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Republic of Madagascar

Diagnostic Trade Integration Study (DTIS) Update

Levelling the playing field for renewed and
inclusive growth

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GTCDR

AFRICA



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Abbreviations and Acronyms

AET	Autorisation Exceptionnelle de Transfert (Exceptional Transfer Authorization)
AGOA	African Growth and Opportunities Act
APEI	Accelerated Program for Economic Integration
APTR	L'Association Professionnelle des Transporteurs Routiers
ASYCUDA	Automated SYSTEM for CUsToms DAta
BASA	Bilateral Aviation Safety Agreement
BNM	Bureau de Normes de Madagascar
BPO	Business Process Outsourcing
CCCO	Certificat de Contrôle de Conditionnement et d'Origine
CET	Common External Tariff
CFA	Customs and Forwarding Agents
CIF	Cost Insurance Freight
COMESA	Common Market for Eastern and Southern Africa
DTIS	Diagnostic Trade Integration Study
EDBM	Economic Development Board of Madagascar
EIF	Enhanced Integrated Framework
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
FOB	Freight On Board
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GUE	Guichet Unique à L'Exportation (Single Window for Exports)
GPTE	Groupement de Transporteurs Professionnels de l'Est
HACCP	Hazard Analysis Critical Control Point
INTH	Institut National de Tourisme et d'Hôtellerie (Nat. Tourism and Hospitality Institute)
ISO	International Organization for Standardization
ITBM	International Trade Board of Madagascar
ITC	International Trade Centre
LDC	Least Developed Country
MCC	Ministère de Commerce et de la Consommation
MENA	Middle East and North Africa
MICTSL	Madagascar International Container Terminal Services Ltd.
MFN	Most-Favoured Nation
NTM	Non-Tariff Barrier
NTM	Non-Tariff Measure
PPA	Power Purchase Agreements
ODD	Observatoire des Délais des Douanes
PND	National Development Plan
SADC	Southern African Development Community
SEZ	Special Economic Zone
SNC	Service des Normes et du Conditionnement
SOE	State-Owned Enterprise
SPAT	Société du Port à Gestion Autonome de Toamasina
SPS	Sanitary and Phyto-Sanitary
STRI	Services Trade Restrictiveness Index
TBT	Technical Barriers to Trade
TFA	Trade Facilitation Agreement
TRIST	Tariff Reform Impact Simulation Tool
TTI	Tourism Training Institute
UNIDO	United Nations Industrial Development Organization
VAT	Value-Added Tax
WTO	World Trade Organisation

Executive Summary and Action Matrix

With a newly elected government, Madagascar is emerging from years of political trouble. The return to constitutional order has sent a strong signal but the political situation remains fragile and uncertain, and private investors remain hesitant. While macroeconomic stability was maintained during the latest crisis, the crisis has severely affected the private sector and led to quasi-stagnation during 2009 and 2014. As a result, but also following a longer-term trend, poverty has increased and poverty rates are among the highest in the world with 90.6 percent of the population living below the international poverty threshold of US\$2.0 per day, and 78.2 percent below the extreme poverty line of US\$1.25 per day in 2012.

The new government aims to re-launch the economy and ensure national reconciliation and has presented a broad strategy with the National Development Plan (PND). While the PND does not explicitly look at trade policy issues, these need to be strategically integrated into the country's development strategy to allow the economy to grow, especially because domestic demand remains limited, especially for a large proportion of the goods Madagascar produces. Reducing the costs it takes Malagasy entrepreneurs to transfer intermediate inputs into final products and bring them to destination markets will increase their competitiveness, open new export opportunities, and allow for job growth. High trade costs to destination markets, but also high internal trade costs and a number of administrative barriers hamper the growth of the export sector in particular and need to be urgently addressed.

Trade policy in Madagascar needs to recognize that in the modern global economy, production processes are increasingly specialized, and are increasingly undertaken by firms spread across the globe. Trade policy needs to focus evenly on imports and exports. Past strategies of industrial development that supported the emergence of entire supply chains, can no longer work, especially in a small economy like Madagascar. Whether participating in an international value chain or not, all firms effectively compete with firms that are part of such chains and benefit from access to the low-cost and high quality inputs around the globe. To be successful, access to such high-quality and low-cost intermediate inputs is important for all companies. Policies also need to aim at reducing other costs to businesses as these ultimately affect their competitiveness. Such “behind-the-border” reforms need to complement what has been historically understood as ‘trade policy’.

