4. MADAGASCAR

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4.1 Introduction

Madagascar, an island nation, is situated in Indian Ocean. It was a French colony from 1896 until independence in 1960. It had the good fortune, in the past, to be governed and united under a great sovereign: ANRIANAMPOINIMERINA, who, in the 10 years from 1800 to 1810 succeeded in creating a government worthy of the name. He was succeeded, with varying degrees of success by RADAMA I, RADAMA II, RANAVALONA I, RANAVALONA II, and RANAVALONA III. The last queen was expelled from the country by French in 1895.

It has a total area of 592.000 square kilometers with a total population of 14 million, 80 percent of whom live in the rural areas. Moreover, 55 percent of Malagasy people are under 20 age. The ancestor of Malagasy people came from Asia and Africa. Madagascar has 19 tribes which are: Sihanaka, Merina, Antesaka, Antambahoaka, Antandroy, Antefasy, Antemoro, Tsimihety, Bara, Betsileo, Bezanozano, Betsimisarka, Sakalava, Vezo, Mahafaly, Antankarana, Makoa, Tanala, and Antanosy. This implies the existence of different traditions and dialects. However, despite the diversity, Madagascar has a common language namely " Malagasy Ofisialy", which constitutes its official language apart from French.

Malagasy people are animist. They believe traditionally in only one God " ZANAHARY", creator of the universe, the nature and the men. Only 45 percent of the population are Christian. However, there is no border between the two beliefs, since the Christians, Catholic or Protestant, continue to practice the traditional rites. In fact most practice a kind of syncretism with a more or less harmonious combination of monotheism and Ancestor worship.

Madagascar has ample and varied resources, and a wide variety of soils and climates. Its environmental assets (flora and fauna) are unique in the world, but very much at risk as forests have been reduced. Main tourism attractions include the island coast in the northwest, and the southeast.

Political structure

Madagascar is a multiparty and unitary Republic with a bicameral legislature. Its legal system has based essentially on the Napoleonic Code and Customs. It adopted a new constitution through the national referendum, which occurred in March 1998. This constitution has decreed the implementation of six autonomous provinces and considerably strengthened the power of the president. In addition, certain democratic mechanisms, stipulated in the previous constitution have been maintained such as motion of censure, and impeachment. However, the previous constitution is still in effect in certain areas until the new institutions are established.

The president and the Member of Parliament, elected by universal suffrage respectively serve five and four years. It belongs to the president to appoint his Prime minister but from the candidates proposed by the National Assembly. Legislative power is exercised through the National Assembly and Senate, executive power through the council of Ministers and the presidency, and judicial power through the Supreme Court.

Education

Madagascar is one of the very few developing countries in Africa that had reached near universal primary education in the early 1980s. Moreover, higher education was valued and recognized by many neighboring countries. However, following over a decade of poor economic and sectoral management, the gross enrollment ratio in primary education has fallen back to about 73 percent, and quality of education and training has declined dramatically. According to the census, less than half of the children in school age (i.e., 6 to 14 years old) were attending school and the percentage of illiterates among the young is now more important than among the young adults and the adults under 50.

In addition, a recent report by the office of the Prime Minister indicates that the number of teachers in State schools fell from 32. 265 in 1992 to 27.743 in 1997. The number of State primary schools declined from 11.389 to 10. 435 over the same period. There is evidence of significant declines in attendance during the rainy season. The explanation given is that, once the rainy season begins, pupils find it more difficult to attend school because of flooding. In sum, school attendance has a pronounced seasonal character; it is relatively high at the beginning of the school year and gradually declines. Unsurprisingly, only 15 percent of rural schools provide the complete five years primary school curriculum.

Health

Indicators related to the health of the Malagasy population are somewhat worse than those of other Sub- Saharan African countries. For example, access to safe water is limited to 32 percent of the population, well below the Sub-Saharan African average of 47 percent. Child immunization complies with region averages, 59 percent for measles and 67 percent for DPT. In contrast, child malnutrition affects one third of the population under the age of 5, and is among the high- end of African countries.

In terms of human resources, however, Madagascar is better equipped than most other African countries. The country has 12,273 persons per medical doctor and 4,090 persons per nurse(against, respectively, 18, 480 and 6, 532 in Sub- Saharan African). The public health staff is almost sufficient to meet World Health Organization recommended targets. Madagascar is also relatively well-equipped in terms of infrastructure, with 87 hospital and 1, 812 basic health facilities. These centers cater for almost three quarters of the poor and, if operating optimally, could treat over 80 percent of the diseases which afflict the poor.

4.2 Overview of Macroeconomic Activity

During the last three decades, Madagascar’s GDP has grown at annual average rate of 0.5 percent, exceeding that of only four countries (Niger, Nicaragua, Haiti, and Kiribati). Low GDP growth and population increases of about 3 percent annually have led to continuous declines in living standards. Consumption per capita in 1997 US dollars has slipped by half, from US$ 473 in 1970 toUS$227 in 1997. As a result poverty has worsened, from affecting two fifths to three-quarters of the population. During the same period Madagascar has experienced low investment (an average of about 10 percent of GDP over the period 1997-97), which has also been very inefficient; a deterioration in the quality of human capital, evidenced in part by a fall from virtually universal primary school enrollment ratios to about 73 percent; and a decaying physical infrastructure, from a road network of over 15,000 miles at independence in 1960 to about 10,000 miles. Much of them are in very poor conditions due to the lack of regular rehabilitation.

This decline in per capita GDP and corresponding increase in poverty is stunning given the many endowments and inherited advantages of the country: rich mineral deposits; fertile land with plentiful rain; an environment attractive to different types of tourists with a unique

Eco-system, varied topography, and several climatic zones; and a coastal perimeter of about 3000 miles which provides access to rich maritime resources. Key economic sectors have remained dormant for decades such the mining and tourism sectors, mainly because of shortcomings of the business environment, which governments have been ineffective, and frequently unwilling, at addressing.

This poor performance reflects the impact of policies of economic nationalism and self-sufficiency that insolated the country, and extensive State intervention in economic activities. These policies, particularly during the seventies and most of the eighties, included prices controls to complement public enterprise monopolies; an overvalued exchange rate defended by restrictions on external trade and unsustainable foreign borrowing; budget deficits financed by money creation; and tax system heavily dependent on taxation of exports and imports.

Beginning in the second half of the 1980s, with some few exceptions after 1991, government authorities have adopted a more pragmatic economic policy stance. The exchange rate now floats freely and the country has set up a " zone franche" to attract export- oriented investment. Gradually, foreign investment has risen from virtually zero to US$ 14 million in 1997, or about a third of one percent of GDP. Private investment has increased, though it is still lower than public investment, 5 and 7 percent of GDP in 1997 respectively. The tax structure is more efficient than in the early 1990s, notably with an increased reliance on revenues from the value added tax and the elimination of the external trade taxes. Non-traditional exports have performed well for instance the fisheries sector and the export processing zone, allowing to reduce the share of traditional exports from three fourths of total exports to less than one third.

At times, however, policies have been less decisive. From example, the implementation of Madagascar's privatization program has proceeded at a very slow pace: as of mid-1998 no privatizations have occurred and timing of the most relevant ones are now likely to take place only in 1999. Direct government intervention in many activities has been maintained or even restored. The country also experienced periods of inflation during 1990s, negatively affecting confidence of economic agents in the economy. As a result, growth has alternated between promising rates in late 1980s, though barely sufficient to match population growth, and new episodes of stagnation during the first half of the 1990s. Return to a promising performance has taken place in 1996 and 1997, though still insufficient given the high rates of population growth that characterize Madagascar. Such erratic performance is due to the hesitant implementation of reforms, precluding Madagascar from providing a convincing signal of departure from past failed economic policies.

Table 4.1 Growth and GDP per Capita Performance for Countries which had in 1970 Incomes Similar to that of Madagascar

Country	Ratio of GDP per Capita to that of Madagascar 1970	Ratio of GDP per Capita to that of Madagascar 1995	Average Annual Growth Rate of GDP for 1970-95(%)
Botswana	0.8	12.7	11.1
Korea	1.7	43.4	8.5
Indonesia	0.5	4.4	7.3
Lesotho	0.4	2.2	6.1
Pakistan	1.0	2.0	5.3
Tunisia	1.7	8.6	5.1
India	0.6	1.5	4.4
Madagascar	**1.0**	**1.0**	**0.5**

Source: World Bank Economic and Social Database and Africa Regional Database.

A. International Environment

A.1. Foreign Trade and Current Account Balance

Madagascar has relied on commodities as a source of foreign exchange earnings. Although merchandise export volume has been rising at an average annual rate of 6.4 percent over the 1988-97 period, earnings have suffered from high variability owing to the fluctuations in international market conditions. Prices for coffee, cloves, vanilla, and shellfish have dropped substantially over the past 10 years. To counter, Madagascar has diversified: 43 percent of export earnings came from the four commodities in 1997, compared to 75 percent in 1988.

Owing to diversification, exports have been rising as share of GDP from 12 percent in 1988 to 14 percent in 1997, reaching earnings of US$ 537 million or about 70 percent of the merchandise import bill at the time. Over the same period, imports have grown at an average annual rate of 6,3 percent in volume terms, while the terms of trade have deteriorated by 20 percent, or approximately 2 percent a year.

Despite the adverse movement in the terms of trade, Madagascar's economy has become more open. Merchandise exports and imports together comprised 27 percent of GDP in 1988 and increased to 36 percent of GDP in 1997. Although fluctuations in the trade balance have existed in the late 1980s and very early 1990s, the period's ten-year average balance of – 5.7 percent of GDP is representative of the trade balance in recent times.

Madagascar's current account balance has been improving in recent years reflecting better exchange rate and fiscal management. Variability in the trade balance in 1989 and 1990, stemming from expensive fiscal policies of the period and high interest payments in 1991(at the time of the Paris Club rescheduling agreement), make up for the high current account balance of 1990- 1991 beyond 12 percent of GDP. Subsequent to 1991, both the trade balance and the service balance remain rather stable and the CAB in turn reflects the declining interest payment obligations.

