PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: PIDC25773

Project Name	Public Sector Performance Loan (P150116)
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Country	Madagascar
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Theme(s)	Other public sector governance (100%)
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Project ID	P150116
Borrower(s)	Ministry of Finance
Implementing Agency	PREA - Programme pour l'efficacité des réformes de l'Administration
Environmental Category	B-Partial Assessment
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Concept Review Decision	Track II - The review did authorize the preparation to continue

I. Introduction and Context

Country Context

1. Since its independence in 1960, Madagascar has experienced recurrent political crises, which have amplified economic and social fragility and inhibited development. The most recent crisis, which began with an unconstitutional regime change in March 2009 only recently came to an end with the presidential and parliamentary elections of December 2013. These elections were a critical step of the Roadmap, an agreement signed by the Malagasy political leaders in September 2011 under the auspices of the SADC and the African Union. A process of national reconciliation has since been initiated under the leadership of President Hery Rajaonarimampianina with the support of the Council of Christian Churches (FFKM) and the involvement of all four former Presidents. Despite an end to the most recent crisis, since 2011 Madagascar continues to remain a fragile state that struggles with weak institutions and political instability.

2. The five year crisis following the unconstitutional change of government in 2009 had

negative effects on the country's social and economic outlook. The political instability stemming from the 2009 unrest led to the closing of several businesses resulting in a total job loss of 336,000 which in turn contributed to fuelling increased poverty. The government in turn remained unable to reverse the trend due to limited resources stemming from the decrease of internal revenues and the reduction of support by international donors. The public sector has been unable to sustain the provision of basic services such as healthcare, with the closing of 10% of the local health centers (Centre de Santé de Base), and education which has seen an increase of out-of-pocket expenditures for households. The crisis also severely affected the governance of the country with limited oversight over the actions of the government leading to increased corruption and failure to uphold the rule of law. The transition period has seen a surge in illegal exploitation of natural resources which was symptomatic of the prevailing governance context.

3. As a result of the protracted crisis, GDP growth remained considerably lower than population growth, which has resulted in increased poverty rates. In 2014, per capita income fell to its 2005 level, around US$ 275, from US$ 302.3 in 2008 . To reach even the 2008 level again, projections show that it would take the country five years on an average with annual GDP growth of 5 percent . Extreme poverty increased from an estimated 77.5 percent in 2001 to over 82 percent in 2010, and absolute poverty increased from an estimated 88.9 percent to 92.8 percent of the population over the same period. Roughly 80 percent of the country's population lives in rural areas and the rural population accounts for 86.2 percent of the poor. Disparities are also noted across regions, with the Analamanga region (which comprises the capital city) having a poverty rate of 45.4 percent as compared to the Atsimo Atsinanana (South-East) region, where poverty rates reach as high as 94.3 percent. In general, the southern regions of the country tend to have higher poverty rates, averaging 90 percent, and poverty is highest among the youngest groups. Despite the general increase in poverty over the period, the poverty gap has slightly decreased since 2000, showing a small increase in the well-being of the poorest groups.

4. Since the new President took office in early 2014, the Government has managed to maintain stable macroeconomic conditions. At the end of 2014, gross domestic product (GDP) growth was estimated at 3 percent, mainly driven by the extractive industry and tertiary sector. Inflation at the end of the period was contained at 6 percent despite the gradual removal of subsidies on petroleum products. Preliminary estimates indicate a surplus in the balance of payments in 2014, mainly resulting from a substantial decrease in the trade deficit following the strong performance of mining and textile exports and improvement in service balances. Incoming FDI is estimated around US$ 360 million in 2014, below the average of the last five years, reflecting the end of the investment stage in large mining projects, and slow up-take of new investments. Credits to the economy grew by 18.8 percent in 2014, with new credits equally allocated between short-term loans and investment credits.

5. Due to its enduring fragility and increasing poverty, it is unlikely that Madagascar will meet any of the Millennium Development Goals (MDGs). Between 2003 and 2009, enrollment in primary education increased from 3.4 million to 4.3 million; however, the number has stagnated since 2009 and the enrollment rate in primary education decreased from 73.4 percent in 2010 to 69.4 percent in 2012 . Although enrollment has slightly resumed over the last three years, learning outcomes and completion rates have deteriorated, with less than 50 percent completing the primary cycle. At the same time, while the infant mortality rate (under one year) has improved since 1997, falling from 93 to 42 per 1000 live births in 2013, it has since stagnated and is not expected to reach the target of 31 per 1000 live births by the end of 2015. Over the same period, immunization coverage, a proxy indicator for the overall performance of the health system, decreased rapidly from 80 percent in 2009 to 60 percent in 2013 and only 35 percent of the rural population currently has access to clean drinking water. With a level of 478 per 100,000 live births (compared to a MDG

target of 122 by 2015), maternal mortality has stagnated for over 10 years. Finally, poor nutrition status remains a concern as around half of the children under five suffer from chronic malnutrition leading to issues such as severe stunting.