Recognizing this challenge, the Government of Madagascar has asked the World Bank to update the Diagnostic Trade Integration Study (DTIS) that had been prepared between 2001 and 2003 with a view to identifying key barriers to integrating into global markets. Implementation of the reforms proposed in the first DTIS in 2003 has been very limited as only 16 out of 59 proposed activities have been mostly or fully implemented (paragraph 28). Focus has mostly been on undertaking additional studies, rather than implementing actual policy reforms. This Update of the Diagnostic Trade Integration Study (DTIS) identifies the trade related policy constraints that prevent Madagascar from increasing trade, diversifying and deepening its production base, and identifies key priorities for actions and reforms. This update aims to formulate a prioritized and high-impact matrix of proposed policy reforms that could serve as the framework for support from all development partners in the area of trade and

competitiveness, and could help re-ignite economic growth if consistently implemented. While infrastructure constraints abound in Madagascar, the recommendations of this study focus on fixing policies (rather than physical investments) that are essential to maximize the impact from such investments.

Trade openness can play a critical role in the fight against poverty, but complementary policies are also needed. Such policies should aim to ensure that the most vulnerable are sheltered from negative impacts, as trade openness does not automatically and unequivocally benefit the poor. Facilitating the flow of labor towards more productive sectors, and towards productive companies within sectors, should be the corner stone of such policies, effectively protecting people, not jobs, and facilitating adjustment rather than generating new rigidities. Levelling the playing field to allow new foreign and domestic investment and increased competition will be essential.

This study finds that a number of cross-cutting challenges present hurdles to strong private sector growth needed for economic recovery. With 22 million people with an average income of US\$ 447 in 2012, back at its 2001 level, Madagascar's total economic size remains small and access to export markets will be essential to allow companies to benefit from economies of scale and sustained growth. Average labor productivity in Madagascar is low, although large differences exist at the sector and regional level, indicating that if conditions and processes are right, firms can be very successful. The supply of workers with vocational skills or professionals with specialized skills is limited, especially outside the capital, access to land remains a challenge, and access to finance is limited as lenders remain risk averse. In addition, competition in many critical sectors is hampered both by the practices of informal firms as well as by strong incumbents, negatively affecting access to key inputs for downstream firms. Coupled with a weak legal and regulatory environment, an inefficient judiciary system, and endemic governance issues across government and private institutions, these factors make it challenging to do business, unless politically connected (paragraphs 19-20).

Madagascar's export performance has been very volatile over the last 10 years, affected by domestic political as well as international crises and exports remain concentrated. Minerals and mining have driven export expansion, as have exports of vegetables and food stuff, while the apparel and clothing sector declined following the suspension of AGOA preferences although it has somewhat recovered as operators targeted other markets in Europe and South Africa. Overall, exports doubled between 2005 and 2008, declined during the global recession and political crisis and have shown strong signs of recovery since 2011. Exports remain concentrated, although less so than in some comparator countries, and 10 products still account for 56 percent of total merchandise exports. Trade in services has been increasing faster than trade in goods, contributing to some export diversification and offering opportunities for job growth. The emergence of new markets in the Asia and Pacific –principally China and India has contributed to geographical diversification and the share of exports going to the EU and the USA declined from more than 80 percent to 56.3 percent between 2007 and 2012. Exports to other Sub-Saharan African countries increased, though from a low base, largely driven by improved market access resulting from regional trade agreements. The share of imports originating in Asia has also increased while less than 10 percent of Madagascar's imports originate from Sub-Saharan Africa, mostly SADC (paragraph 41).

Madagascar remains geographically far from many of its destination markets, and reducing domestic costs through policy reforms in key areas is therefore particularly important. Transport costs to destination markets remain high and overall transport times long. However, addressing them is largely outside the control of the government as changes in shipping routes and reduced trade volume have resulted in shipping times for containers to Europe or Asia that have increased from 25-35 days in 2005 to 30-50 days today (paragraph 124). While the port in Toamasina aims to become a regional hub which could contribute to reduced transit times, this is by no means certain, and the port is only likely to develop into a hub if domestic trade increases significantly as well. For that, facilitating, accelerating, and increasing the movement of goods in and out of the port and along the Toamasina-Antananarivo corridor will be essential.

In this light, the government should aim at address those trade costs that result from processes, procedures, and regulatory requirements within Madagascar to reduce operating costs to businesses and increase their competitiveness. Currently, exports are driven by few, large companies that manage to export more or less consistently and incumbent firms accounted for more than 90 percent of the total exports in 2012. The ten largest exporters accounted for more than 38 percent of all exports in 2012, down from 42 percent in 2006. However, every year around one third of all exporters were new companies that had not been exporting the year before, showing significant potential for export growth. The data also indicate, however, that about one third of companies each year did not manage to sustain exports into the following year, and better support to such enterprises as well as lower trade and transaction costs could help these enterprises to sustain operations.