Over the 1988-97 period Madagascar has financed its current account deficit primarily by external grants, debt relief, and accumulation of arrears. Over the period, current and capital grants combined have amounted to approximately 5 percent of GDP, while arrears accumulation and debt relief together have amounted to 10 percent of GDP. The financing pattern remains stable during the period, with debt relief and the new accumulation of arrears alternating as a sizable financing source.

Table 4.2 Madagascar: Summary Balance of Payments, 1984-1997 (in millions of SDRs)

	1990	1991	1992	1993	1994	1995	1996	1997
Trade balance	-183.4	-77.8	-100.2	-127.1	-68.6	-69.4	-83.4	-103.7
Exports, FOB	234.1	243.9	230.1	237.9	312.4	344.6	360.6	369.4
Imports, FOB	-417.5	-321.7	-330.3	-365.0	-381.0	-414.0	-444.0	-473.1
Service, net	-167.2	-210.9	-173.1	-193.1	-189.9	-193.4	-171.6	-131.7
Current account balance*	-293.9	-239.9	-195.9	-238.5	-226.5	-213.3	-194.3	-175.4
In percentage of GDP	-12.9	-12.3	-9.2	-9.9	-10.9	-10.2	-7.0	-6.7
Current account balance**	-175.5	-157.6	-106.5	-126.3	-145.5	-146.3	-103.3	-27.7
In percentage of GDP	-7.7	-8.1	-5.0	-5.2	-7.0	-7.0	-3.7	-1.1

*: Excluding net official transfers, **: Including net transfers

Source: Central and IMF.

Table 4.3 Madagascar: Direction of trade, 1994-1997 (In percentage of total)

	1994	1995	1996	1997
Exports(FOB)	**100**	**100**	**100**	**100**
European Union	53.0	50.6	55.2	54.2
Of which: France	29.8	27.2	31.7	34.1
Other Europe	0.8	4.0	2.5	3.6
United States	6.9	6.3	4.2	4.7
Asia and Middle East	10.8	7.4	20.0	11.9
Of which: Japan	7.0	5.9	15.8	3.2
Africa	7.7	12.5	12.1	13.0
Of which: Reunion	5.5	5.7	5.7	5.5
Mauritius	1.7	3.7	3.9	4.9
South Africa	0.4	….	0.6	1.2
Other countries	20.8	19.2	6.1	12.5
Import(CIF)	**100**	**100**	**100**	**100**
European Union	45.1	48.8	44.9	41.7
Of which: France	29.8	30.1	30.6	26.0
Other Europe	1.7	2.2	1.1	1.1
United States	4.4	3.8	4.9	5.1
Asia and the Middle East	27.9	23.2	9.4	22.7
Of which: Iran	5.0	10.2	9.0	2.2
Japan	9.7	6.0	5.7	7.0
Africa	11.3	0.8	9.5	8.2
Of which: Reunion	0.2	0.1	0.1	0.2
Mauritius	0.5	10.2	0.9	1.0
South Africa		…	8.1	6.3
Other countries	9.5	21.2	10.2	21.2

Source: Central Bank of Madagascar, "*Bulletin d' Information et de Statistiques, Suppplement Annuel*", 1997.

The weakness of Madagascar's balance of payments stems from a number of factors:

- Sluggish growth of the volume of exports
- Increasing dependence on food import
- A large services deficit
- Substantial burden of transportation and related to cost
- Small inflow of external resources relative to population or the size of the economy.

Table 4.4 Madagascar: Composition of Exports, FOB, 1994-1998

(Values in millions of SDRs, volumes in thousand tons, and unit value in SDR per kg)

	1994	1995	1996	1997	1998
Sisal					
Value	2.3	2.8	3.5	1.4	0.7
Volume	10.4	11.2	11.0	3.8	1.6
Unit price	0.2	0.3	0.3	0.4	0.4
Petroleum products					
Value	3.8	10.0	9.0	10.6	7.5
Volume	83.1	185.1	121.8	162.9	150.3
Unit price	0.0	0.1	0.1	0.1	0.1
Chromite					
Value	3.8	7.7	6.8	6.5	6.9
Volume	90.0	128.5	110.1	117.8	138.4
Unit price	0.0	0.1	0.1	0.1	0.1
Graphite					
Value	5.5	6.3	5.4	5.0	5.3
Volume	15.6	16.5	14.3	14.0	14.3
Unit price	0.4	0.4	0.4	0.4	0.4
Essence of cloves					
Value	2.2	3.7	2.9	3.8	2.7
Volume	1.3	1.6	1.0	1.4	1.0
Unit price	1.7	2.4	2.9	2.7	2.8
Rice					
Value	0.0	0.2	0.0	0.0	0.0
Volume	0.0	0.0	0.0	0.0	0.0
Unit price	0.0	0.0	0.0	0.0	0.0
Others items					
Value	75.4	82.8	82.3	93.1	90.0
Volume	0.6	0.6	0.7	0.9	0.9
Unit price	119.8	140.5	110.9	106.2	95.8
Exports of the export processing zone(EPZ)					
Value	44.7	69.7	120.9	135.8	143.9
Volume	0.4	0.5	1.1	1.3	1.5
Unit price	119.8	140.5	110.9	106.2	95.9
Total Value	**312.4**	**344.6**	**360.6**	**366.7**	**385.2**
Percentage change	**31.3**	**10.3**	**4.6**	**1.7**	**5.0**

Source: Central Bank of Madagascar.

Table 4.5 Madagascar: Composition of imports, CIF, 1994-1998

(In millions of SDRs)

	1994	1995	1996	1997	1998 (Prov.)
Food	55.0	44.1	41.5	35.3	40.8
Rice	26.2	12.2	5.9	12.3	12.8
Others	28.9	32.0	35.6	23.0	28.0
Nonfood consumer goods	74.5	69.1	73.8	88.3	101.3
Energy(petroleum)	50.3	53.2	73.2	84.9	68.0
Equipment goods	99.9	92.7	112.7	106.3	114.8
Raw materials and spare parts	78.0	100.0	82.2	100.0	95.3
Other imports 1/	90.5	127.9	139.0	168.3	160.9
Total, CIF	**448.3**	**487.1**	**522.4**	**583.0**	**581.1**
Total, FOB	**381.0**	**414.0**	**444.0**	**495.6**	**493.9**

Source: Central Bank of Madagascar.

1/ Including the imports of the enterprises set up in the export processing zone (EPZ) and enterprises under special tax regimes(ARD).

A.2 Exchange rate and exchange system

The float exchange rate system was introduced in Madagascar on May 6,1994. In fact this system has provoked a significant depreciation of the Malagasy Currency (Fmg). The Malagasy Franc has lost successively 65 and 53 percent of its value if compared to French Currency (FF) in 1994 and 1996. However, it is slightly appreciated in 1997.

Concerning the other currencies, owing to the appreciation of US $(from 5,1 FF in 1996 to 5.7 FF in 1997), the depreciation of Malagasy Franc against US$ was significant, 25 percent. The effect of this evolution combined with the internal depreciation result in depreciation of 19.3 percent against SDR.

Table 4.6 Madagascar: Exchange Rate

On average	1993	1994	1995	1996	1997	1998
FMG/FF	338.2	559.3	855.2	792.5	874.3	922.8
% Change	-4.0	+65.4	+52.9	-7.3	+10.3	+6.1
FMG/US$	1913.8	3067.2	4265.6	4053.5	5101.3	5441.4
% Change	+3.7	+60.6	+39.1	-4.9	+25.9	+8.1
FMG/SDR	2672.4	4414.1	6474.4	5882.2	7016.1	7383.3
% Change	+1.8	+65.4	+46.6	-9.1	+19.3	+6.2

Source: Central Bank of Madagascar.

A.3 Foreign Direct Investment

As a developing country, Madagascar needs the transfer of technology, know-how, and modern management by foreign investment. The establishment of EPZs and the passage of new investment code in 1990 contributed to an expansion of foreign investment. Despite the implications of the title, the EPZs do not require registered companies to establish themselves in specific geographic zones but merely constitute entities that fall under a specific fiscal code. The EPZs are financially attractive in that registered companies only pay one tax on profits and another on revenues from capital transfers, and in the case of the former, receive an exemption of as much as the first fifteen years of operation.

From 1990 to 1993, 100 new companies had established themselves in the EPZs, creating more than17.500 jobs and generating more than US$113 million in foreign investments. The majority of these firms were distributed among three economic sectors: clothing 48 percent, handicrafts 13 percent, and agro-processing 9 percent. French and Mauritian respectively owned 55 percent and 16 percent of them.

Table 4.7 Madagascar: Foreign Direct Investment

(In millions of USS$)

	1980	1989	1990	1991	1995	1996	1997
FDI	0	6.4	14.26	28.53	10	20	14

Source: IMF.

Factors of the weakness of Foreign Direct Investment

1) Legal environment

The legal environment of Madagascar is typical of many developing countries. As reflected in an assessment by the 1996 International Business Law Journal, the Malagasy' s legal framework does not sufficiently attract international investors and local economic agents operate in the context of informal structures, which themselves emerge as a result of the prevailing legal and judicial insecurity.

The weakness of Madagascar' s legal environment can be grouped under three main headings. First, a series of outdated legal texts (e.g, the law concerning "*societes anonyme*" dates back to 1867 and that on limited liability companies is of 1925) has combined with recent updates to create a peculiar mix of French law and Malagasy custom. Second, access to legal texts and related legal documentation is limited by lack of means(e.g., the judges often lack key legal documentation, including relevant decrees, and as a result cannot effectively carry out their duties). Third, clearly established property rights do not exist, with land tenure standing out as a main development constraint that Madagascar society needs to address without delays.

2) Entry Barriers

Potential investors (domestic and foreign) face high transaction costs and long waiting periods due to excessive formalities. Lack of information about the different formalities to be met also lead to delays. Direct and indirect fixed costs associated with registrations, licences and permits can represent an important investment burden, penalizing all but the largest investors. The existing web of required permits is so cumbersome that a market has developed to help firms navigate the maze of regulations for setting up a company.