Sectoral and Institutional Context

Poor Tax and Customs Management have Limited Revenue Mobilization and Fiscal Space for Service Delivery

6. Unrealized internal tax revenues significantly limit Government fiscal space. Generally, the country's legislation is considered up to standards according to IMF evaluations. However, despite the quality of the tax legislation, domestic revenues remain low. The fiscal revenue to GDP ratio remains at 10.1 percent, well below the target set in the budget and also below the regional average for Sub-Saharan Africa (SSA). Effectiveness of the VAT is the lowest in the Southern African Development Coordination Conference (SADCC) region with an efficiency factor of 0.28, compared to 0.54 in Mauritius and 0.58 in Zimbabwe. Over the last five years, the country has accumulated an unrecovered tax bill estimated at 3.5 percent of the GDP. In addition, numerous exonerations and special regimes, such as the Free Zone Act and the Large Scale Mining Investment Act, have further limited internal revenues, estimated to account for 2.5 percent of the GDP. Although an online taxpayer registration system has been put in place to simplify processes, the overall registration into the taxpayer's database remains low. Finally, the low rate of taxation is also reflected at the local level with only 30 percent of properties and land parcels recorded for tax purposes.

7. Most customs transactions continue to be treated through lengthy processes and exceptions and exonerations are estimated by the IMF at 23.2 percent of customs revenue. Despite efforts to secure transactions and revenue collection, the customs administration lacks the necessary capacity to verify transactional values on which rates are applied. Flaws are also evident in the customs administration's ability to monitor and secure export of high-value goods, such as timber and gold. Finally, numerous exemptions and corrupt practices in tax and customs administration have undermined the overall transparency of revenue collection efforts and have increased rent seeking behavior by the private sector.

8. Poor tax and customs management have jointly limited fiscal space, which has resulted in poor Government performance in service delivery and policy implementation. Over time, the Government effectiveness indicator has performed worse than other WGI clusters, decreasing from the 45th worldwide percentile in 2007 to the 15th percentile in 2013, below the SSA average. Tight fiscal space also undermines Government public investments geared toward social sectors (education and health), agriculture, and public works. Although the Government made efforts to reverse the sharp contraction of public investments during the crisis, public investment barely reached 3.5 percent of GDP.

9. To improve the tax system and legislation, a series of reforms were initiated since 2008 to bring the tax system up to international standards. Madagascar's tax laws and regulations, assembled in the General Tax Code (Code général des impôts – CGI), have built a simple and clear regulatory framework with moderately streamlined tax rates. More recently, the Ministry of Finance and Budget (MFB) began the implementation of a Tax Department 5-year Strategy (2015-2019) in January 2015, informed by a recent analysis conducted by the IMF . The strategy has eight objectives: (i) institutional reforms; (ii) improved revenue collection; (iii) enhanced internal

controls; (iv) simplified procedures; (v) improved communication and client relations; (vi) support to local Government tax collection; (vii) monitoring and evaluation; and (viii) a contribution to the objectives of the PGE promoting inclusive and equitable growth.

10. Similarly, customs legislation and guidelines have been modernized over the past few years and Madagascar has been implementing the WTO Valuation Agreement. Particular efforts have also been made by the Government for the computerization of customs operations and the streamlining of customs procedures. Customs have benefitted from a private-public partnership with a private firm, Gasy Net, to better use information technology (IT) to support cross-border trade and streamline processes for low risk transactions. A three ye ar strategy (2015-2018) was adopted in September 2014 with the objective of strengthening the role of customs in securing additional revenues to support the country's development efforts, promote trade acceleration, and reinforce the protection of citizens against potential risks. The strategy is aligned with overall Government strategy and will focus over the next few years around the new vision of establishing a relationship of trust between Customs, users, and partners (Government entities or private sector). A short-term Customs Action Plan (March-April 2015) was also developed, which revolves around the strengthening of internal controls and guarding against corruption.

11. The recent political crisis has limited donor engagement; however, development partners are progressively reengaging. The African Development Bank (AfDB) has recently funded an Institutional Governance Support Project (Projet d'appui à la gouvernance institutionnelle, PAGI) to provide technical assistance to modernize the Tax Administration and Custom's IT systems as well as the necessary computer training. The project also supported the City of Tulear with the objective of strengthening the Tax Department capacity to reach tax payers. For its part, the Bank supported a human resources assessment of the Customs Department through the Madagascar Second Governance and Institutional Development Project (Projet de gouvernance et développement institutionnel, PGDI II) in 2014. Finally, the IMF conducted a capacity building assessment of both Tax and Customs Departments in June 2014.

