in the energy, agriculture and transport sectors).

Social Impact

PACE will help to improve the people's living conditions and reduce poverty by promoting productive investments in job-creating sectors, supporting practical and innovative approaches in agriculture, enhancing power supply and opening up the country's most remote economic zones.

Impact on the Environment and Climate Change

The programme is a general budget support whose reforms will not have any impact on the environment and climate change. It is classified under Category III.

Impact on Sector Governance

Measures supported by PACE will help to enhance power, transport and agro-industry sector governance. In turn, this will boost economic competitiveness and attract private investments.

Impact on Public Finance Management

The programme will also help to improve public finance management. The promotion of PPPs will lead to a reduction in Government's direct financing needs. Furthermore, enhancing energy and transport sector performance will help to scale back State transfers and subsidies to public enterprises. Thus, the priority and social sectors could benefit from more resources freed up after the successful implementation of programme reforms.

4.2. Implementation, Monitoring and Evaluation

4.2.1. PACE implementation will be coordinated by a Budget Support Steering Committee, placed under the supervision of the Secretary-General of the Ministry of Finance and Budget. This committee is responsible for monitoring the implementation of all budget support programmes funded by development partners. It coordinates regular meetings with development partners on the implementation progress of economic and financial reforms agreed with the authorities.

4.2.2. This operation will be followed by a third phase in 2019. After the conclusion of the third phase, a project completion report will be prepared to evaluate progress relative to the results-based logical framework and draw lessons for future operations.

4.3. Financial Management and Disbursement

4.3.1. ***Country Fiduciary Risk Assessment (CFRA):***

The level of fiduciary risk is deemed significant overall. However, it is possible that it drops in the medium term to a moderate level, given the Government's commitment to implement the three-year (2017-2019) action plan of the National Public Finance Management Strategy (PSMFP) adopted in 2016, as well as the complementary risk mitigation measures defined in the Country Fiduciary Risk Assessment (CFRA) matrix prepared by the Bank to help improve the country's PFM performance. (The detailed analysis is attached to this report as Technical Annex 1).

4.3.2. ***Financial Management Mechanism***:

Since this is a budget support operation, the resources will be used within the public expenditure chain circuit. The Ministry of Finance and Budget will assume responsibility for the financial and accounting management of PACE resources, and improve the implementation of its own internal control mechanism

4.3.3. ***External Audit of the Use of Funds*****:**

The PACE financial flows will be audited by the Court of Auditors of Madagascar, which has the required capacity for this exercise. However, this work will be based on terms of reference approved by the Bank. Furthermore, as part of its external public expenditure control prerogatives, the Court of Auditors will consider budget execution reports and the draft Audited Budgets of each financial year, with a view to issuing its Notice of Compliance. The Audited Budgets from FY 2017 to 2019 and the Court of Auditors' Notice of Compliance will be transmitted to the Bank within the statutory timeframes.

4.3.4. *Disbursement Methods*:

Second phase programme resources will be disbursed in one tranche on a special account opened in the Central Bank of Madagascar, subject to the country's fulfilment of the conditions precedent enumerated in Section 5.2.2.

4.4. Procurement

Madagascar's public procurement framework is thought adequate for an effective use of Bank resources allocated as budget support. Reforms of the national procurement system were engaged by Government with the support of the Bank and other TFPs. Progress has been noted, beginning with the ongoing update of the Public Procurement Code. Thus, Government undertakes all procurements under the budget support programme aimed at improving economic competitiveness, in accordance with the law instituting the Public Procurement Code (see Technical Annex 2).

V. LEGAL DOCUMENTATION AND AUTHORITY

5.1 Legal Documentation

The legal documentation is the Grant Protocol Agreement between the African Development Fund and the Republic of Madagascar to finance the budget support.

5.2. Conditions Associated with the Bank's Intervention

5.2.1. *Conditions Precedent to Effectiveness*:

The TSF Grant Agreement shall become effective on the date of its signature.

5.2.2. *Conditions Precedent to the Disbursement of Resources:*

Apart from the effectiveness conditions outlined in paragraph 5.2.1 above, the disbursement of UA 10 million TSF grant resources shall be subject to the following: *Show evidence of opening a special account in the Central Bank of Madagascar (BCM) meant to receive grant resources*.

5.3. Compliance with Bank Group Policies

PACE-II complies with Bank Group policies and guidelines for programme-based operations. It is also consistent with the operational priorities of the Bank's Ten-Year 2013-2022 Strategy and the 2017-2021 I-CSP.

VI. RISK MANAGEMENT

The major risks likely to affect the achievement of this operation's development objectives are presented in Table 6 below:

Table 7: Risks and Mitigation Measures

Risks	Mitigation Measures
Risks of: (i) socio-political instability; and (ii) macro-economic instability **High**	Mitigation measures: (i) Partnership forged between Technical and Financial Partners around ongoing reforms as well as IMF's ECF; and (ii) Government commitment to preserve security and maintain political stability.
Risk of inadequate institutional and technical capacity to implement reforms **Moderate**	Mitigation measure: All the technical and financial assistance provided by TFPs to strengthen institutional capacity can mitigate this risk.
Risk of corruption **Moderate**	Mitigation measure: Continued implementation of anti-corruption reforms, especially with the gradual establishment of anti-corruption units in ministries and institutions (see Technical Annex I).
Fiduciary risk: The risks identified by CFRA can have a negative impact on programme implementation and achievement of programme objectives (§6.5.1) **Significant**	Mitigation measure: The implementation of PAGI will help to mitigate the fiduciary risk by strengthening the institutional and human capacity of MFB, improving budget management, internal and external control. Furthermore, the implementation of PSMFB (2017-2026), the technical assistance packages and PFM improvement support projects financed by other development partners in Madagascar, will also contribute to improving public finance management and further mitigate the risks identified by the CFRA.