The fact that there are so many entities involved in the registration process presents a fertile ground for corruption. In addition to the direct costs of firm registration, the time involved in such process is long and unpredictable. For example, unless a company seeks help of investment " facilitators'', it takes at least 35 days to set up a *Societes a Responsabilites Limitee*, 50 days for a *Societes Anonymes*, and more than 6 months for an Export Processing Zone company.

3) Exit costs

Few, if any, bankruptcy cases reach their conclusion, notwithstanding Article 511 of the commercial Code which requires bankruptcies to be settles within three months. Bankruptcy procedures are long, costly, and unclear, as is the rest of the judicial system. The main obstacles are labor indemnization costs, and inefficient and corrupt court officials. It is difficult for a company to stop its operations, and exit by selling assets is complicated by excessive regulations, particularly those that limit foreign ownership of land. These barriers deter private sector development because in market economies the bankruptcy procedure is the mechanism through which economic resources are redirected to more efficient uses.

4) Land Access

Access to land and real estate is also an important constraint for investors, with the debate often wrongly seen as a problem of ownership of land by foreigners. The real problem is that land ownership rights are unclear, both for domestic as well as foreign investors. About 80 percent of land is supposed to be public land owned by the State (*domain prive de l'Etat*) and about 10 percent of the total land area is covered by legal title. In practice, most land is occupied and used on the basis of customary allocations.

A.4 Foreign Debt

Over the 1988-1997 period, Madagascar has financed its current deficit primarily by external borrowing and grants. It has been perceived as an over-indebted country. It benefited in 1997 a significant reduction of the external debt by the Paris Club. The negotiation resulted in cancellation of SDR 833 million.

Consequently, the external debt amounted to SDR 2.958,9 million in1997, which reduced about 6,1 percent if compared to the debt in 1996. However, it still constitutes a burden for the Malagasy economy because it represented 115 percent of GDP, 521,7 percent of exports of goods and services, and 69 percent of tax revenue. For 1998, the external debt climbed to US$ 4 billion, which represented 130 percent of GDP.

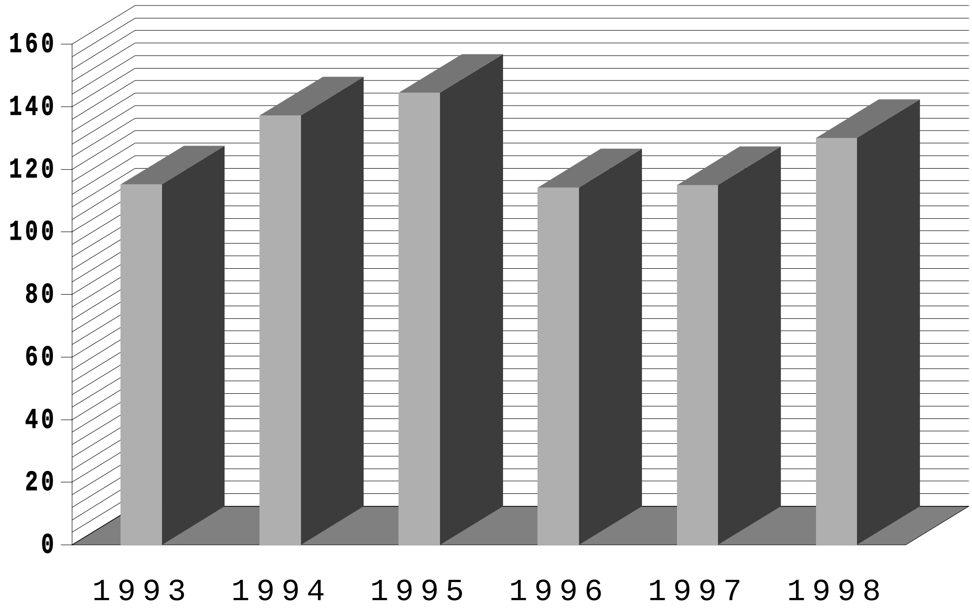
Table 4.8 Madagascar: External Debts

(In millions of SDRs)

	1993	1994	1995	1996	1997
Official Creditors	798.3	669.0	556.9	497.4	1.673.6
% Change	28.7	23.5	18.5	15.8	56.6
International Organizations	1.038.6	1.054.9	1.122.3	1.173.2	1.287.1
% Change	37.4	37.1	37.3	37.2	43.5
Private Creditors	38.3	23.3	23.2	5.2	-1.8
% Change	1.4	0.8	0.8	0.2	-0.1
Other debts	904.7	1.094.0	1.305.8	1.475.1	…
% Change	32.5	38.5	43.4	46.8	…
Total	**2.779.8**	**2.841.2**	**3.008.3**	**3.150,9**	**2.958,9**
Annual variation	4.3	2.2	5.9	4.7	-6.1
% of GDP	115.2	137.3	144.5	114.2	115.0
% of Exports of goods and services	742.8	578.8	593.7	551.7	521.7

Source: Central Bank of Madagascar.

Figure 4.1 External Debts as a percentage of GDP



A.5 Foreign Aid

To achieve economic progress, Madagascar has had to rely on foreign aid. These aids are primarily intended to finance the projects on infrastructure, population (health and nutrition), agriculture, and education. Regarding the bilateral assistance, France has been the largest donor of the country; for instance its grants amounted to US$157 millions in1991, which represented about 43 percent of the total. The next countries were Japan and United States, which respectively provided US$56.8 million and US$ 71 million in 1991.

As to the multilateral assistance, the International Development Association (IDA) has been the largest donor. It has 21 active projects in Madagascar and current commitments are about US$ 600 million. About 30 percent of projects are in population, health and nutrition, 18 percent in agriculture sector, 18 percent in the finance sector, and 19 percent are multi-sector.

Table 4.9 Foreign Assistance, Selected Years, 1979-1991

(In millions of USS$)

	1979	1982	1985	1988	1991
Bilateral Assistance					
France	38.4	96.4	47.4	108.5	157.0
Germany	2.1	12.6	16.3	14.3	30.3
Italy	0.2	1.6	2.6	3.7	21.6
Japan	21.0	28.3	11.6	42.8	56.8
Switzerland	5.8	6.8	4.8	25.8	15.3
United States	3.0	15.0	17.0	13.0	71.0
Other	7.8	7.4	5.7	9.5	13.5
Total Bilateral Assistance	**78.3**	**168.1**	**105.4**	**217.6**	**365.5**
Multilateral Assistance					
African development Fund	…	2.0	7.2	8.7	17.7
European Economic Community	15.8	21.6	17.8	30.6	17.3
International Development Association	12.6	33.1	58.4	51.0	106.0
Other	12.5	23.9	11.7	18.6	50.4
Total Multilateral Assistance	**40.9**	**80.6**	**95.1**	**108.9**	**191.4**
Other	13.8	15.0	0.0	2.7	0.0
Total	**133.0**	**263.7**	**200.5**	**329.2**	**556.9**

Source: IMF.

B. Domestic Environment

B.1 GDP growth rate

Madagascar's economy severely deteriorated from the 1960s to the late 1980s, particularly as a result of the misguided economic policies of the Ratsiraka regime. Whereas the growth rate in the gross domestic product rose at an average of 2.9 percent in real terms during the 1960s, during the 1970s and the early 1980s this figure declined to 0,2 percent, compared with 2,6 percent population growth. Real GDP rebounded in the later half of the 1980s, reaching a high of 4,1 percent in 1989. Since 1990, GDP growth has gradually decreased. In 1991, it was –6,3 percent because of the strikes, which paralyzed the economy; it stagnated during 1992-96. However, since 1997 Madagascar's GDP has started to rise, from 2,1 percent in 1996 to 3,6 percent in1997and 3,9 percent in 1998 due to the amelioration of economic situation as whole such as the growth of exports, investment (domestic and foreign).

Table 4.10 GDP by Sector in Current Prices, 1993-1997

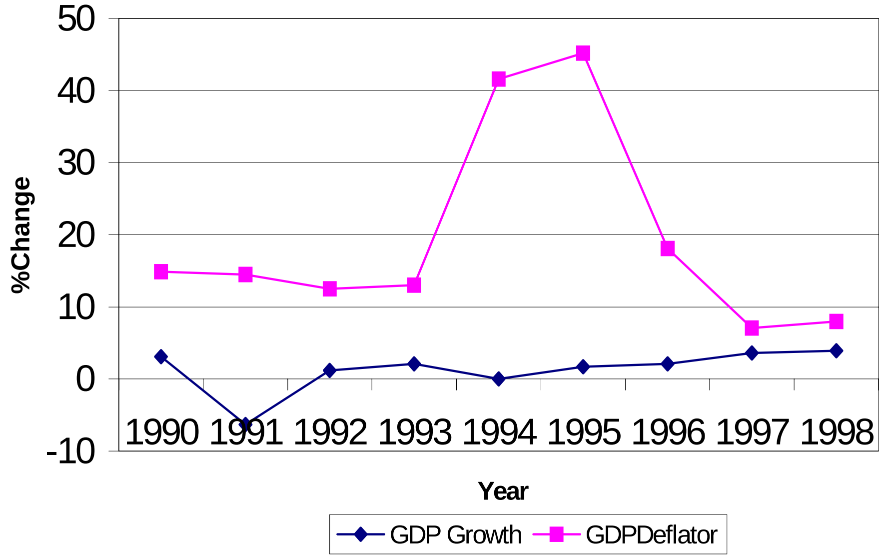
(In billions of FMG)

	1993	1994	1995	1996	1997
Primary sector	2.041.1	3.342.6	4.109.3	4.807.5	5.319.2
Secondary sector	832.9	1.155.1	1.716.9	2.047.6	2.351.3
Tertiary sector	3.221.6	4. 202.5	6.885.3	8.449.5	9.619.7
GDP at factor Cost	6.095.6	8.700.1	12.525.6	15.304.6	17.290.2
GDP at Market Price*	6.423.5	9.087.6	13.478.8	16.225.4	18.437.2
GDP at Market Price**	6.450.9	9.131.1	13.605.8	16.372.7	18.632.8

*W/o EPZ, **With EPZ

Source: Ministry of Finance and INSTAT.