12. Building on the reengagement momentum, a number of challenges will need to be addressed in order to increase domestic revenue and improve fiscal space. Moving forward, the Government needs to broaden its tax basis and to improve internal and external controls to significantly reduce potential leakages. Human resources challenges, including capacity building, performance, and change management, have to be addressed. Intensified internal and external communication with staff and taxpayers will also be required to ensure successful implementation of reforms. Finally, to support increases in revenue collection, better coordination between the Tax and Customs Departments is paramount. To this end, the MFB recently announced its intention of establishing a Fiscal Policy Department, which would be housed under the Permanent Secretary's Office and its objective would be to streamline and ensure consistency between the various tax and customs regimes.

Illegal Exploitation and Leakages in the Mining Sector have Likewise Limited Revenue Mobilization and Fiscal Space for Service Delivery

18. Non-transparent management of mining activities jeopardizes future revenues. Transparent and efficient management of mining titles is one of the factors determining exploration and subsequently growth in the sector. With available and promising geological information, management of mining titles – and especially the continuity of tenure – is carefully looked at by

potential investors. The creation in 2000 of the Office of Mining Cadastre (BCMM: Bureau des Cadastres Miniers de Madagascar), to be in charge of the deliverance of mining permits, considerably improved the transparency of mining sector in Madagascar. However, following the latest political crisis, a moratorium was declared in 2011 on all new titles and renewing or transforming the existing ones became impossible for most of the title holders. This has meant that exploration has stopped in most of the country, although recent research shows that new mining projects could potentially increase the contribution of mining from 1% to 10% of national fiscal income.

19. Sharing revenues generated by mining royalties at the local level poses considerable challenges. The M ining Code defines the allocation of mining revenues between the central government and the decentralized administrations (provinces, regions, and local government). The 2 percent mining royalty is split between a national royalty (redevance minière) of 0.6 percent and a local royalty (ristourne) of 1.4 percent. However, the interpretation of the legislation is ambiguous and has resulted in tensions around the two main mines. The arrival of important revenues generated by mining represents a unique opportunity for communes, regions, provinces, and more generally, communities. However, it also raises a range of challenges in terms of sharing those revenues in a transparent, equitable, sustainable, and efficient manner in a context of high needs and poor absorption capacity. Reflective of the hesitations these challenges provoke, the Government has not yet billed Ambatovy for royalty even though production started three years ago. In the meantime, the new Decentralization law establishes a new system of “perequation” with unclear consequences for the existing mining communities.

20. Increased informal mining and illegal exports limit the contribution of mining to national revenues. Improvements to the fiscal regimes for industrial mining will only come to fruition in the long run, when and if new mines reach production. In the short run, artisanal and small-scale mining could generate revenues. However, increased informal mining and illegal exports are evidenced by striking differences between official statistics of gold and precious stones exports and mirror statistics of imports globally. If only 2% (equivalent to the royalty) of the gold and precious stones imported by Dubai from Madagascar had been collected, the country could have obtained more than US$ 4 million in revenues in 2011. Improving official exports, and thus formalizing the gold and precious stones supply chain, is a priority for the Government.

21. Government reforms to address the identified challenges have been recently initiated. Over the crisis period, no significant reform was conducted, which contributed to deepening the gap of transparency in the mining sector governance. Given the economic potential of mining and petroleum activities, the new Government expressed the intention to introduce a series of legal and institutional reforms to increase the contribution of mining to the economy, professionalize artisanal mining, and improve governance and transparency in the extractive industry sector. The mining sector is featured in the PND as one of the main pillars of the country’s future development. The PND points to the importance of supporting the formalization of artisanal mining, and improving the regulation and monitoring of this activity. Additionally, the Government adopted new Mining and Petroleum Policies in August 2014. The new policy aims at: (i) increasing the benefits generated by the sector; (ii) ensuring the sector’s contribution to the country’s economic growth; (iii) improving the management of social and environmental impact; and (iv) improving governance, transparency and controls.

22. In the mining sector, the World Bank has been the main donor/technical partner for a long

time. During the crisis, the Bank supported the Extractive Industry Transparency Initiative (EITI) and launched a Research program on mining benefits in partnership with the Ministry of Mines and the Chamber of Mines (as well as a range of actors including GIZ which is supporting private sector development around the QMM mine). In November 2014, the Bank agreed to provide technical assistance through an Extractive Industry Technical Assistance Facility (EI-TAF) project to provide expertise to the Government in the context of the legal reform. Part of the support to be provided by EI-TAF is to support the development of a revised mining and petroleum fiscal regime. The African Development Bank is also active in the mining sector notably by supporting the EITI process and contributing to the development of Ambatovy, a large exploitation of Nickel in the Eastern Coast of Madagascar.

23. Going forward, the improvement of the management of mining titles is needed to ensure further development of the sector and to curb trafficking. Main needs comprise: cleaning up of the mining cadaster, reopening of BCMM, organization of selected tenders on the basis of transparent procedures, and strengthening and decentralization of the mining cadaster. A preliminarily “cleaning up” phase will require a lot of efforts to avoid the perception that BCMM is arbitrarily or discretionally cancelling titles. In view of BCMM reopening, Government will want to select areas and put them to tender, which is possible under certain circumstances but requires a rigorous approach and transparent procedures. In view of a sustainable and efficient management of titles, BCMM will require capacity strengthening both at the national and decentralized levels.