VII. RECOMMENDATION

It is recommended that the Boards of Directors approve a TSF Grant of UA 10 million in the form of general budget support within the framework of a programme-based approach to finance the second phase of the Economic Competitiveness Support Programme (PACE-II).

ANNEX 1: GOVERNMENT'S REQUEST

REPOBLIKAN'I MADAGASIKARA

Fitiavana - Tanindrazana - Fandrosoana

MINISTRY OF FINANCE AND BUDGET
SECRETARIAT GENERAL
GENERAL DIRECTORATE OF THE TREASURY
DIRECTORATE OF PUBLIC DEBT
External Aid and Debt Department

Antananarivo,

THE MINISTER OF FINANCE AND BUDGET

To

THE DIRECTOR GENERAL
SOUTHERN AFRICA REGION
AFRICAN DEVELOPMENT BANK

N° -2017 -MFB/SG/DGT/DDP/SADE/as

Subject: Request for Budget Support - Economic Competitiveness Support Programme

Madam Director General,

Supported by its historic partners since returning to the concert of nations, Madagascar has continued, through Government action, to intensify efforts to strengthen the foundations of its economy. In this regard, I wish to thank the AfDB for its abiding support.

In a bid to improve the quality of life of its people through strong and inclusive growth, I am pleased on behalf of the Government of Madagascar, to submit this request for the grant of a credit of **THIRTY MILLION Units of Account** (UA 30,000,000) for a three-year programme-based support programme covering the 2017-2019 period.

Overall, the budget support aims to contribute to creating favourable conditions for strong and inclusive economic growth by enhancing the country's economic competitiveness.

While waiting for a favourable outcome of our request and thanking you in advance for your kind consideration, please accept Madam, the assurances of my highest consideration.

<u>cc.</u>:

- Mr. A. BENJEBBOUR, AfDB Resident Representative, MGFO

ANNEX 2: GOVERNMENT'S LETTER OF ECONOMIC POLICY

REPOBLIKAN'I MADAGASIKARA
Fitiavana - Tanindrazana - Fandrosoana

MINISTRY OF FINANCE AND BUDGET

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The Minister

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Antananarivo, 15 May 2018

Mr. Mohamed ABDALLAH CHERIF

African Development Bank Country Manager in Madagascar

Mr. Country Manager,

Since the return to constitutional order marked by the holding of presidential elections in late 2013, Madagascar has continued to work for economic recovery. The National Development Plan (NDP) and its implementation plan (IP) served as a basis for this process, since they defined the strategic thrusts around which public programmes had to be implemented. In the same vein, the programme concluded with the IMF under the Extended Credit Facility (ECF) helped to initiate and accelerate public finance management and tax reforms. The main objective of the ECF programme is to preserve macro-economic stability and improve the business climate.

This letter is proof of Government's commitment to address the challenges of creating favourable conditions for robust and inclusive economic growth by improving economic competitiveness. Government is now implementing reforms to create a favourable and a more competitive business climate conducive to the multiplication of investment projects as evidenced in transformative activities capable of creating high value-added jobs. These measures will guarantee sustainable growth and ensure that the whole population of Madagascar benefits from the dividends of growth.

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Most Madagascans live in rural areas on the fringes of technical innovation and technological developments. Their inaccessibility is heightened by the poor road coverage and network. The telecommunications network penetration rate is lower than one would expect, which is aggravated by the inadequate rural electrification rate. The primary sector employs over 75% of the population but its share in internal production is only 28% of GDP due to low productivity. Agriculture in particular, including rain-fed rice cultivation, is exposed to and affected by the negative effects of climate change. Stockbreeding techniques also remain primitive and rural insecurity hinders farmers from developing their activities.

In urban settings, population growth has reached critical levels compared to the insufficiency of infrastructure, including housing. The development of slums is widespread and leads to serious problems of sanitation, hygiene and health. Most towns in Madagascar are exposed to epidemics that are aggravated by climate change.

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However, economic prospects remain optimistic. Medium-term economic growth will remain robust at an average annual rate of 5.2%. Nevertheless, this goal can only be attained if agricultural production becomes more resilient to silting and flooding, in particular in the face of cyclones. The primary sector indeed accounts for a non-negligible 28% of GDP and its growth is expected to stand at 2.5%. The growth of industries is estimated at an annual average of about 7.0%, with a share in GDP of around 13%. This performance must be supported by higher electricity production and exports of manufactured goods. The robustness of the tertiary sector is what should contribute the most to economic growth because this sector accounts for 58% of GDP and is expected to increase to 5.7% per year in the medium term.

In the public finance sector, management reforms have been stepped up to guarantee effectiveness of public funds allocation. The State's reduced financing capacity made it possible to only partially implement sector plans and strategies. Macro-budgetary management is focused firstly on increasing the budget space by broadening the tax base and secondly by promoting external financing through better *financing readiness*. The Government has also prioritised measures to combat the embezzlement of public funds, corruption and capital flight.