Figure 4.2 GDP Growth and GDP Deflator



1) Agricultural sector

As to sectoral performance, the agricultural sector has seen modest growth averaging 1.9 percent annually since 1990. Rice, the most important of Madagascar's crops, has averaged annual increase in production of 0.5 percent, similar to that other staple foods with the exception of maize. Maize output rose by 2.5 percent on average, almost keeping up with population growth of 3 percent. Part of the difference in response between maize and rice can be attributed to the market of the farmer being free while government has continued intervention in rice until1996. Perturbations in the rice market were caused by imports that have been highly variable and sold at prices not always reflecting market conditions. Export performance has been good despite declines in the world market prices of the traditional exports. Volumes have risen except for coffee. More importantly, other agricultural exports have responded strongly to the liberalization measures adopted in the mid- eighties, rising from US$51 million (15 percent of total exports) in1984 to US$112 million (23 percent of total exports) in 1996.

2) Mining sector

The mining sector has performed well below its potential, with its formal contribution to GDP virtually stagnant since 1990 and remaining marginal, with only US$ 10 million of value added in 1996(0.3 percent of GDP) and 3.5 percent of total exports. Madagascar is best known for the production of chromite, graphite and mica, but there have been a wide variety of other minerals produced in the country; including gold, quartz, and ornamental and semiprecious stones. Recent developments have focused on gold and gemstones, but they have taken place in the informal sector and production has been smuggled out of the country.

Many other minerals have been identified (including titanifer sands, nickel and cobalt), but foreign investments failed to materialize because of continued State intervention in the sector, combersome regulations, a lack of definition in the role played by key public institutions, and overall disincentive to the development of mining operations at an industrial scale.

The private sector has shown serious interest in Madagascar's mining potential. A new graphite mine is currently under construction, with financing provided by South- African investors. A US$400 million titanifer sands project sponsored by QIT/RTZ (one of the biggest mining corporation in the world) has been under negotiations for several years. More recently, Phelps Dodge, the biggest US copper producer, has shown interest in investing up to US$500 million in the development of nickel- cobalt mine.

3) Service sector

The service sector continues to be the largest source of value added (55 percent of GDP) and the growth of the sector has closely mirrored that of GDP. Services are dominated by community services (16 percent of GDP); transport (14 percent of GDP); trade (11 percent of GDP); and public administration (6 percent of GDP). Tourism related earnings have grown unevenly from US$30 million in 1990 to US$ 45 million in 1996. In 1997, the sector observed a marked expansion and the number of foreign tourists visiting Madagascar increased by 35 percent. Foreign exchange earnings rose to US$ 58 million.

B.2 Employment and Wages

The majority of the labor force is engaged in subsistence agriculture and informal sector activities. Out of an economically active population of 5.6 million in 1995, an estimated 1 million have salaried employment. The vast majority of the remainder is in agriculture although precise numbers are not readily available. Formal sector employment is limited to about 375,000, with 150,000 in manufacturing, 125,000 in the civil service (including the security forces), 80,000 in paid agricultural employment, and the remainder in the rest of the services sector.

The labor market has stagnated in terms of creation of formal wage employment, particularly with a virtually freeze on net public sector employment creation. Most entrants to the labor market have been absorbed by the informal sector. Unemployment is below 3 percent of the labor force. Those who declare themselves unemployed are estimated to number 115,000. Unemployment is widespread and has been estimated as affecting 85 percent of the labor force.

For the private sector, the decline in wages largely reflects the decline of the economy, particularly for unskilled workers. The ratio of earnings relative to GDP per capita remained relatively constant for the period 1990-96. Thus, loss in purchasing power can be reasonably blamed on a shrinking per capita economy.

In the public sector over the same period there has been a significant reduction in public sector wages relative to GDP per capita, except at entry level. This continues a dramatic long-term decline in earnings; at the middle levels of the civil service monthly wages have fallen from US$602 in 1960 to US$78 in 1990, only to rise to US$82 in 1997. At the top of the civil service the decline is even more shocking: from US$900 a month in the early 1970s to US$321 in 1990, and US$ 170 in 1997.

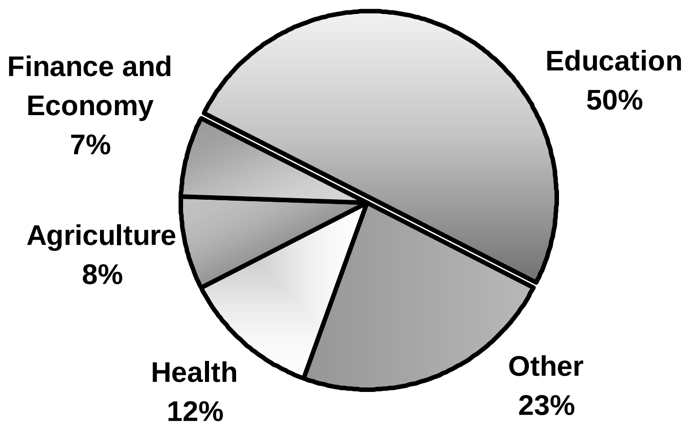
The distribution of civil service across regions in 1997 shows that the province of Tananarive, the capital city, has a higher share of civil servants (42 percent) than its share in total population (29 percent). This ratio has been fairly constant over time, reflecting the concentration of the general administration in the capital city. Thus human resources are not distributed rationally so as to meet local needs. Based on the 1990 census, more than 40 percent of the civil service is concentrated in the largest cities, which account for only 15 percent of total population. Moreover, ministries are reported to be overstaffed in large cities, especially in the capital city, due to a number of reasons such as security problems in rural areas and statutory provisions that grant married couples of civil servants the right to be assigned in the same locality.

Table 4.11 Madagascar: Distribution in percent of Population and Civil Service

Region	Population 1997(est.)	Civil Servants 1990	Civil Servants 1997
Antananarivo	29	42.2	43.2
Antsiranana	7.8	6.8	6.5
Fianarantsoa	21.7	16.8	16.8
Mahajanga	11.1	9.9	9.6
Toamasina	15.8	12.8	12.8
Toliara	14.6	11.4	11.3
Total	100.0	100.0	100.0

Source: Ministry of Finance.

Figure 4.3 Distribution of Civil Service by Sector 1/



1/ Excluding the Military

B.3 Money supply and Inflation rate

Madagascar's monetary policy during the 1990's mirrors the country's toil and success with stabilization in the late 1980's and 1990, the political events in 1991-93, and recourse to a more consistent policy making after the 1994/95 crisis. More specifically, during the late 1980s and early 1990s the objective of monetary policy was to accommodate economic expansion while avoiding the pitfalls of domestic inflation and widening of external current account.

Late 1990 and 1991 saw a turn-about owing to exogenous economic and political factors. Increased demand for imports due to the economic expansion and a drop in export prices pressured the country's current account, which deteriorated from 8.6 percent of GDP in 1990 to 11.7 percent in 1991, and reduced Madagascar's foreign reserves from 5 months to one month of imports. One of the remedies chosen was 16 percent devaluation. Economic events coupled with delays in the democratization process, led to political turmoil and a change in government, and resulted in the reversal of stabilization and adjustment policies.

The banking system's credit to the government expended by 30 percent in 1991 and 121 percent in 1992. Concurrently, credit to the private sector (including public enterprises) grew at the rate of nominal GDP growth. The increase in domestic credit partially served to offset the loss of external reserves and to keep broad money growing at rates of earlier years, which averaged about 20 percent per annum for the period 1989-93.

Prices did not initially respond to changes in credit policies. The CPI (for traditional items) fluctuated between single and double digits over 1989-93, ranging between 9 and 15 percent; the average annual change in the CPI was 10.8 percent, with a standard deviation of 2.8. The average annual change in the GDP deflator, a broader and more stable measure of prices, over 1989-93 was 12.5 percent, with a standard deviation of 0.9.

The stability in the rate of change in the deflator, with declining rates of economic growth, implied a reduction in the velocity of money. However, as the government's expansive fiscal policy was sustained through1994, inflation picked up and reached an annual rate of 62 percent at the end of 1994.

Madagascar's policy reversals towards protectionism and a government run economy were short-lived. The government signed a Policy Framework Paper with the Bretton Woods institutions, reversing the policy setbacks instituted in 1992 and turning towards more responsible fiscal and monetary management. Since then the guiding principle behind monetary policy has been to eliminate excess liquidity with the objective of reducing inflation, and turning real interest rates positive.

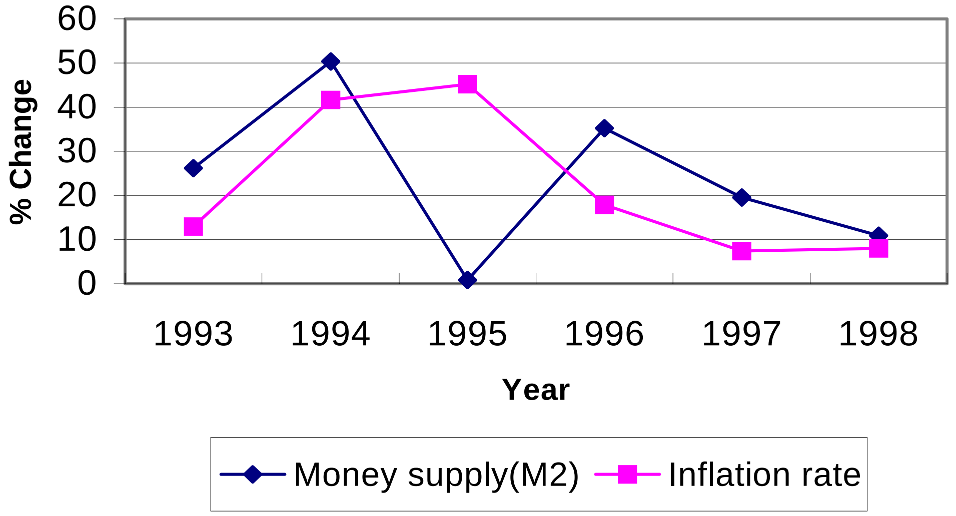
In terms of policy instruments, this was achieved by a through reduction in Bank credit to the government, increases in reserves, and recovering outstanding loans for two state banks. The net effect was a 15 percent increase in credit to the private sector and a reduction of governed sector credit by 3 percent in 1995. Broad money grew at 16 percent in 1995, compared to 48 percent in1994. The measure, however, succeeded in curbing the annual inflation rate, to 37 percent by December 1995. Continuous adherence to monetary discipline succeeded in reducing the annual inflation rate to 9 percent in December 1996. Conservative fiscal policy through 1997, and a tight stance on monetizing the deficit (7 percent of GDP) contributed to holding inflation to 4.5 percent at end 1997.