To that end, the government will have to develop a competitiveness strategy based on the key recommendations of this report (paragraph 75). This strategy that will have to go beyond the newly proposed 'export strategy' as it would look at broader competitiveness issues, including the importance of access to relevant skills, (imported) intermediate inputs, and a level playing field that allows transparent and consistent treatment of enterprises and individuals. Levelling the playing field in Madagascar will be essential for renewed, sustainable, and inclusive growth. The Ministry of Commerce, together with the NSC, will have to take the lead in raising the strategic importance of trade policy and streamline critical issues into high-level policy making.

Such a strategy will have to address five main elements: a) continuing to improve the trade and economic policy environment to facilitate the access to goods and services inputs, b) facilitating trade by reducing unnecessary costs and delays at ports, c) reviewing other administrative processes that increase trade costs, d) improving transparency and institutions supporting trade and e) coordinating trade policy issues in Madagascar more effectively. A number of sector-specific recommendations are also proposed. Some of the proposed measures can be undertaken over the short run, while others that are evenly important will demand further consultations and could be supported through further technical assistance from development partners. A cross-cutting feature throughout will be the need to level the playing field by reducing uneven treatment and discretionary benefits to specific actors.

Improving trade and economic policies

In the global economy, it is essential that producers get access to the inputs they need at the prices that allow them to be competitive – and often these will only be available outside Madagascar. The government therefore should ensure that trade policy is simple, transparent and does not generate unnecessary distortions. The 2015 MFN tariff schedule contains only four tariff bands, but overlapping membership in regional organizations SADC and COMESA, as well as the Economic Partnership Agreement (EPA) with the EU add to the complexity of the tariff schedule. Madagascar’s current tariff structure at times puts higher duties on raw materials than on intermediate products, creating a bias against exports as companies focus on a captive domestic market. At the same time, non-transparently applied exemptions affect competition in the domestic market and largely benefit larger and well-established companies. Reducing discretionary exemptions for imports, improved customs control and more effective sanction mechanisms for non-compliant companies and colluding border agents to allow even access by all economic operators based on clearly defined criteria would reduce domestic distortions. In 2012, 13 percent of all imports entered with complete tariff exemptions under the Large Mining Law, and 7 percent under various Government and Diplomatic exemptions. Rebates on Value Added Duties on imports were larger than tariff rebates, accounting for nearly 60 percent of the US \$126 million of exemptions granted. Overall, exemptions under the Mining Law accounted for 41 percent of exemptions of duties, and 71 percent of VAT exemptions, or 58 percent of total exemptions granted at borders. Ensuring that only eligible imports obtain exemptions would help level the playing field while protecting revenues (paragraphs 53-54).

Madagascar is planning to replace the current tariff schedule with the COMESA CET once approved by Parliament, leading to an increase of average tariffs by almost 30 percent (paragraphs 55-58). This would negatively affect consumers and companies. The government should communicate the coming changes to potentially affected companies and consumers early on, allowing them to adjust to these changes which could raise consumer prices, or increase operating costs for companies as inputs become more expensive. It should also consider a more detailed assessment of potential impacts for key commodities, or affecting specific companies, and allow for the formulation of transition or mitigation measures. These discussions should be undertaken already, even while the submission to and approval of the transition to the CET by the National Assembly is still pending. Being a small economy, increasing tariffs across the Board will not be in Madagascar’s interest and if still possible, the government could consider discussing with other COMESA members potential revisions to the CET, for example to ensure zero tariffs for capital goods, raw materials, and basic commodities.

Productivity in services plays a critical role as a strategic driver of economic competitiveness but their use is limited in Madagascar (paragraphs 192-195). The use of services inputs tends to be positively correlated with increased productivity in the enterprises using such services. Data on the total value added of services (exports) for Madagascar indicate that services represent important inputs into other areas of the economy, including for exports. This demonstrates that services are omnipresent and access at the right price/quality can decide whether a (manufacturing) product can successfully be exported. While professional services are generally available and are used by exporters in Madagascar, their use is lower than in comparator countries. Improving domestic regulations and strengthening domestic regulators could ensure increased competition and the removal of explicit barriers. A first step

in this direction would be a detailed regulatory audit of key services sectors where the government is willing to reform. An open and transparent dialogue during this review between regulators, providers, and users of such services will be essential. Collaborating with other countries in the region on such regulatory reforms could be particularly beneficial to reduce barriers to the movement of professionals. Madagascar could for example participate in the Accelerated Program for Economic Integration with Malawi, Mauritius, Mozambique, Seychelles, and Zambia.