With regard to public expenditure, Government's priorities remain the development of the social sector and strategic infrastructure. Although social expenditure will absorb a great share of the budget, the allocation given to the infrastructure sector will be prioritised in order to construct, reconstruct or rehabilitate strategic infrastructure including roads, railway networks, airports and ports. Over the last few years, the sector bringing together public security, national defence and the gendarmerie has also absorbed an increasingly significant share of the State budget. Banditry in urban/rural areas, theft in the countryside, *dahalo*s and strikes have increased in recent years due to diverse and complex phenomena. In the administrative sector, several measures were also taken to fight corruption and streamline management at the level of public services.

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Many challenges remain unresolved because of the magnitude of the sequel of the last socio-political crisis, which was exacerbated by natural disasters. Poverty stands at a critical level, coupled with the low school enrolment rate, the population's reduced life expectancy and continuously dwindling household income due especially to the depreciation of the local currency, under-employment and the poor wealth redistribution. The pre-electoral political situation marked by political upheavals could also hurt the development process. This situation could delay the implementation of reforms necessary for good governance (for instance the dematerialisation of administrative procedures) and also erode foreign investor confidence.

However, prospects for Madagascar remain optimistic with its numerous advantages: unmatched biodiversity, great agricultural potential, abundant natural resources and labour. With complementarity between physical and human capital guaranteed as well as good governance, the country will become prosperous.

Government is determined to make the economy more competitive and attract more investments. Actions focus particularly on developing the energy sector, strengthening the transport sector, improving the business climate and providing better access to economic opportunities in agriculture.

Access to electricity services is very low in Madagascar. Barely over 15% of the population benefits from these services. This rate will drop to 6% if only rural dwellers are considered. In 2015, the Government adopted the 2015-2030 New Energy Policy (NEP), aligned on the National Development Plan, to address the country's urgent economic, social and environmental challenges. By 2030, 70% of households are expected to have sustainable access to power. To speed up electrification, Madagascar's Electricity Code was revised following Law No. 2017-020 promulgated last April.

JIRIMA's financial difficulties continue to overburden the State budget. This year 2018, an initial subsidy of MGA 209 billion was granted, plus an additional subsidy of MGA 100 billion to subsidize its fuel and energy purchase needs and for the lease of generators. Government took these bold measures to limit transfers to JIRAMA, which was required to adjust electricity rates, switch from diesel-powered generators to the more economical heavy fuel generators, and prepare a new law punishing electricity and water theft. JIRAMA adopted its business plan in June 2017 aimed at implementing governance reforms and improving its financial performance. In this regard, all JIRAMA Directors signed performance contracts with the General Manager

In addition, the State will still pay JIRAMA arrears of the water and electricity consumption bills of the central administration for previous years. Payment of these arrears is spread until 2019. For 2018, the Government has already released MGA 7.8 billion.

The Government is committed to promoting PPP (Public-Private Partnership) to boost investments in sectors that stimulate economic growth, especially infrastructure, agriculture, tourism, the industrial and mining sectors. This commitment is confirmed by the Law on PPP signed in 2016. An implementing decree of this law related to the establishment of a PPP project management structure was prepared and adopted by the Council of Ministers.

In the same vein, the Government decided to create a legal and institutional framework to facilitate the establishment of Special Economic Zones (SEZ) in Madagascar. The objective is to propose a competitive business environment to investors. Textile/dress-making, agro-industry, Information and Communication Technologies (ICT) and tourism are the main sectors identified. Law No. 2017-023 to establish SEZs was passed by Parliament in December 2017, but the High Constitutional Court recommended that some of its provisions be amended. An in-depth study will be carried out and will be entrusted to a consultancy firm. The corresponding contract was signed with EDBM.

Agriculture is the backbone of Madagascar's economy. Nearly 80% of the population live in rural areas and most of them engage in agriculture as their main activity. Agricultural productivity in Madagascar is low. According to the FinScope consumer survey of 2016, 9% of households that depend on agriculture for their livelihood also engage in commercial agriculture. To promote this practice, the Government engaged the process of standardising three laboratories for agricultural product analysis, with a view to their international accreditation. In fact, the food health safety system is a major challenge for export procedures. Since the agricultural sector, stockbreeding and fishing account for 70% of the Madagascar's exports, compliance with international standards of foodstuff phyto-sanitary safety will be a priority for the country. Therefore, the law instituting sanitary standards of agricultural and agro-industrial products should be urgently applied. The corresponding implementing decree has been submitted to the Council of Ministers for adoption.

The implementation of all the actions envisaged under the National Development Plan will enable Government to meet its objectives, especially to boost economic growth and reduce poverty. However, due to limited resources, the Government is soliciting financial support from the African Development Bank in the form of a budget support.

(Stamp of the Ministry of Finance and Budget)
(Signed) (ANDRIAMBOLOLONA Vonintsalama S.)