Table 4.12 Madagascar: Money Supply

	1993	1994	1995	1996	1997
Broad Money	1564.87	2339.37	2717.32	3209.75	4018.51
Money supply	1038.00	1601.03	1842.30	2180.71	2500.27
Currency	378.74	614.53	758.70	831.24	875.10
Demand deposits	659.26	986.49	1083.60	1349.46	1625.18
Quasi-money:	526.87	738.34	875.02	1029.04	1518.23
Of which foreign deposits	19.21	230.70	284.63	285.15	328.21
Inflation rate(average)	13.0%	41.6%	45.2%	17.9%	7.4%

Source: Central Bank of Madagascar.

Figure 4.4 Money Supply and Inflation Rate



B.4 Investment

Madagascar's investment as a share of GDP has remained low if compared to the other developing countries. During the period 1985-87, it was 9.2 percent in average, reached to 13.8 percent in 1988-90. However, it sharply decreased to 10.6 percent in 1991.This low growth was primarily attributable to the general economic slow down at that time.

Since 1992, the investment has been stagnant (about 10.9 percent); nevertheless, it had relatively increased to 13.3 percent of GDP in 1997. The following table shows the permanent predominance of public investment, continued increase in consumption and gross domestic savings in Madagascar.

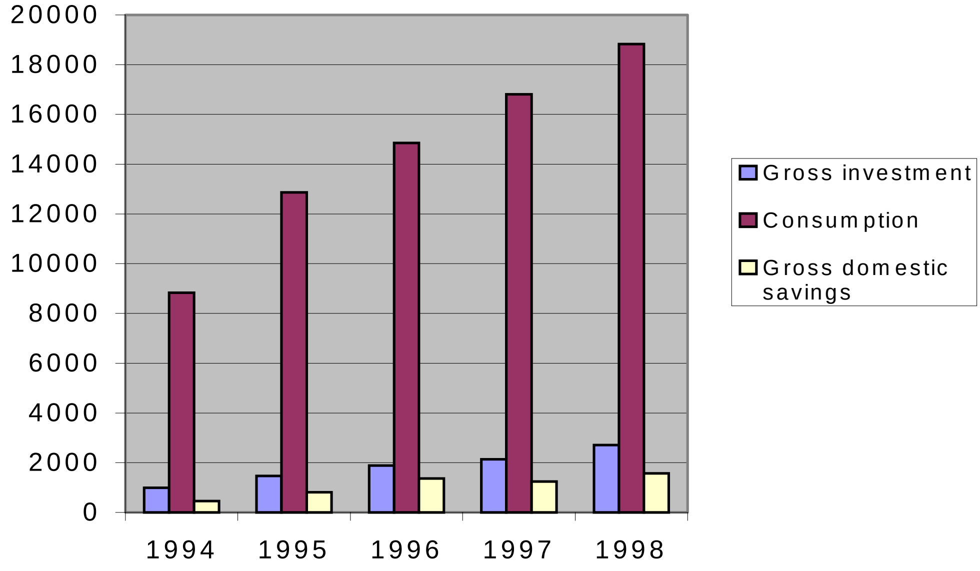
Table 4.13 Investment, Consumption and Gross domestic savings

(In billions of FMG)

	1994	1995	1996	1997	1998
Gross investment	995.6	1,474.9	1,888.0	2,139.5	2,716.3
Private	411.2	666.2	806.2	1,003.3	1,246.3
Public	584.4	808.7	1,081.8	1,136.2	1,470.0
Consumption	8841.0	12,860.1	14,861.6	16,805.8	18,827.6
Private	8212.2	11.955.9	13,875.9	15,427.7	17,586.6
Public	628.8	904.2	985.7	1,378.1	1,241.0
Gross domestic savings	456.8	808.7	1,362.8	1,245.0	1,570.2
Private	405.6	558.9	1,033.3	954.9	1,443.4
Public	51.2	249.8	329.5	290.1	126.8

Source: Ministry of Finance and Economy; Ministry of Budget and Development of Autonomous Provinces; and INSTAT.

Figure 4.5 Performance of Gross investment, Consumption, and Gross domestic Savings



Unlike the investment, private consumption in Madagascar has always exceeded government consumption. This confirms the important role of private sector in the economic. Since 1994, private consumption has been 12.5 times larger than government consumption.

C. Fiscal Position

The Malagasy public sector is currently unable to provide the level or quality of public goods and services required to achieve and sustain rapid growth. Investment in human capital and infrastructure are extremely inadequate, with the level of spending in some of these areas among the lowest in the world. It can be expected that faster revenue mobilization might lead to an increase in non-interest current spending, by as much as 4 percent points of GDP over the next 10 years. But public sector effectiveness in delivering public goods and services is low, and increases in available resources may not necessarily translate into improvements.

C.1 .Government expenditures

Since 1980, the evolution of government expenditures' composition has been dominated by the problem of debts. The debt servicing has represented 40 percent of current expenditures between 1980-1995. Even after the cancellation and rescheduling negotiated to the Club du Paris (*termes de Naples*) in 1997, debt servicing has continued to absorb about 30 percent of current expenditures. This situation has resulted in significant reduction of personnel expenditure, which has fallen from 7 percent to 4 percent of GDP during the last twenty years. Generally, the government expenditure is divided into two categories:

- Current expenditure
- Capital expenditure

The public expenditure had been generally controlled in 1998. Current and capital expenditures increased by 23.6 percent and 27,9 percent respectively if compared to the fiscal year 1997. This increase in capital expenditures was particularly attributed to the intensification of public investment projects notably in infrastructures. The increase in current expenditure was essentially due to the rise in:

- Expenditure of personnel (17.2 percent) owing to the increase in wages and salaries of the civil servants;
- Purchases of goods and services(6,2 percent) due to the increase in expenses related to the fight against locust;
- Interest payments (119.6 percent).

Table 4.14 Government Expenditure

(In billions of FMG)

	1994	1995	1996	1997	1998 (prov.)
Operating expenditure	574.9	810.3	920.0	1334.8	1493.4
Wages and salaries	329.5	444.5	523.1	696.6	816.4
Services and goods	245.4	365.8	396.9	638.2	677.0
Interest payments	491.9	687.9	759.2	214.6	471.3
Interest on external debt	29.7	63.6	130.6	50.6	384.0
Interest on domestic debt	462.2	624.3	628.6	164.0	87.3
Other current expenditure	95.0	25.2	24.6	99.6	74.0
Current expenditure	1.161.8	1.523.4	1.703.8	1.649.0	2.038.7
Capital expenditure	616.8	850.4	1.179.6	1.239.2	1.585.0
Total expenditure	**1.778.6**	**2.373.8**	**2.883.4**	**2.888.2**	**3623.7**

Source: Ministry of Budget and Development of Autonomous Provinces.

C. 2. Borrowings

The budgetary austerity applied since 1960 had abandoned at the end of 1970s.Therefore, the Malagasy's public treasury has recorded a deficit, which has been primarily financed by both domestic and foreign sources. As shown in table14, in 1997 and 1998, another sources, namely exceptional financing and privatization receipt were used. The exceptional financing amounted to 927.2 billion FMG in 1997 and 317 billion FMG in 1998. Concerning the privatization receipt, it amounted only to 4 billion FMG in 1998.

Table 4.15 Deficit Financing

(In billions of FMG)

	1994	1995	1996	1997	1998 (prov.)
Budget deficit	742.6	832.1	792.9	406	818.8
In percent of GDP	8.1	6.2	4.9	2.2	4.0
Financing	367.5	212.9	217.4	428.5	1060
Foreign (net)	154.2	251	232.4	353.2	163
Domestic(net)	213.3	-38.1	-15	-145.5	902
Banking system	201.3	-57.6	-46.7	-146.0	742
Nonbanking system	12	19.5	31.7	0.5	160
Exceptional Financing	-	-	-	927.2	317
Privatization receipt	-	-	-	-	4.0

Source: Treasury of Madagascar (OGT).

C.3. Government Revenue

Taxes in Madagascar have fallen from a peak of 14 percent of GDP in 1987 to a low of 7.8 percent in 1996, 9.4 percent in 1997 and 9.7 percent in 1998. This poor performance of taxes is largely a function of declining per capita income. During 1984-1990, while per capita income fell slightly from US$ 352 to US$ 347, tax performance was broadly stable, averaging12.1 percent of GDP. During this period, the variability of taxes largely reflects the influence on export taxes of sharp movements in world prices of coffee and cloves. The sharp decline in taxes of 24 percent over 1990-1996 largely mirrors the 19 percent fall in per capita income and the17 percent decline in disposable incomes. Indeed the steady fall in income per head from an average of US$345 during the period1984-1990 to US$280 in1996 is mirrored by the decline in disposable income per capita from US$311 in 1990 to US$258 in 1996. Had the economy been able to sustain per capita income growth, the revenue lost from export taxes and the rationalization of domestic taxes could have been made up.

On a more mechanistic side, eighty percent of the decline in taxes from 1987 to 1997 can be attributed to the elimination of export taxes which declined from 5.0 to 0.1 percent of GDP over this period. Despite rationalization and reduction of nominal rates, import taxes have continued to yield about 3.8 percent of GDP on average with some year to year variations. Taxes on income and profits and on goods and services have suffered equally small declines of 0.5 percent of GDP in total. The remaining reduction in taxes of 0.9 percent of GDP can largely be attributed to other taxes and explained in large part by a rationalization of the tax system, largely in line with recommendations from IMF.