24. Further support is also needed to improve the management of the exploitation of gold and precious stones. Main identified needs include: legal changes (set up of new conditions for artisanal and small scale mining titles); institutional changes (reform of the Gold agency and possibly BCMM); field campaigns (awareness raising on changes and inspection visits); pilot projects (gemstones markets near mine sites), etc. Artisanal and small-scale mining can be a huge challenge both from an economic, social and environmental point of view. International experience shows that addressing those should be the result of an integrated approach, as opposed to a strategy restricted to increasing revenues without consideration of other risks.

Weak Public Financial Management Limits Efficiency in Spending for Service Delivery

25. Budget unpredictability affects budget execution throughout the year, jeopardizing the achievement of results. While program budgeting presentation is formally used, budget laws are prepared using a line-input budget approach, bypassing Madagascar's own budget legislation and limiting links to results. Strategic budgetary outlook is undermined by the insufficient time given to line ministries to present and discuss their budgets, which also affects the predictability and comprehensiveness of the final budget document. As an illustration of budget unpredictability, extra-budgetary operations represented around 20% of total expenditures in 2012. This unpredictability and lack of a comprehensive outlook on all public resources has led to inefficient treasury planning as illustrated by regulation rates putting a limit on budget engagement for line ministries and institutions across the fiscal year. Consequently, while the average annual budget execution rate is around 80%, it remains very uneven, with most budget engagements allowed only toward the two last quarters of the year. These constraints are compounded by the failure of line ministries to prioritize projects and anticipate implementation by preparing and launching procurement processes in the first half of the fiscal year. From the end of October (which is the deadline for submission of the General Procurement Notices) to March, no action is taken to prepare bidding documents. The late planning of procurement activities only leaves a brief window of time

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for contract execution (generally two months). In some cases, total cancellation of an entire program has occurred due to late contract signature.

26. The uneven release of allocated budget complicates budget execution and service delivery for line ministries and local governments. Limited fiscal space leading to budget unpredictability, protracted and poorly-executed public procurement processes, and inefficient treasury management constrains the investment capacity of line ministries. Line ministries remain prudent and prefer to limit engagement on large investment because of the lack of assurance of resource availability across the year. This in turn leaves insufficient time for normal implementation processes in the remaining months of the fiscal year, leading to rushed projects with poor quality at entry, abandonment of critical projects, and increased use of exceptional procedures limiting value for money (frequent fractioning of contracts, direct contracting, etc.). Local Governments are also severely constrained due to lack of actionable resources for public services. Consequently, performance in the provision of service and policy implementation has been severely eroded in recent years contributing in the inability of the country to reach the Millennium Development Goals.

27. Madagascar’s public financial management systems have not been reformed as planned and have lost basic strength. A new budget law was adopted in July 2004 (LOLF – Loi organique relative aux lois de finances), which included provisions for expenditure programming by mission and programs, output and outcomes indicators on performance, strengthened budget management, improved Parliament participation and budget transparency, job ceilings, and some flexibility in allocation management. However, the suspension of donor support in March 2009 drastically limited Government resourc es, which stalled the enactment of the LOLF and other on-going reforms in PFM. This lack of progress is reflected in the results of the 2014 PEFA self-assessment with only two budget credibility indicators (PI-05 and PI-03) progressing between 2008 and 2014. All other indicators declined, were stalled, or were not assessed (see Annex 3). Most notably, major declines in performance were identified in the areas of (i) policy-based budgeting (PI-12 indicator) and (ii) predictability and control in budget execution.

28. To address public expenditure management challenges, the Government has adopted an interim Public Financial Management (PFM) Action Plan (July 2014) and is preparing a new Strategy (2015-2020). Building from the 2014 PEFA self-assessment, the Government developed a short-term (2014-2015) emergency action plan with IMF support, the Public Finance Management (PFM) Strategy, Plan d'actions prioritaires (PAP). The interim action plan aims at addressing urgent PFM problems, and paving the way for more in-depth PFM reforms, including: (i) promoting change management; (ii) strengthening transparency of public finance management; (iii) strengthening budget credibility and sustainability of public finance; (iv) enhancing spending control; and (v) holding managers accountable. Madagascar’s PFM 5-Year Strategy should be available in September 2015 and is expected to propose revitalization of structural reforms in PFM, such as performance budgeting, computerized systems connection, and/or control restructuration.

29. With respect to procurement, the regulatory body (ARMP) has designed a strategic vision aimed at addressing public procurement system challenges. The primary axes of this strategy are: (i) promoting compliance, capacity building, and professionalization to enhance post procurement reviews and enforce the complaint review mechanism; (ii) strengthening ARMP’s efficiency and effectiveness through further deployment of a functioning integrated procurement information management system (SIGMP) and supporting creation of a standardized price listing system; and (iii) improving transparency including access to information and building trust with the private

sector and civil society.