ANNEX 3: 2017-2019 PROGRAMME REFORMS MATRIX

Programme Components	**Reform Measures and Indicators**			**Outcome Indicators**
	2017	**2018**	**2019**	**2020**
Component 1 : Improve the regulatory and institutional framework to promote investments	*1.1 Support the development of public-private partnerships*			Rate of public investments and Rate of private investments as % of GDP: 10.5% of GDP and 10.9% of GDP Number of jobs created in 2019: 100,000 [5] (75% of them women) Growth of value added in the primary sector (PS) and secondary sector (SS) : 2.7% (PS) and 7.7% (SS), against 1.6 % (PS) and 5.5% (SS) in 2016.
	Adoption of a manual on selection criteria for projects to be financed in PIP *Indicator: PIP project selection manual adopted*	Adopt the PPP strategy *Indicator: PPP Strategy approved in Council of Ministers* *Implementation progress: The PPP strategy is available, it is expected to be adopted in Council of Ministers before end-June 2018*		
		Establishment of PPP project management structure *Indicator: PPP projects management structure established by decree* *Implementation progress: Structure was put in place by decree. The officer in charge of the PPP Unit is already recruited by Government.*	Promotion of PPPs *Indicator : 1 PPP project ongoing*	
	Adoption of the law on SEZ *Indicator: Law on SEZ adopted*	Finalisation of feasibility study for the establishment of SEZ *Indicator: Feasibility study approved* *Implementation progress: Law on SEZ was passed by Parliament in March 2018, the contract with the consulting firm tasked with preparing the study was signed in January 2018, the study commencement report is available and the study will be finalized in August 2018*	Establishment of the SEZ *Indicator: Bid invitation for the establishment of the SEZ*	
	1.2 Modernize the legal and institutional frameworks to favour the upsurge of investments in agro-industry			
	Adoption of the implementing decree on the management, maintenance and preservation of irrigation schemes *Indicator: Decree adopted*	Adoption of implementing decree on the sanitary standards of agricultural and agro-industrial products *Indicator: Decree adopted* *Implementation progress: Draft decree is ready and will be presented to the Council of Ministers for adoption in May 2018*	Installation of an incubation centre for youth in agriculture and industries *Indicator: an incubation centre for the youth*	
	Preparation of draft law on industries *Indicator : a draft law is prepared*	Prepare the draft law governing agropoles *Indicator: Submission to Council of Ministers of the decree on agropoles*	Adoption of the decree governing agropoles and the law governing industries	

5 Three-year total of the programme

Programme Components	Reform Measures and Indicators			Outcome Indicators
	2017	2018	2019	2020
		Implementation progress: The integrated agro-industrial growth pole project, which has to define the regulatory instruments governing agropoles, is ongoing. This Bank-financed project was approved in 2017. The draft decrees will be available by end-2018	*Indicator: Decree on agropoles is adopted by the Council of Ministers and the law on industries is submitted to Parliament*	
		Prepare the draft decree governing the agropoles promotion and management structure *Indicator: Draft decree* *Implementation progress: The draft decrees will be available before end-2018*	Preparation of a draft decree governing the agropoles promotion and management structure *Indicator : the structure is set up by decree*	
		Prepare a draft decree governing a transparent mechanism for allocating land in agropoles and contact specifications for private investors and the local population *Indicator: Draft decree* *Implementation progress: The draft decrees will be available before end-2018*	Adoption by decree of a transparent mechanism for allocating land in agropoles and contract specifications for private investors and the local population *Indicator: Mechanism defined by decree*	
Component 2 : Strengthen sector governance to support economic competitiveness	*2.1 Strengthen electricity sub-sector performance*			
	Preparation of an energy value chains development masterplan (production, transmission and distribution) *Indicator: Masterplan being prepared*	Adoption of the energy value chains development masterplan (production, transmission and distribution) *Indicator: Master plan is adopted by the JIRAMA Board of Directors* *Implementation progress: The JIRAMA masterplan is being prepared ; adoption by the JIRAMA Board of Directors is expected in August 2018*	Signature of a contract with a private operator to produce 192 Mw of hydropower *Indicator : production contract signed with a private operator*	JIRAMA's recovery rate rises from 54% in 2016 to 75% in 2019 Rationalization of public expenditure is strengthened: reduction of State transfers to public enterprises from MGA 750 billion in 2017 to 150 billion in 2019 Public investment rate and private investment rate as % of GDP: 10.5% of GDP and 10.9% of GDP
	Promotion of the signature of contracts of agreed objectives[6] between the State and JIRAMA Management *Indicator: Contract signed*	Promotion of results-based management through the signing of contracts of agreed objectives between the JIRIMA General Manager and Directors *Indicator: Performance contracts signed* *Implementation progress: Performance contracts between the JIRAMA General Manager and Directors are signed*	Evaluation of the outcomes of the objectives-based contract signed in 2017 *Indicator: independent evaluation of the objectives-based contracts signed*	
	Improvement of JIRAMA's commercial performance: Recovery of the central government's unpaid bills	Improve JIRAMA's commercial performance: Recovery of all categories of unpaid bills (including enterprises and households) *Indicator:*	Improvement of JIRAMA's commercial performance: Recovery of all categories of unpaid bills (including enterprises and households) and installation of prepaid smart metres *Indicator:*	

[6] Contracts will specify commitments of the State and JIRAMA, based on the business plan aimed at achieving financial balance for the company by 2020