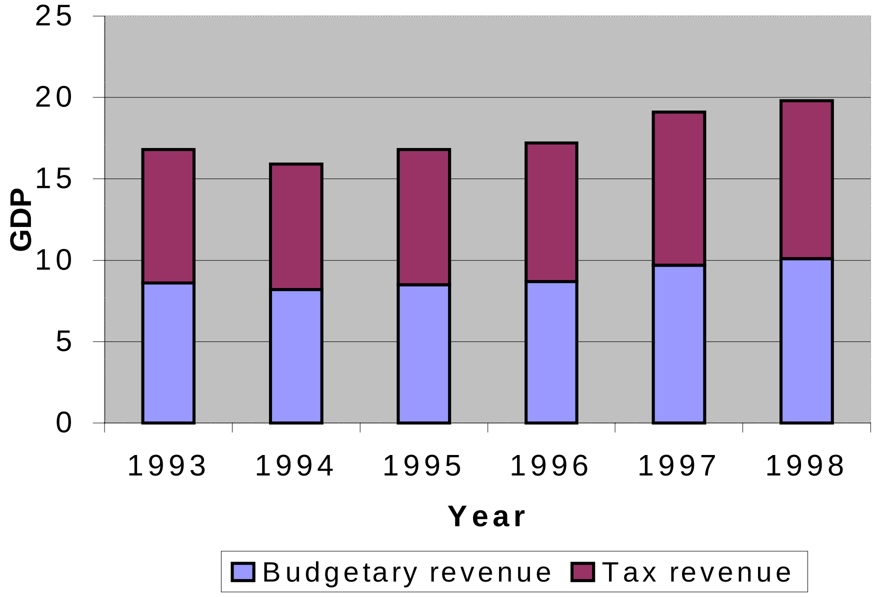
Table 4.16 Fiscal position, 1994-1998

(In billions of FMG)

	1994	1995	1996	1997	1998 (commitment basis)
Total revenue and grants	**1.036**	**1.542**	**2.091**	**2.703**	**2.804.9**
Total revenue	762	1.150	1.407	1.747	2.146.4
Budgetary rev.	748	1.149	1.405	1747	2068.7
O.w: tax revenue	702	1.121	1.374	1.688	1976.2
Extrabudgetary and capital rev.	14	1	3	0	77.7
Grants	274	392	683	956	658.5
Current grants	39	31	116	378	59.8
Project grants	235	362	567	579	598.7

Source: Ministry of Finance and Economy; Ministry of Budget and Development of Autonomous Provinces.

Figure 4.6 Budgetary Revenue and Tax Revenue as A Percentage of GDP



C.4. Aggregate Tax Revenue

Like in most countries, taxes constitute the main source of revenue in Madagascar, which has amounted to 90 percent since. Despite the several reforms adopted in 1972, 1988, 1990, 1994 and 1995-98, the structure of tax revenue in Madagascar has not greatly been changed since its independence.

Taxes on international trade have represented more than 50 percent of total tax revenue, equivalent around to 4 percent of GDP. The composition of custom duties, however, has slightly been changed. The gradual decrease in taxes on exports since the beginning of 1980s, which had completely repealed in 1997, has been offset by a corresponding increase in taxes on import of petroleum. Accordingly, as a main source of revenue, the tax performance essentially depends on import duties and taxes.

The domestic indirect taxes- primarily the VAT and excise taxe- has contributed about 25 percent of tax revenue. However, these taxes have slightly fallen from 3.5 to 2.5 percent of GDP due to the increased informal sector. The direct taxes have fluctuated around 2 percent of GDP within forty years.

Table 4.17 Structure of the tax revenue and government expenditure 1995-1998

Revenue			Expenditure		
Budgetary revenue			*Current expenditure*		
Direct taxes	16%		Debt servicing	39%	
Corporation	9%		Wages and salaries	33%	
Household	6%		Goods and services	14%	
Indirect taxes	78%		Transfers	12%	
On import	51%		Extra-budgetary	2%	
o/w petroleum pro.	10%				
VAT	19%				
On export	1%				
Domestic VAT	15%				
Excise tax and others	11%				
Budgetary non-revenue	3%				
Extra-budgetary	0%				
Current grants	4%				
Current tax revenue	100%	77%	Total	100%	60%
Investment receipts			*Capital Expenditure*	40%	
Grants	99.5%				
Self-financing	0.5%				
Total	100%	23%			
Total tax revenue and Grants	100%		Total expenditure	100%	

Source: Treasury of Madagascar (OGT).

4.3 Tax Structure

4.3.1 Tax institutions and reforms

Malagasy's tax administration has been inherited from Old French administration. Until 1997, it had divided into three quasi-autonomous divisions:

- Direct Contribution (*Contribution Directe*)
- Indirect Contribution (*Contribution Indirecte*)
- Registration and Stamp *(Enregistrement et Timbre*).

These divisions had been controlled and coordinated by the Tax Direction (*Direction des Impots*). Moreover, each division has had its branches in the provinces and districts, which constitute the regional tax office.

The Direct Contribution (*CD*) has been responsible for the administration of direct taxes such as Corporation Income Tax, Individual Income Tax, Land Tax, Tax on buildings, Professional Tax, Tax on transfers abroad, etc.

The Indirect Contribution (*CI*) has administered the following indirect taxes: Excise Tax, Fiscal monopolies, Liquor tax, Entertainment Tax and other miscellaneous indirect duties. In addition, in certain provinces, it has been in charge of collecting and examination of VAT and Tax on Transactions.

The Registration and Stamp (*ET*) has mainly been in charge of administration of Death and Gift Duties, Tax on company cars, Capital Gain Tax, Registration fees as well as the miscellaneous Stamp duties. It has been also responsible for collecting and examination of VAT and Tax on transaction in some provinces.

In Madagascar, the Custom Service which has been an independent organ from Tax

Direction (*DI*) has collected the taxes on international trade and customs duties. Since1997, the oganizational structure of Malagasy's tax administration has progressively changed. The authorities, under recommendation of IMF, intended to modernize the tax administration by implementing a new system, namely CFPE(*Centre Fiscal Pilote des Grandes Entreprises*) in Tananarivo. This organ was designed to unify the three old divisions and then to ameliorate the collection of indirect, direct taxes from the large-scale corporations, which have an annual turnover more than 250million of FMG.

On July 9,1998, a ministerial order No 6725/98 VPMDB/SG/DGRF had changed the name of CFPE in Service of Large-scale Companies (*SGE: Service des Grandes Entreprises*) and stipulated the organization as well as its attributions. So the SGE is in charge of the administration, collection and examination of all taxes levied on the large-scale corporations, which have an annual turnover more than 250 million of FMG for Tananarive and 1billion of FMG for the other provinces. In addition, the SGE is assigned to carry out the tax registration across the country.

On October 28 of the same year, a decree No98915 was adopted to re-organize completely the Malagasy's tax administration in the aim of rationalization of the structure, improving the efficiency of administration and then ameliorating the tax performance. The new structure can be presented as below:

a) *Central Administration*

The General Direction of Tax (*DGI*), divided into Service of Inspection and Orientation, Service of General coordination, Service of Statistics and Service of Formation, consists of the following directions:

- Direction of Tax Operations
- Direction of Tax laws
- Direction of Control and Examination
- Direction of Human Resources

b) *Provincial Administration*

There are six Provincial Tax Services across the country: Antananarivo, Toamasina, Toliary, Antsiranana, Fianarantsoa, and Mahajanga. Each Provincial Tax Service is responsible for the assessment and collection national taxes within its jurisdiction. In addition, it directs and supervises Tax Offices (*Centres Fiscaux*) located in its jurisdiction.
The Provincial Tax Services consists of:

- Provincial Service of large-scale companies
- Provincial Service of fiscal Operations
- Tax Offices (*Centres Fiscaux*)

c) *Tax Offices(Centres Fiscaux)*

Under the new structure, each Tax Office is responsible for assessment and collection of national and local taxes within its jurisdiction. Unlike in the past, every tax office deals with all types of taxes. Tax office is the organ most closely connected with taxpayers. The number of tax office is not available yet. It is nowadays under discussion.

In sum, the new tax institutions noted above are not effectively functional yet except in Tananarive due to the staff problems and especially the financial means. Accordingly, the old structure provisionally remains in effect within the others provinces.

4.3.2 Tax Structure

Malagasy's tax system, which is highly centralized broadly divides into national taxes and local taxes. The revenue collected from national taxes represents more than 95 percent of total tax revenue; whereas local taxes contribute only less than 5 percent to the total tax revenue.

National taxes primarily include:

- VAT
- Corporation Income Tax
- Excise tax
- Customs and import duties
- Death and gift duties
- Property transfer duties
- Tax on capital income
- Tax on transfers abroad
- Tax on insurance contracts
- Tax on company cars
- Redevance

Local taxes include:

- Tax on buildings
- Land Tax
- Professional tax
- Liquor Tax
- Synthetic tax
- Other miscellaneous sources

The following taxes are state taxes but the part of revenue are transferred to the local government:

- Personal Income Tax
- Domestic Tax on transactions
- Import tax on petroleum products
- Tax on motor vehicles.

a) VAT

The VAT was introduced in Malagasy's tax system on August 1, 1994 by supplementary budget No.94 019. This tax replaced former sales tax, namely Tax on transaction. In fact, Malagasy's VAT reveals a tax on total consumption expenditure. That implies that the real taxpayers are the consumers.

Scope of Tax

Individuals, corporations and associations are liable for VAT if they realize:

1. a business activity
2. domestic transactions
3. and an annual turnover more than 250 million FMG

The tax is levied at all stages of production and distribution. Moreover, the tax law stipulates that the importation of goods and services are also subject to the VAT.

Exemptions

The following goods and services are not subject to the VAT:

1) Medicines, medical services and equipment, raw materials for making medicines;
2) Unprocessed or preliminarily processed products of agriculture and livestock;
3) Importation, sales, printing of newspapers, magazines;

4) Sales of books, copybooks, pens, special bulletin etc;
5) Supply of amateur sports services;
6) Public services;
7) Fees paid for education services at any level
8) Life insurance;
9) Electricity and water for domestic use up to 80Kwh and10 m3 respectively
10) etc

Tax rates

There are only 2 tax rates:

- 0% which is only applied on exports
- 20%(normal rate) applied on other goods and services.