30. Throughout the crisis, the World Bank and other donors contributed to limiting further degradation of the public financial management system. Before 2009, the Bank supported the implementation of an Integrated Financial Management Information System (IFMIS), to improve budget execution, information, and transparency. It also supported strengthening the capacity of revenue agencies, control and auditing institutions, and procurement reforms. However, the crisis slowed down the development of the IFMIS and institutional reforms stalled. Support provided through the PGDI II contributed to limiting the degradation of the IFMIS. The project also financed the 2014 PEFA self-assessment and an evaluation of the consolidation of public financial management reforms . These two analyses set the basis for future reforms and engagement. The Bank is currently reviewing the country financial management and procurement systems to inform decision making on a greater use of country systems for Bank projects. Building on the outcomes of PGDI II, the African Development Bank is currently engaged on PFM through the PAGI, which intends to support the identification of a strategy to increase the Government's revenue. The European Union, under its Administration for All project, focuses on wage bill management with the establishment of a human resources information management system, and on strengthening control institutions. The IMF (AFRITAC and FAD) is also actively engaged in an emergency technical assistance (TA) program on PFM.

31. As donors are progressively reengaging in Madagascar, reconstruction and reform of all PFM aspects will require support from external aid. Results of the PAP, proposals by the IMF TA, and the upcoming PFM strategy can only point at the necessity and urgency to rebuild the bases of a sound PFM system and increase transparency of public expenditure. Preliminary priorities have been identified with the Government: (i) reinstating and improving the LOLF, by re-introducing multi-year prevision through a comprehensive and sector-specific MTEFs linked to the PND, and performance budgeting through budget programs, performance indicators, and periodic performance reporting and auditing; (ii) at the central and local levels of Government, reinstating budget discipline in line Ministries and at the Ministry of Finance to prevent extra-budgetary spending and arrears, and focusing on investment management; and (iii) strengthening internal and external controls and audits, in order to restore budget and accounting discipline, and introduce performance auditing.

Limited Resources and Weak Public Financial Management Undermines Performance in Key Social Service Delivery Sectors such as Education

32. The performance of the education sector has been affected by the low public resources leading to a bumpy budget execution cycle. The ability of the Ministry of Education to execute its budget is limited by the unpredictability of Government budget and revenues. The current budget for the sector is composed up to 80 percent by remuneration of public servants. Another 10 percent is allocated to subsidize community teachers and another 10 percent is allocated to cover other current expenditures. Little to no budget is allocated for sectoral investment and most investments are covered by donor funding, amounting for about 20 percent of the total sectoral budget. Thus, most of the budget is spent on remuneration leaving little less than 10 percent for operational expenses, which limits support for school functioning. Although the education sector is the second highest spending sector with 22% of the budget allocation, its budget execution rate is well below the national average (Graph 1).

33. The education sector financing is relying heavily on external funding and on household contributions. The estimated structure of education sector financing for the year 2010 shows that 49 percent of education expenditures are financed by the Government, 24 percent are financed by households, and 27 percent by external funding. Throughout the years, education expenditures financed by households have shown an increase. This increase of the households' contributions is illustrated by the reliance on community teachers to deliver education services. Despite subventions from the State, the cost of community teachers is mostly supported by school parent's associations.

34. Regular payment of community teachers is undermined by the unpredictability of resources. The unpredictability of resources is illustrated by the use of budget regulation rates limiting the percentage of the allocated budget a ministry is allowed to engage during each quarter of the fiscal year. For example, the Ministry of Education reported that during the first quarter of 2015, they were allowed to engage only 4 % of the budget allocation to the education sector. The arbitration done among categories of expenditures usually affects subsidies to community teachers as non-priority expenditures leading to significant delays in their payments. The payment of subsidies for community teachers follows a process of fund transfer among several levels of Government which takes between 40 days to 81 days. The Ministry's ability to engage funds at the central level, taking into account the regulation rates as well as treasury limitations at central and local levels, contributes to increasing the delay.

35. The existing mechanism to improve the quality of education services is insufficient. The national teacher training institute INFP (Institut National de Formation Pédagogique) and its regional offices, CRINFP (Centre Regional de l'Institut National de Formation Pédagogique), have limited capacity. Only civil servant teachers have benefited from initial, pre-service training, and pre-service training was suspended between 2006 and 2012. This lack of appropriate training is likewise aggravated by the lack of coherent teacher support system. School inspectors have virtually disappeared and the ratio of pedagogical advisors to teachers in the school districts is as low as 1:173. At the same time, the sub-district officers (chefs ZAP), who are closest to schools, lack of resources, time, and skills to support teachers with limited teaching and language skills.