Programme Components	Reform Measures and Indicators			Outcome Indicators
	2017	**2018**	**2019**	**2020**
	Indicators: *-a plan for settlement of State arrears owed JIRAMA is signed by both parties* *-payment by the State of MGA 3.9 billion to JIRAMA*	*-payment by the State of MGA 7.5 billion to JIRAMA as consumption arrears* *-65% recovery in 2018 of bills of all categories* *Implementation progress: Done*	*- payment by the State of MGA 7.5 billion to JIRAMA as consumption arrears* *-75% recovery in 2019 of bills of all categories* *-Installation of smart prepaid metres in government departments*	
	Strengthening of transparency in granting management concessions *Indicator: Adoption of model concession contract*	Strengthening of transparency in granting management concessions *Indicator: Zero management concession without tenders* *Implementation progress: Done*	Strengthening of transparency in granting management concessions *Indicator: Zero management concession without tender*	
		Streamlining of JIRAMA's financial situation: *Indicator: Audit of JIRAMA's assets and liabilities* *Implementation progress: JIRAMA has already recruited an external audit firm. The audit of liabilities is ongoing while that of assets will begin in June 2018. The assets/liabilities audit will be finalised latest in August 2018*	Implementation of the JIRAMA assets/liabilities audit recommendations *Indicator: an implementation plan of the JIRAMA assets/liabilities audit recommendations is prepared and adopted by the JIRAMA Board of Directors*	
	Rates increase: *Indicator : Average 7.5% increase applied*	Rates increase: *Indicator: Average 7.5% increase applied* *Implementation progress: Done*	Rates increase: *Indicator: Average 7.5% increase applied*	
	2.2 Improve air transport sector performance			
	Conclusion of a strategic partnership between Air Madagascar and a leading private company *Indicator: Signing of the strategic partnership agreement*	Settlement of Air Madagascar's liabilities and implementation of the carrier's medium-term business plan *Indicator: Settlement of part of Air Madagascar's liabilities* *Implementation progress: Government undertook to settle all arrears estimated at USD 94.3 million (MGA 303 billion) at end-2018. The government has already reimbursed USD 55.7 million (MGA 179 billion). The balance of USD 38.6 million (MGA 124 billion) will be settled by end-2018*	Settlement of Air Madagascar's liabilities and implementation of Air Madagascar's medium-term business plan *Indicator: Settlement of part of Air Madagascar's liabilities*	
			Implementation of Air Madagascar's business plan: *Indicator: 30% increase in domestic flights (from 2,444 flights/year registered in 2016 to at least 3,177 flights/year by end-2019*	
			Reduction of State subsidies and transfers to Air Madagascar *Indicator: MGA 0 State transfers to Air Madagascar*	

ANNEX 4: NOTE ON RELATIONS WITH THE IMF

IMF Staff Reviews Progress of Madagascar's Economic Program

March 28, 2018

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

- Performance under the ECF-supported program is positive overall.
- Economic growth is projected at 5.0 percent in 2018, and prudent monetary policy is helping to contain inflation.
- Scaling-up public investment, accelerating reforms at JIRAMA, and passing laws to strengthen governance are key to advance program priorities.

A team from the International Monetary Fund (IMF) led by Marshall Mills, Mission Chief for Madagascar, visited Antananarivo from March14–28, 2018 to hold discussions on the third review of Madagascar's economic reform program supported by the IMF's three-year Extended Credit Facility (ECF). [1] Good progress was made during the discussions, and they will continue in the coming weeks. Following conclusion of ongoing discussions, the IMF Executive Board could consider the third ECF review in June 2018.

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

"Madagascar's economic conditions remain favorable, with sustained growth and macroeconomic stability in spite of some shocks. Economic growth was estimated at 4.2 percent in 2017, despite the effects of a major cyclone and drought on agriculture and hydropower, as well as an outbreak of the plague on tourism. Growing export revenues from vanilla—boosted by high prices—and light manufactured goods led to a strong currency and created room for a substantial accumulation of foreign exchange reserves, which exceeded 4 months of imports at end-2017. The central bank has appropriately managed an associated increase in bank liquidity. Growth is projected to accelerate to 5.0 percent in 2018, led by rising public investment, continued growth in manufacturing, a rebound in agriculture and a recovery in the mining sector. Inflation is expected to decline gradually to below 8 percent by end-2018, after it rose slightly to 9 percent in 2017 due to weather-related shocks.

"Performance under the ECF-supported program remains broadly satisfactory. Based on current data, all quantitative performance targets for end-December were met and for most with a large margin. In particular, reserve accumulation and the fiscal balance continued to exceed program targets. Implementation of structural reforms in the program generally advanced as planned, except for fuel pricing and a minor delay in the new statistics law.

"Staff urged the authorities to maintain the momentum of the program to date. In particular, shifting from less productive public spending to investment and social spending is a core program objective. In the context of discussions between the authorities and the fuel distributors on a new price structure, there were delays in adjusting pump prices to rising world prices, which led to the authorities accumulating liabilities to fuel distributors. Staff recommended that the authorities adjust pump prices gradually to align them with world market prices and to eliminate the liabilities by year end.

"Financial difficulties at the state-owned public utility JIRAMA continue to weigh heavily on public finances despite the launch of an ambitious plan to restructure the company. Large losses last year exacerbated by the drought exceeded budgeted transfers, putting additional pressure on public resources. Under the authorities' current plans, JIRAMA's transfer needs are also expected to exceed budgeted transfers this year, as higher world fuel prices and service on the debt accumulated in recent years offset the impact of favorable rainfall on hydropower production. Staff urged the authorities to implement measures to limit these operational losses and JIRAMA's need for government transfers. In addition, higher than expected needs for the government's wage bill and pensions will also require increased public resources.