Initially the tax rate was 25 percent. However, since 1996, it was reduced to 20 percent due to the strong complaint of taxpayers' association and politicians.

Tax base

The tax base of VAT is:

1. the total value of imports including charges and taxes except the VAT;
2. the total value of goods or services rendered including charges and taxes except the VAT

Tax calculation

For calculation of the VAT liability, the taxpayers can use one of the following methods: credit-invoice method or direct subtraction method.

- Credit invoice method

Tax due = Output Tax- Input Tax

- Direct subtraction method

Tax due = (Output Price- Purchases' Price) * Tax rate

Filing returns and payments

Taxpayer is required to file returns monthly or quarterly, depending on the level of the annual turnover. So the taxpayers, who have an annual turnover equal or more than 1 billion FMG are obliged to file tax returns every month; obviously the rest must file them quarterly. This tax is levied through the self-assessment system where taxpayers are required to calculate by themselves their tax liability. Filing returns and payments must be done at the latest by the 20^{th} of the month following the tax period by means of the notice of tax payment issued by the tax office. The law stipulates that in case where taxpayers do not have a tax liability to pay, that is the output tax equals to input tax or for other reasons, they are required to file returns, namely " *Bordereau de situation*" during the same period.

Tax credit and refund

When the input tax exceeds output tax, the difference constitutes a tax credit, which can be reported or refunded according the circumstances. In fact, if the value of tax credit is less than 50 million FMG, the taxpayers are only entitled to impute it on the tax liability of the next period. The taxpayers, which have a tax credit more than 50 million FMG and the exporters are allowed to request refund. Finally, it is interesting to note that the VAT mentioned in the invoice is only deductible.

b) Corporate Income Tax

Corporate Income Tax, classified as a state tax was introduced and in effect in Madagascar on 1st January 1978. As a principle, this tax is levied on net profit of the company at the end of an accounting period.

Scope of tax

The scope of corporate income tax is relatively large because it is generally levied on all revenues realized by all companies in Madagascar either domestic or foreign companies except those which legally benefit the exoneration. Apart from the ordinary companies, the associations, partnership, group of persons, public or private establishments endowed with a legal entity or not fall within the scope of the law. Precisely, the term " revenue realized in Madagascar" means all revenue of companies having a head office in Madagascar.

Exemptions

The following types of revenue are exempted from corporate income tax:

- Revenue realized by religious association, cultural association legally existed;
- Revenue realized by non-profit-making organization aiming exclusively at promoting the small and medium-sized companies(*PME:Petites et Moyennes Entreprises*);
- Interest paid by the Savings Bank (*Caisse d'Epargne de Madagascar*).

Tax rate

In the aim of simplifying the tax system and especially improving equity, the authorities apply a single rate 35 percent for all types of activity.

Tax base

Art 01-01-06 of Internal Revenue Code stipulates that the tax base is a net profit determined from the results of all operations realized during the accounting period, including notably those from assignment of assets, accessory profits as well as the other gains. The accounting period, in principle must be twelve months. Exceptionally, tax official can accord another period inferior or more than one year, but at most 18 months. The following expenses are deductible from taxable income:

- Wages and Salaries
- Rents paid by the company
- Depreciation of assets
- Taxes except corporate income tax. It is interesting to note that the company is not allowed to deduct fines, transactions, confiscation and penalty
- Debt interest contracted for normal need of the company
- Donations
- Net losses carried forward from previous five accounting periods
- Bad debts.

Some tax breaks are granted to the company engaged in investment. The reduction of tax liability, which ranges from 5 to 50 percent, depends upon the type of investment.

Filing returns and tax payment

Domestic and foreign companies are obliged to file returns before 1st of May of the following year if the accounting period coincides with a calendar year, before 1st of October if the accounting period closes on 30th of June. Payment of tax must be made at the time of filling of return. In case of failure to file correct returns within the required date, the taxpayers are punishable by fine 10 percent for the 1st month of delay, and 5 percent for each following months.

c) *Personal Income Tax*

Despite the effort of the authorities to adopt a comprehensive income tax in 1990, Personal Income Tax remains in practice divided into two categories: Employment Income Tax and Non-employment Income Tax.

Scope of tax

Types of Income Taxable in Madagascar

The following sources of income are liable for Personal Income Tax whether they are realized in Madagascar:

- Wages and salaries from public or private employment;
- Capital gains;
- Agricultural Income;
- Life annuity;
- Profits derived from all sources of business(professional and vocational occupations etc);
- Indemnity, refund as well as fringe benefits offered/ paid to the staff of the company;
- Assignment of assets, sale of patent;
- Others.

Taxpayers

Taxpayers may be natural person or legal entity, which is not subject to the corporate income tax. Madagascar does not explicitly use the criteria “resident” or “non-resident” in order to determine the taxpayer. In fact, the persons who have a “ regular residence” within Madagascar are taxed. According to the tax law, persons having a regular residence mean those who have habitation as a legal owner, tenant, or usufructuary.

c.1 Employment Income Tax

Employment Income Tax is subject to withholding at source and levied at progressive rates, which consist in eight brackets (Table 17). The withholding tax system is the system under which the company, sole proprietorship…etc calculate and collect the tax amounts at the moment they pay the salaries of their employees, and then pay to the tax office or public treasury according to the case prescribed by the law. The withholding agents are required to file returns and make a payment within 15 days of the next month.

Table 4.18 Individual Income Tax rates and Tax Brackets

No.	Income Bracket(FMG)	TaxRate(%)
1	Not exceeding 150,000	500FMG
2	151,000-250,000	2
3	251,000-500,000	10
4	501,000-750,000	15
5	751,000-1,000,000	20
6	1,001,000-1,500,000	25
7	1,501,000-2,500,000	30
8	Over 2,500,000	35

c.2 Non-employment Income Tax

Under this tax, the taxpayers are required to file returns within 4 months after the end of accounting period if it coincides with the calendar year. Filing return must be done before 1st of October if the accounting period ends at 30 of June. Of course, tax payment must also be made within the same period. The following table indicates in the one hand the tax brackets and in the other hand the corresponding tax rates.

Table 4.19 Non-employment Income Tax rates and Tax Brackets

No.	Income Brackets (FMG)	Tax Rate (%)
1	Not exceeding 250,000	10,000 FMG
2	251,000-600,000	5
3	601,000-1,000,000	10
4	1,001,000-1,500,000	15
5	1,501,000-2,500,000	20
6	2,501,000-5,000,000	25
7	5,001,000-10,000,000	30
8	Over 10,000,000	35

d) Tax on buildings

As we mentioned above, this tax is a local tax. Tax on buildings is levied on rental value of buildings and of immobile equipment. Tax officer through the declaration submitted annually assesses the tax liability. Buildings owned by government, local authorities, public institutions, and charities are exempt. Certain tax privileges are also stipulated in the internal tax revenue; so the new buildings are exempt for 5 years, from the date of completion.

Tax rate

Table 4.20 Tax rates on Buildings

	Owner-occupied	Nonowner-occupied
Residential	3 to 6 percent	4 to 6 percent
Non-residential	5 to 10 percent	6 to 10 percent

e) Land tax

Land tax is levied annually on estimated productive value of land based on type of crop use. Land owned by government, local authorities, public institutions, land used for health, and education or social purpose is permanently exempt from tax.

Tax rate

Rates essentially vary according to land use (per hectare):

a) FMG 50-300 for grazing land;
b) FMG500-1000 for industrial plantations;
c) 1 percent of intrinsic value for land in nonagricultural use;
d) FMG400-800 for woods, forests, lakes, and swamps;
e) FMG1000 to 2000 for unworked exploitable land.

f) Tax on capital income

It is levied on capital income, attendance fees, price bonds, and premiums distributed by companies to individuals or to other companies. This tax is withheld at the source. Investment income from Credit Union is exempt.

Tax rate

Tax rate is 25 percent for all taxpayers.

g) Tax on transfers abroad

The tax base is the income transferred abroad to nonresident persons or companies. It is levied through the withholding system. Exemptions include scholarships, normal purchase prices transferred abroad for imports, and capital income subject to tax in Madagascar.

Tax rate

It is fixed at 15 percent.

h) Property transfer duties

It is levied on sale, lease, or exchange of property, company formation, corporate mergers, transfer of shares; on selected transactions, namely transfer of goodwill, financial claims, and auctions. The assessment is based on declared value of property or nominal value of the assets involved. Social housing, churches, government and local authorities, and charities are exempt.

Tax rate

Fixed and proportional rates are applied; the later vary between 6 percent and 12 percent according to type of transaction plus 2 percent additional tax which goes to the FAR.

i) Death and gift duties

It is levied on net value of property transferred causa mortis or intervivos and situated within Madagascar. From the net estate of the deceased, a deduction of FMG1.5 million is allowed for the spouse and each direct dependent, plus a deduction of FMG 0.5 million for each dependent child.

Tax rate

Proportional rates vary between 2 percent and 25 percent depending on the value of the property transferred.

j) Transactions tax

The main nature of this tax is that it is nonrefundable and nondeductible. It is levied on the turnover of retail businesses and certain services. Various exemptions specified and listed in the General Tax Code are granted.

Tax rate

Tax rate is 15 percent for all transactions.

k) Professional tax

Professional tax is annually levied on any person, company, or partnership engaged in trade, industry, or professional services. The following are exempt: wage, earners, university restaurants and canteens; farmers (owners); fishing and hunting; agricultural enterprises; artists; directors of technical and general schools; newspaper and magazine salesmen; local authorities; wholesale activities; sanitary operations of enterprises; intermediaries in government contracts markets for goods financed by foreign aid; procurement services of enterprises.