36. Furthermore, the geographical repartition of the resources is inequitable and affects the performance of the sector. For instance, the pupil-teacher ratio has improved from 52:1 in 2007/08 to 44:1 in 2013/14, but this ratio varies a lot across regions from 36 for Analamanga to 63 for Androy, showing that teachers, especially community teachers, are not equitably distributed among schools. In the same trend, subsidies for community teachers are also not allocated based on priorities according to school-mapping and school's needs.

37. These issues and challenges impact on service delivery in the education sector and have negative effects on sectoral outcomes. The inefficient use of scarce resources has put a heavier burden on users as households support a sizable share of education funding. The increased financial demand on parents is one of the major reasons leading to a decrease in attendance rates, especially in rural areas. Attendance rate has decreased from 79.6 percent in 2005 to 72.9 percent in 2012 at the national level. The decrease has been steeper for rural areas, from 78.0 percent to 69.6 percent between 2005 and 2012. Additionally, completion rates have also decreased. Since 2009, the primary completion rate has declined from 73 percent to 71 percent, whereas the average in Sub-Saharan Africa has increased from 67 to 69 percent. Between 2005 and 2010, the number of children having never attended school increased relatively to the number of those who dropped out, showing an increase in the share of children without even the basic level of education. A 2010

household survey showed that 70 percent of the 1.4 million out-of-school children aged 6 to 14 years in 2010 had never attended school while the remaining 30 percent had dropped out . The unequal access to education services and lack of financial means given to school also contributed to affecting the quality of education as illustrated by education quality indicators. Comparison of data in 1998, 2005, and 2012 indicates a sharp downward trend in several areas.

38. To address these challenges in the education sector the Government has developed an interim strategy. The strategy revolves around three axes which are (i) improve access to limit the decrease in school enrollment; (ii) improve the quality of education to curb the decrease in sectoral outcomes; and (iii) strengthen capacity at all levels and improve community participation. Through the implementation of subsidies to community teachers' salaries and school grants, the Government has made an effort to limit the decline in education outcomes. However, the management of community teachers' subsidies and school grants shows inefficiencies including non-optimal transfer procedures and significant delays in payment. The Government has also been unable to correct the unequal geographical allocation of human and financial resources.

39. Since 2012, donors have cautiously resumed policy dialogue while providing increased but still limited financial support. The World Bank Emergency Support to Critical Education, Health, and Nutrition Service Project (P131945) aims to preserve social services in five regions. Key education activities include subsidies to community teacher salaries, support to school grants, and school health and nutrition activities. The project also promoted participatory community management at school levels. The other World Bank project, the Emergency Support to Education For All Project (P132616) supports the strengthening of the foundations of the primary education system by rebuilding stakeholders' capacity and improving community participation and transparency, in addition to contributing in lowering the costs of access to education for families. The European Union is engaged in five regions and also contributes to supporting community teachers' salaries and school grants. Additional EU programs also support teacher and school director training, and institutional development at sub-national levels. UNICEF is also engaged through teacher training, school building and promotion of girl schooling. The Bank and UNICEF also collaborate through cost-sharing on certain activities of institutional strengthening.

40. Going forward, strengthening sectoral governance is crucial to improving service delivery and outcomes. While the Government has made effort to support the first and second axes of the education interim strategy, much remains to be done on the third axis revolving around sectoral governance. Several donors are also active in the education sector mainly supporting the improvement of direct education outcomes (school grants, academic materials, etc.) while no donor is currently working on sectoral governance. Going forward, improvement of sectoral governance, including: (i) the efficient allocation and use of resources based on actual needs and priorities (school-maps); (ii) the improvement of resources transfer processes for funds to reach beneficiaries in a timely manner; (iii) and the strengthening of planning and management capacity at central and local level are necessary.

Slow Progress in Decentralization has Likewise Negatively Impacted the Service Delivery Performance of Local Governments

41. Attempts for decentralization over the last 20 years have largely failed to address the issue of unequal development and access to public services. The recognition of the existence of geographical inequalities in access to public services and development level, due to uneven State

presence across the territory, suggested the need for greater decentralization. However, decentralized entities lack the means to implement their mandates, due to low local revenues and low central Government transfers. As an illustration, the State transfers only 5 percent of the revenues collected by the central Government in the regions, while regions outside Analamanga, account for nearly 90 percent of the population of the country.

42. In 2006, in an attempt to strengthen institutional and financial capacity of local Governments to better incorporate them to the development effort, the Government defined the National decentralization and deconcentration policy (PN2D: 2006-2015). The PN2D aimed at consolidating years of decentralization reforms, reinforcing the role of decentralized and deconcentrated entities, and creating more synergies between them. The first phase of the implementation, aiming to set the basis for decentralization, (2006-2008) allowed for the implementation of local governance supporting structures such as the Local Development Fund (FDL- Fond de Développement Local). The FDL was created in 2008 to strengthen the capacity of local Governments and to channel State grants to communes in order to improve the provision of services in education and health as well as the development of rural roads. The FDL also developed the IGL (Indicateur de Gouvernance Locale), which is a composite index, analyzing participation, accountability, and efficiency of local Governments in order to assess local Government's performance (see Box 1).