“Discussions also addressed priority medium-term structural reforms in monetary policy, financial sector development, and public investment. The BFM continues to develop its operational framework for monetary operations, through a better focus on managing excess bank liquidity and strengthening the legislative framework. The central bank and the ministry of finance and budget also plan to update the legal and regulatory framework for the operation of the foreign exchange market. Building on the Financial System Stability Assessment (FSSA), the authorities will update the legal and regulatory supervisory framework, move towards risk-based prudential supervision, and submit a revised banking law by year end. They are also working to speed up the execution of investment spending that is central to the program’s growth strategy. The recently adopted investment management strategy should improve implementation monitoring and ensure the consistency of new investment projects with the national development strategy.

On governance, staff stressed the vital importance of enacting the asset recovery and Anti-Money Laundering laws submitted to parliament, to fight corruption and maintain good banking relationships internationally. It also remains important to follow through with implementation of the strengthened anti-corruption legislation, asset declaration framework, and improvements to public financial management.

“The mission met with President Hery Rajaonarimampianina, Minister of Finance and Budget Vonintsalama Andriambololona, Minister of Economy and Plan Herilanto Raveloharison, Central Bank of Madagascar Governor Alain Rasolofondraibe, senior officials, as well as private sector representatives, and development partners.

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

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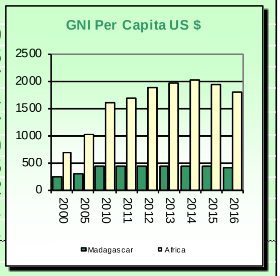
[1] The ECF is a lending arrangement that provides sustained program engagement over the medium to long term in case of protracted balance of payments problems. The arrangement for Madagascar in the amount of SDR 220 million (about US$304.7 million or 180 percent of quota) was approved by the IMF Executive Board on July 28, 2016 (see Press Release No. 16/ 370). Augmentation of access was granted under the program for SDR 30.55 million (about US$42.39 million or 12.5 percent of the country’s quota) following the IMF Executive Board meeting on June 28, 2017 (see Country Report No. 17/223).