Tax rate

Two rates are applied:

1) Fixed rate varying from FMG 7,500 to FMG240,000 per annum according to the type of business or profession(classified into 5 categories), population of the town in which the enterprises is located, and number of employees and equipment used in the enterprise.
2) Proportional rates based on rental value of premises, including equipment used; 5 separate rates are applied to each of 5 categories specified in the Tax Code, i.e., 3.33 percent, 5 percent, 6.66 percent, 10 percent, and 20 percent.

l) Business licenses

It is levied on producers and traders of alcoholic beverages, including premises serving these drinks. Exemptions include producers of traditional drinks, military canteens and messes, university restaurants.

Tax rate

Rates vary according to the type of enterprise and population of the town in which the enterprise is located.

m) Tax on motor vehicles

It is annually levied on owners of motor vehicles. Vehicles owned by government, farm tractors, and road construction equipment are exempt.

Tax rate

The tax rate depends on the ages and horsepower of the vehicle.

Table 4.21 Tax Rates on Motor Vehicles

(In FMG)

Age of vehicle	Horsepower	1-4	5-9	10-12	13-15	Other 15
Under 5 years		3.500	4.000	4.500	6.500	9.500
5-10 years		2.500	3.000	3.500	5.500	8.500
10-20 years		1.500	2.000	2.500	3.500	4.500
Over 20 years		750	1.000	1.200	2.500	4.000

However, tax of vehicles used exclusively for commercial purposes or for mass transit, as well as taxicabs is FMG 1,000; and FMG 200,000 for the airplanes.
It is noted that half of the proceeds are transferred to local authorities.

n) Tax on company cars

It is annually levied on cars owned by companies and used for nonbusiness purposes.

Tax rate

Tax liability depends on horsepower of the vehicles:

1) FMG200,000 for 1to 9 CV;
2) FMG20,000 per CV for more than 9CV.

o) Customs duty

It is mostly levied on c.i.f value of imports. Exemptions apply to several products listed in the Code and in the Customs Tariff.

Tax rate

Rates vary from 0 percent to 20 percent; most is between 0 percent and 10 percent.

p) Import duty

It is also mostly levied on c.i.f value of imports. Several exemptions are granted in the Code and in the Customs Tariff.

Tax rate

Rates vary from 0 percent to 30 percent. For any imported product, the sum of the custom duty plus import duty should be equal to or lower than 30 percent (excluding exemptions).

q) Import tax on petroleum

It is mostly levied on volume, except lubricants on c.i.f value, and gases per K/net. Exemption is granted for lamp oils.

Tax rate

Specific taxes vary per product.

r) Stamp duty

It is levied on:

a) legal documents;
b) administrative documents;
c) receipts;
d) and commercial instruments issued.

Tax rate

Fixed or proportional rates applied according to the type of document. Fixed rates vary from FMG400 to FMG 1,000. Proportional rates are 0.5 percent on face value of commercial instruments and 0.05 percent on postal checks.

s) Excise tax

It is mostly levied on alcohol, tobacco, mineral products, and cosmetics. Inputs and pharmaceuticals are exempt.

Tax rate

Tax rates vary from 10 percent to 100 percent.

4.3.3 Double Taxation

Madagascar does not have many tax treaties. However, there are two major tax treaties concluded in the aim of avoiding double taxation:

a) the first is with France in 1983, concerning the following taxes: Personal Income Tax, Corporate Income Tax, Tax on Capital Income;
b) the second is with Mauritius in 1995,concerning also the Personal Income Tax, Corporate Income Tax, and Tax on Capital Income.

4.3.4 Tax Disputes

When the taxpayers' rights are infringed by the actions of the tax officers in respect of a national tax and local tax, there are legally two ways by which these protests can be examined and relief be given: the administrative protest system and the litigation system.

Miscalculation in determination of tax liability, typing errors in the tax assessments notice, problem of interpretation of tax law, simple request for reduction of tax liability constitute the main tax disputes in Madagascar. It is interesting to note that most of the cases(more than 90 percent) are solved at the level of administrative protest system.

When the taxpayers are not satisfied with the decision given by the Directorate General of tax department, they can go to civil court for the disputes concerning the indirect taxes (including the death and gift duties, property transfer duties), administrative court for the direct taxes.

4.4 Country Specific Fiscal Issues

4.4.1 Situation of tax administration

Despite the reform adopted since 1997, the tax administration practically remains archaic and woefully badly organized especially at the local level. This old organizational structure constitutes a serious impediment for the tax performance. First, it generates a complexity for the taxpayers that are required to submit three declarations of existence to each three divisions(Direct Contribution, Indirect Contribution, Registration and Stamp). Second, given the lack of appropriate coordination between them, the tax officers can not technically carry out an efficient control.

In addition, the tax administration is not largely decentralized yet. The tax offices are mostly centralized in certain cities. So the taxpayers located in the regions where there is no tax office must commute long distance to pay their tax liability or declare their operations. As a result, most of them do not logically pay their tax regularly.

The tax officers are qualitatively and quantitatively insufficient. The lack of recruiting for more than fifteen years has caused a serious staff problem for the taxation department. The civil servants that died, were dismissed, or resigned have not been completely replaced yet. According to the statistics, from1996 to 2001, Madagascar will have 381 retired tax officers. Moreover, tax administration is characterized by lack of facilities especially in computerization, so most of activities are accomplished manually. That implies that most of statistics and information about taxation is not available.

Table 4.22 Number of Tax Officers by Age and Provinces in 1999

Provinces	20- 25	26-30	31-35	36-40	41-45	46-50	51-55	56-60	Tot.
Antananarivo	-	15	33	66	116	156	133	199	718
Antsiranana	-	-	1	7	28	28	21	19	104
Fianarantsoa			2	10	22	38	31	47	150
Mahajanga	1	-	2	7	26	29	23	33	121
Toamasina	-	-	1	11	24	42	41	27	146
Toliary	-	-	3	8	26	27	27	25	116
Total	**1**	**15**	**42**	**109**	**242**	**320**	**276**	**350**	**1355**

Source: Direction of human resources (DRH).

4.4.2 Narrowness of tax base

An eroding fiscal base has left the country a low level of tax revenue. Tax system has concentrated on formal sector incomes and transactions. The rural and low-income population remains largely outside the tax system, paying little or nothing.

a) Informal sector

The number of informal production unity has become more and more enormous since 1994. In Tananarive, according to the survey realized by MADIO in 1995, it was about 123.000 including all type of sector. The informal sector has substantially decreased the amount of tax collected because its contribution has been estimated around 1,2 percent of its value added only.

b) Abundance of tax exoneration

The tax exoneration, generally established for economic reasons (favor certain operations or activity sector) or social (protect certain category of taxpayers) has been considerably accumulated in Madagascar. They have affected the different categories of tax, such as a corporate income tax, VAT, tax on transaction, especially tax on import and customs duties.

The high level of exemptions is negatively affecting revenue collection, potentially compromising the sustainability of the macroeconomic framework and distorting market competition in many economic sectors. This wedge between potential and actual collection results in custom revenues on imports which amount to 16 percent of the import bill in a country with a weighted import tariff of over 20 percent. Exemptions are continuously granted to public and private enterprises, denoting a discretionary decision making process in the administration of public finances.

Moreover, the Investment Code of 1989 provides exorbitant tax advantages that have not been monitored, while creation of employment and investment has not been significant. Consequently, abuse is widespread. Actually, it is estimated that 1 percentage point of GDP in government revenues is lost due to this special tax exemption agreements envisioned in the Code.

Similarly, the status of EPZ firms generates also the revenue lost close to 1 percent of GDP through tax breaks. As opposed to the EPZ in other countries, it is important to highlight that in Madagascar these firms are not located in any special zone but across the country, making their control a true and costly fiscal dilemma. As a result, abuses are taking place, that is these enterprises illegally sell in the domestic market their production beyond the limit authorized (5 percent of total production).

4.4.3 Tax evasion

The main factors leading to tax evasion in Madagascar are:

- Lack of voluntary tax compliance
- Lack of transparency of revenue management.
- Tax discrimination from exoneration and different preferential tax treatment. As a matter of fact, the excessive unjustified exoneration certainly undermines tax compliance because those who do not benefit intend sooner or later to seek other ways of avoiding partially or completely tax payment.
- Insufficiency of information and tax education
- Lack of efficient examination and cross checking.

4.5 Conclusion

As noted above, Madagascar is still facing many economic difficulties such as low growth, privatisation, weakness of tax revenue which leads to huge budget deficit, decrease of foreign and domestic investment. In fact, the country is actually still in the transition period to the market economy where the private sector plays an important role in the sustainable development. However, following the adoption of a board-ranging adjustment strategy in 1994, Madagascar tightened financial policies and made significant progress during 1995 and 1996 with the deregulation of key economic sectors, the liberalization of external sector transactions, and strengthening of banking supervision. Accordingly, confidence was restored again, as reflected in rising domestic financial savings; in addition, output recovered, the rate of inflation declined significantly, and the external position strengthened.

In FY1998, the authorities started out with an ambitious program of structural reform and fiscal consolidation. The government laid the basis for stronger revenue collection through a series measures, including a streamlined VAT legislation, an adjustment of excise and petroleum taxes, publishing of the name of tax evader, adoption of a new tax (synthetic tax), designed especially to tax the informal sector and reorganization of the tax department. At the same time, a comprehensive program of institutional and procedural reforms was introduced, with a view to enhancing transparency, accountability, and efficiency of budget execution and treasury cash management.

The government's program for 1999 focuses on public sector reforms, and on cautions financial policies to promote fiscal consolidation, maintain appropriately tight monetary conditions, and ensure exchange market stability. Along with efforts to boost revenues and strengthen expenditure control, the authorities plan to prioritize public expenditure and improve the delivery of public services, including through a process of political and administrative decentralization of government. For this purpose, an institutionally and financially viable framework of decentralization is being developed, which would include a revamped civil service reform strategy.

The authorities also intend to complete all the major privatization projects; make further progress toward reducing import tariffs; take steps to streamline the regulatory framework, including those governing activities in such key sectors as mining, petroleum, air transport, and telecommunications; and improve adherence to rules in the public administration.

In short, we can say that if the reforms noted above are consolidated, and if political stability continues, the Malagasy economy as whole will recover rapidly, that is the GDP of 6,7 percent, and tax performance more than 12 percent could be attainable.

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