43. While the FDL still remains, the onset of the 2009 crisis limited the implementation of the two other phases of the PN2D which had the objective of better incorporating communes and regions into the development effort. Only recently, in September 2014, the Government adopted a new decentralization legislation through which communes are formally given increased responsibilities for service provision, especially in the social sectors (education and health) and in infrastructure, in accordance to Axis 3 of the PND.

44. Throughout the crisis, the Bank contributed to supporting resilience at the local level. Local Governments remained a resilience factor, having developed ways to maintain service delivery to compensate for the decreased central Government support. Communes are the Government entities closest to the population and thus have stronger accountability to the community that they serve. Under this rationale, the World Bank, through the PGDI II project, reinforced its support to local governance in a selected 124 communes out of the 1500 existing communes. The intervention led to improvement of the communes' financial management and service delivery capacity as measured by the IGL. In that sense, the composite aspect of the IGL provided reform orientations to the communes while also offering a quantitative benchmark. In light of the positive experience on local governance, these efforts need to be strengthened and communes better supported for effective service delivery.

45. In spite of the recent confirmation of strategic orientation for the decentralization process in Madagascar, challenges still remain to strengthen capacity of local Governments. While strategic orientations have been set with the adoption of the new legislation, actual action plans are still missing for their implementation. Several challenges can be identified. First, previous experience has shown that policy and institutional implementation remain a challenge. While provinces were created by the constitution of 2010, in practice they still do not exist. As a corollary, the issue of coherence, coordination of roles and responsibilities, and collaboration between different institutional layers also need to be clarified. Second, while the legislation compels the Government to transfer resources to the communes, the challenge is to give the means to the Government to

actually make the transfer. Third, even though supporting institutions such as the FDL exist, their capacity, control mechanisms, and monitoring and evaluation require strengthening to serve the needs of more than 1500 local Governments. Finally, local Governments are seriously underfinanced, which limits their capacity to provide services, despite the legal obligation of the State to transfer the necessary resources to the communes in the exercise of their mandate.

Relationship to CAS

46. The challenges above have been highlighted in the draft Madagascar Systematic Country Diagnostic (SCD), which will inform the future 2015-2020 Country Partnership Framework (CFF). Governance is the central challenge for Madagascar, and is the prevailing cause for the continued fragility in the country. Accordingly, the draft Madagascar Systematic Country Diagnostic finds elite capture of the economy results in limited benefits of fragile growth flowing mainly to a small minority of elites resulting in economic inefficiency further hindering growth potential. As a result, institutions are used to the maintain power of particular groups rather than promoting political participation and providing public services. Going forward, the SCD identifies increasing public revenues as one of the critical constraints and opportunities facing Madagascar in accelerating progress toward the WBG's goals of ending extreme poverty and promoting shared prosperity in a sustainable manner. Furthermore, the SCD also calls for the improvement of public service provision by the shortening of the accountability chain between tax collection and the use of their proceeds, through which effective decentralization can be implemented. By seeking better revenue management and its use toward promoting better service delivery to the population, the operation contributes to the twin goals.

47. The proposed operation is also aligned with the Bank's Africa Strategy (2011), which puts governance and capacity for public service delivery at its foundation. Building on lessons learned, the Africa Strategy highlights the importance of investing in both demand- and supply-side governance to enhance accountability. Similarly, the Bank's Governance and Anti-Corruption Strategy has the objective to build capable and accountable states. More specifically, it focuses on strengthening institutions and fostering transparency, participation, and accountability. The proposed project also builds on important lessons learned from the World Bank Approach to Public Sector Management 2011-2020 which recommends better aligning Bank's engagement with Government priorities and focusing on problem-solving.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The Project Development Objective is: "Improve revenue mobilization and public expenditure management to enable service delivery in selected sectors."

Key Results (From PCN)

- Increased effectiveness in voluntary tax compliance;
- Improved perception by traders and other stakeholders regarding the quality of service, responsiveness to complaints, and/or integrity of customs administration;
- Mineral production and taxation revenues database completed and made available to the public;
- Increased alignment of annual budget with medium-term projections or policy priorities; and
- Increased sub-national budget execution in the education sector.
- Improved citizen engagement.

III. Preliminary Description

Concept Description

48. The proposed operation will be financed by an Investment Project Financing (IPF) credit of US$ 35 million to the Republic of Madagascar. In light of the challenges discussed above, the project intends to contribute to addressing the barriers limiting public sector performance in service delivery. The project will support reforms for the securing and effective collection of public revenues to harness the country's revenue potential. In doing so, the project will support tax and customs administration reforms to optimally participate in securing internal revenues. In its approach to secure revenues, the project will also contribute to improving mining sector governance to limit resource leakages and improve public revenue from natural resources. In addition, the project will support reforms so that the use of the country's revenues and resources contribute to strengthening the delivery of efficient public services to the population. The project will then contribute to addressing public financial management barriers that hinder public service delivery at the central and local levels so that the flow of resources supports access to services for the population. The education sector, which receives the second largest share of Madagascar's budget, has been identified as a possible sector of high impact if governance issues related to public financial management are addressed adequately. Finally, the project will provide block grants to communes and improve local public finance and service-delivery.