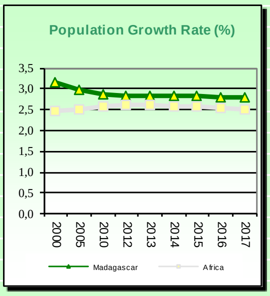
ANNEX 5: KEY ECONOMIC INDICATORS

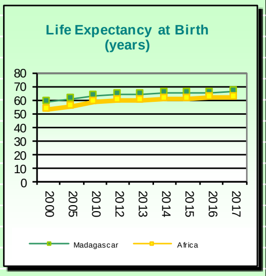
Madagascar

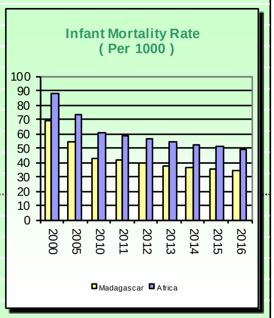
COMPARATIVE SOCIO-ECONOMIC INDICATORS

	Year	Madagascar	Africa	Develo-ping Countries	Develo-ped Countries
Basic Indicators					
Area ('000 Km²)	2017	587	30 067	80 386	53 939
Total Population (millions)	2017	25,6	1 184,5	5 945,0	1 401,5
Urban Population (% of Total)	2017	36,4	39,7	47,0	80,7
Population Density (per Km²)	2017	44,0	40,3	78,5	25,4
GNI per Capita (US $)	2016	400	2 045	4 226	38 317
Labor Force Participation *- Total (%)	2017	86,4	66,3	67,7	72,0
Labor Force Participation **- Female (%)	2017	83,8	56,5	53,0	64,5
Sex Ratio (per 100 female)	2017	99,5	0,801	0,506	0,792
Human Develop. Index (Rank among 187 countries)	2015	158	...	...	...
Popul. Living Below $ 1.90 a Day (% of Population)	2012	77,8	39,6	17,0	...
Demographic Indicators					
Population Growth Rate - Total (%)	2017	2,8	2,6	1,3	0,6
Population Growth Rate - Urban (%)	2017	4,6	3,6	2,6	0,8
Population < 15 years (%)	2017	41,2	41,0	28,3	17,3
Population 15-24 years (%)	2017	20,6	3,5	6,2	16,0
Population >= 65 years (%)	2017	2,9	80,1	54,6	50,5
Dependency Ratio (%)	2017	78,9	100,1	102,8	97,4
Female Population 15-49 years (% of total population)	2017	24,4	24,0	25,8	23,0
Life Expectancy at Birth - Total (years)	2017	66,3	61,2	68,9	79,1
Life Expectancy at Birth - Female (years)	2017	67,8	62,6	70,8	82,1
Crude Birth Rate (per 1,000)	2017	33,7	34,8	21,0	11,6
Crude Death Rate (per 1,000)	2017	6,2	9,3	7,7	8,8
Infant Mortality Rate (per 1,000)	2016	34,0	52,2	35,2	5,8
Child Mortality Rate (per 1,000)	2016	46,4	75,5	47,3	6,8
Total Fertility Rate (per woman)	2017	4,2	4,6	2,6	1,7
Maternal Mortality Rate (per 100,000)	2015	353,0	411,3	230,0	22,0
Women Using Contraception (%)	2017	46,7	35,3	62,1	...
Health & Nutrition Indicators					
Physicians (per 100,000 people)	2012	14,3	46,9	118,1	308,0
Nurses and midwives (per 100,000 people)	2012	21,8	133,4	202,9	857,4
Births attended by Trained Health Personnel (%)	2013	44,3	50,6	67,7	...
Access to Safe Water (% of Population)	2015	51,5	71,6	89,1	99,0
Access to Sanitation (% of Population)	2015	12,0	51,3	57	69
Percent. of Adults (aged 15-49) Living with HIV/AIDS	2016	0,2	39,4	60,8	96,3
Incidence of Tuberculosis (per 100,000)	2016	237,0	3,8	1,2	...
Child Immunization Against Tuberculosis (%)	2016	70,0	245,9	149,0	22,0
Child Immunization Against Measles (%)	2016	58,0	84,1	90,0	...
Underweight Children (% of children under 5 years)	2004	36,8	76,0	82,7	93,9
Prevalence of stunding	2009	49,2	20,8	17,0	0,9
Prevalence of undernourishment (% of pop.)	2015	42,3	2 621	2 335	3 416
Public Expenditure on Health (as % of GDP)	2014	1,5	2,7	3,1	7,3
Education Indicators					
Gross Enrolment Ratio (%)					
Primary School - Total	2016	143,8	106,4	109,4	101,3
Primary School - Female	2016	144,0	102,6	107,6	101,1
Secondary School - Total	2016	38,3	54,6	69,0	100,2
Secondary School - Female	2016	38,2	51,4	67,7	99,9
Primary School Female Teaching Staff (% of Total)	2016	55,2	45,1	58,1	81,6
Adult literacy Rate - Total (%)	2012	71,6	61,8	80,4	99,2
Adult literacy Rate - Male (%)	2012	75,0	70,7	85,9	99,3
Adult literacy Rate - Female (%)	2012	68,3	53,4	75,2	99,0
Percentage of GDP Spent on Education	2013	2,1	5,3	4,3	5,5
Environmental Indicators					
Land Use (Arable Land as % of Total Land Area)	2015	6,0	8,6	11,9	9,4
Agricultural Land (as % of land area)	2015	71,2	43,2	43,4	30,0
Forest (As % of Land Area)	2015	21,4	23,3	28,0	34,5
Per Capita CO2 Emissions (metric tons)	2014	0,1	1,1	3,0	11,6









Sources : AfDB Statistics Department Databases; World Bank: World Development Indicators; *last update : May 2018*
UNAIDS; UNSD; WHO, UNICEF, UNDP; Country Reports.

*Note : n.a. : Not Applicable ; ... : Data Not Available. * Labor force participation rate, total (% of total population ages 15+)*
*** Labor force participation rate, female (% of female population ages 15+)*

Tableau 2. Madagascar : comptes nationaux, 2015-22

	2015	2016		2017		2018	2019	2020	2021	2022
	estimations	EBS 16/68	est. prélim.	EBS 16/68	prév.			prévisions		
				(Variation en pourcentage)						
Croissance réelle de l'offre										
Secteur primaire	-0.7	2.2	1.6	2.8	0.8	2.6	2.7	2.7	2.2	2.2
Agriculture	-2.4	2.8	1.4	3.5	-0.3	3.5	3.7	3.7	2.7	2.7
Elevage et pêche	0.8	1.9	1.9	2.5	2.0	2.0	2.0	2.0	2.0	2.0
Sylviculture	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Secteur secondaire	7.3	4.9	5.5	5.0	5.7	6.1	7.7	7.3	7.0	7.0
Aliments et boissons	3.8	3.8	6.4	3.8	5.6	5.6	5.7	5.7	5.8	5.8
Zones franches industrielles	-0.3	9.4	24.7	10.0	15.6	12.5	12.5	10.5	10.5	10.5
Energie	4.1	5.5	8.3	5.5	6.5	8.4	13.5	11.5	9.5	9.5
Industries extractives	19.5	5.0	-1.6	5.0	2.3	3.5	6.5	6.5	6.5	6.5
Autre	1.2	4.5	5.8	4.8	5.5	6.1	6.4	6.3	5.7	5.7
Secteur tertiaire	3.3	4.8	4.8	5.3	5.8	6.5	6.9	6.4	6.0	5.6
Transports	2.0	4.9	2.1	6.4	5.8	7.3	8.8	7.7	7.9	8.0
Services	5.3	5.1	5.2	5.1	5.2	5.3	5.0	5.1	4.3	4.3
Commerce	1.0	3.1	3.1	3.0	3.0	3.0	2.1	3.0	3.0	3.0
Administration publique	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Travaux publics / construction	9.4	10.0	18.6	10.0	15.3	16.5	17.0	13.0	11.0	7.6
Impôts indirects	5.7	4.8	5.7	4.8	4.8	5.4	5.7	5.0	5.0	5.0
PIB réel aux prix du marché	3.1	4.1	4.2	4.5	4.3	5.3	5.9	5.5	5.2	5.0
Composition nominale de la demande				(En pourcentage du PIB)						
Solde des ressources	-3.5	-3.9	-2.1	-5.5	-7.4	-8.1	-7.6	-6.4	-6.2	-6.1
Importations de biens et services non facteurs	35.5	36.8	35.6	37.7	40.3	40.6	40.7	41.0	41.5	41.8
Exportations de biens et services non facteurs	32.1	32.9	33.5	32.2	32.9	32.4	33.1	34.6	35.3	35.7
Solde de la balance courante (dons inclus) = (S - I)	-1.9	-2.3	0.8	-3.7	-4.6	-5.3	-5.0	-4.2	-4.1	-4.0
Consommation	90.4	88.5	86.8	87.3	88.2	86.6	86.2	86.0	86.0	86.1
Publique	10.8	10.0	9.9	9.3	11.0	8.8	8.5	8.4	8.6	9.0
Privée	79.6	78.5	76.9	78.0	77.2	77.8	77.7	77.5	77.3	77.1
Investissement (I)	13.1	15.3	15.2	18.2	19.2	21.5	21.4	20.4	20.3	20.0
Public	3.5	5.3	5.2	8.0	8.3	10.2	10.5	9.4	9.3	9.1
Privé	9.6	10.0	10.0	10.2	10.9	11.3	10.9	11.1	11.0	11.0
dont: investissements directs étrangers	4.5	4.9	4.5	5.1	4.4	4.4	4.4	4.8	5.1	5.1
Epargne nationale (S)	11.2	13.0	16.0	14.5	14.5	16.2	16.4	16.2	16.1	16.1
Publique	0.2	2.1	3.9	3.6	3.2	5.5	6.0	5.6	5.8	5.7
Privée	11.0	11.0	12.1	10.9	11.4	10.7	10.4	10.7	10.4	10.3
Postes pour mémoire:										
PIB nominal (prix du marché)	28,585	31,773	31,769	35,507	35,731	40,183	45,304	50,398	55,846	61,570
Revenu net des facteurs	-3.9	-4.0	-4.1	-4.0	-4.0	-4.0	-4.0	-3.9	-4.0	-3.9
Transferts	5.4	5.6	6.9	5.8	6.8	6.9	6.6	6.1	6.1	6.1
PNB nominal	28,586	31,775	31,772	35,509	35,734	40,186	45,306	50,400	55,848	61,572