49. The project will be organized into two pillars and four components deemed critical to achieve its development objectives. Under Pillar 1, the project will provide technical assistance through components supporting (i) improved revenue mobilization and mining and (ii) improved expenditure (PFM) management; under the Pillar 2, the project will provide a combination of technical assistance and result-based financing through components supporting (iii) education sector service delivery; and (iv) decentralization/local governance.

50. Organized around these four components, the project will utilize three interrelated tools. The first tool is the technical assistance (TA) support that will provide the necessary knowledge and capacity to improve revenue and expenditure management with the objective of supporting service delivery. The second tool is the Eligible Expenditure Programs (EEPs), against which loan proceeds for service-delivery will be disbursed. The third tool is the Disbursement Linked Indicators (DLIs) that establish a performance-based framework to measure progress in service-delivery reform implementation. Success in meeting the project development objectives will be evaluated through these DLIs.

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51. The project will adopt a results-based financing approach that allows for improving Government coordination by better aligning the incentives of different actors and by focusing on results. The proposed approach will address coordination issues and create an authorizing environment to address political economy constraints and resistance to change by aligning incentives of different actors while focusing on tangible and measurable results. Communication of the results achieved will also be an important part of the approach.

52. Project management, monitoring and evaluation, and leadership and change management will be mainstreamed across the four components. The project will cultivate a culture of collaboration for results and ownership of reform processes from within the administration by offering a set of frameworks and tools. This may include establishing a shared vision and ensuring effective ownership; mobilizing coalitions and facilitating collaborative problem-solving; enhancing

ability to manage projects and deliver short-term results that are aligned with long-term plans; and providing some basic tools for measuring progress and holding Government to account. It will be achieved through a combination of workshops, action learning, joint problem-solving, and coaching. Additional support will be provided to PREA to optimize swift implementation of the project. Finally, project will provide funding to conduct “third party monitoring” of DLIs with the objective of mainstreaming citizen’s engagement in project management.

53. A Project Preparation Facility (PPF) will be requested to fund preliminary work. Currently, this would include: the WCO customs audit; an assessment of potential fiscal revenues at the local level; an institutional assessment of FDL; a typology of communes; and the assessment of internal and external audit functions. The duration of the project will be four years.

54. The project will have numerous direct and indirect beneficiaries across a variety of ministries and institutions. These include, inter alia, the The President’s Office, the Prime Minister’s Office, the Ministries of Finance & Budget, Mining and Education as well as the Ministry of Interior & Decentralization, the Local Development Fund (FDL), and local Governments. The final beneficiaries will be the citizens who benefit from the services provided by those ministries and local Governments.

Pillar 1: Technical Assistance for Improved Service Delivery

Component 1: Improved Revenue Mobilization and Mining (US$ 14.00 Million)
- Subcomponent 1.1: Tax Revenues
- Subcomponent 1.2: Customs Administration
- Subcomponent 1.3 Mining Revenue

Component 2: Improved Expenditure (PFM) Management (US$ 3.00 Million)
- Sub-component 2.1: Budget Management
- Sub-component 2.2: Budget Transparency
- Sub-component 2.3: Control in Budget Execution

Pillar 2: Technical Assistance and Result Based Financing for Improved Service Delivery

Component 3: Improved Education Sector Service Delivery (US$ 8.00 Million)
- Sub-component 3.1: Improved Budget Execution
- Sub-component 3.2: Improved Payment of Community School Teachers
- Sub-component 3.3: Teachers Performance Management

Component 4: Support for Decentralization and Local Governance (US$10.00 Million)
- Sub-component 4.1: Grant to Local Governments
- Sub-component 4.2: Strengthen Public Financial Management and Local Governance

IV. Safeguard Policies that might apply

Safeguard Policies Triggered by the Project	**Yes**	**No**	**TBD**
Environmental Assessment OP/BP 4.01	x		
Natural Habitats OP/BP 4.04		x	

Forests OP/BP 4.36		×	
Pest Management OP 4.09		×	
Physical Cultural Resources OP/BP 4.11		×	
Indigenous Peoples OP/BP 4.10		×	
Involuntary Resettlement OP/BP 4.12	×		
Safety of Dams OP/BP 4.37		×	
Projects on International Waterways OP/BP 7.50		×	
Projects in Disputed Areas OP/BP 7.60		×	

V. Financing (in USD Million)

Total Project Cost:	35.00	Total Bank Financing:	35.00
Financing Gap:	0.00		

Financing Source	Amount
BORROWER/RECIPIENT	0.00
International Development Association (IDA)	0.00
IDA Grant	35.00
Total	35.00

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