Sources: Données communiquées par les autorités Malgaches et estimations et prévisions des services du Fonds.

ANNEX 6: MAP OF MADAGASCAR

AFRICAN DEVELOPMENT BANK **AFRICAN DEVELOPMENT FUND**

BOARDS OF DIRECTORS

Resolution N° B/MG/2018/46 - F/MG/2018/57

Adopted by the Boards of Directors of the Bank and the Fund, on a lapse-of-time basis, on 20 July 2018

Grant to the Republic of Madagascar, from the resources of the Transition Support Facility, to finance part of the costs of the Economic Competitiveness Support Programme – Phase II (PACE II)

THE BOARDS OF DIRECTORS,

HAVING REGARD to: (i) Articles 1, 2, 32 and 37 of the Agreement Establishing the African Development Bank (the "Bank"); (ii) Articles 1, 2, 26 and 30 of the Agreement Establishing the African Development Fund (the "Fund" or "ADF"); (iii) the Report on the Fourteenth General Replenishment of the Resources of the Fund (ADF-14); (iv) the Operational Guidelines for the Implementation of the Strategy for addressing Fragility and building Resilience in Africa and for the Transition Support Facility (the "TSF Operational Guidelines"); and (v) the appraisal report contained in document ADB/BD/WP/2018/146/Approval - ADF/BD/WP/2018/102/Approval (the "Appraisal Report");

RECALLING

(i) Resolution B/BD/2008/05 - F/BD/2008/03 approved by the Boards of Directors of the Bank and the Fund on 28 March 2008 establishing a Fragile States Facility;

(ii) Document ADB/BD/WP/2014/46/Rev.2 - ADF/BD/WP/2014/30/Rev.2 entitled "Addressing Fragility and Building Resilience in Africa: The African Development Bank Group Strategy 2014 – 2019"; and

(iii) Document ADB/BD/WP/2017/175 - ADF/BD/WP/2017/123 as well as its corrigendum entitled "Fourth Cycle Assessment of Eligibility for Countries to the Transition Support Facility (TSF) Supplemental Support Funding (Pillar I) Resources" which confirmed, *inter alia*, the eligibility of the Republic of Madagascar to receive financing from the TSF Supplemental Support Window (Pillar I);

DECIDE as follows:

1. To award to the Republic of Madagascar (the "Recipient"), from the resources of the TSF Supplemental Support Window (Pillar I), a grant of an amount not exceeding the equivalent of Ten Million Units of Account (UA 10,000,000) (the "Grant") to finance part of the costs of the Economic Competitiveness Support Programme – Phase II (PACE II);

2. To authorize the President to conclude a protocol of agreement amongst the Bank, the Fund and the Recipient (the "Protocol of Agreement") on the terms and conditions specified in the General Conditions Applicable to Protocols of Agreements for Grants of the African Development Fund, the TSF Operational Guidelines and the Appraisal Report;

3. The President may cancel the Grant if the Protocol of Agreement is not signed within ninety (90) days from the date of approval of the Grant by these Boards; and

4. This Resolution shall become effective on the date above-mentioned.