Availability of electricity remains a major impediment for businesses and private sector involvement in energy generation and distribution should be considered (paragraph 21). The low access rate (only 14 percent of the population had access in Madagascar in 2010, lower than many comparator countries) is in part a consequence of poor performance by JIRAMA, the state-owned electricity and water company. Expensive, volatile and rare access to electricity significantly hampers overall economic development. Allowing independent power producers and developing renewable energy sources are essential steps to expand rural electrification and promote job creation.

In addition, infrastructure remains a significant challenge in Madagascar but policy reforms can significantly contribute to increasing the overall capacity of existing infrastructure, by ensuring it can be used more efficiently (paragraphs 126-129). Overcharging of trucks is frequent practice, further contributing to the deterioration of road quality, a practice that authorities have started, and should continue, to address. Rail and road infrastructure have deteriorated over the past decades, only 10 percent of the network are in good condition and needs to be improved to cope with current and future trade flows – but this will need a lot of time. Traffic at Toamasina has increased but current traffic levels remain below capacity and projections for future growth that would justify large investments need to be assessed cautiously. Over the medium term, the government should strengthen competition between the road and rail sectors, and develop a multimodal transport platform to decongest Toamasina port.

Trade Facilitation

The customs authorities have implemented a number of important reforms over the past decade, but significant room for further improvement remains (paragraphs 77-79). While the customs code has been modernized in 2006, a number of practices that do not conform to WTO provisions remain in place, such as for example the determination of the value of goods using minimum values, or the fees for Gasynet which are based on transaction values. The process of dematerializing customs declarations has advanced but effectively, customs control still only starts once all documentation is physically submitted (and accepted), although there are reports that as of September 2015 piloting of full dematerialization has started. The current practice of focusing on combatting fraud and illicit trade results in delays and additional costs, but do not lead to higher customs revenues, especially because governance issues, and politically-motivated collusion, remain endemic and need to be addressed. Risk analysis remains embryonic and selectivity criteria are very restrictive, causing costs to operators and generating long delays that serve as incentives for traders to avoid formal channels or find alternative solutions altogether. Customs should improve risk management procedures and criteria and use available data more effectively and consistently, allowing results to feed back into those selectivity criteria to consistently improve targeting. Complementing better risk management procedures with

independent post-clearance controls would have a more dissuasive impact compared to current practices and help address governance issues, while facilitating the flow of goods at the same time. Overall, reviewing the way current controls are organized and undertaken could go a long way in reducing trade costs.

Significant delays persist at ports, frequently not resulting from the type of inspections and controls, but rather from the manner in which these controls are actually undertaken (paragraphs 132-137).

With 80 percent of traffic entering at Toamasina port, improving the way in which border controls are conducted should be of highest priority to government. The container terminal in Toamasina is performing well, competitively priced, and services are of high quality, other factors in the port erase the good performance. Customs clearance time in Toamasina in 2014 averaged four working days for goods in the red channel (however, these averages mask significant variance), and significant additional delays ranged from 4 to 72 hours before goods can leave the port and are on their way to final destination. The scanning and physical inspection of goods represents the most important bottleneck at Toamasina, and procedures need to be reviewed especially in this area. Where containers need to be scanned and/or physically inspected, the actual time to undergo procedures is only 45 minutes, while total wait times in between and for entering/exiting the port amounted to 35 hours. This is particularly important because small delays at the port can delay the departure of trucks to Antananarivo by 12 hours. Improving processes around the flow of goods to reduce unnecessary wait time for example when entering the port, before passing the scanner, the validation of the scan image, before physical inspection takes place, or the final report is validated, would significantly reduce overall delays without impacting the overall control exercised by customs. This evenly applies to procedures within MICTSL where delays also occur.

Delays related to the scanning of containers affect truck cycle time and increase transport prices which consequently are 15-30 percent higher than in comparable countries (paragraphs 141-143).

In addition to high costs along major corridors, transport prices between smaller economic centers in Madagascar are especially high (and much higher than on major corridors) and add significant (and at times prohibitive) cost to export products before they even reach major cities or ports. They also negatively affect the opportunities for the emergence of supply chains.

Reducing unnecessary delays for clearance time and movements through the port and container terminal could double or treble truck productivity by increasing the number of rotations possible, and reduce transport prices by 13-15 percent (paragraph 146).

While waiting to be scanned and subsequently inspected, containers have to remain on the trucks, holding trucks 'hostage' and reducing their operational efficiency. The immobilization of goods and trucks significantly reduces the time that transportation equipment can be put to economic use. As a result trucks operating along the Toamasina-Antananarivo corridor seldom can make more than one trip per week and generally do not run more than 40,000 km per year, much less than in the EU where trucks run up on average around 150,000 km per year, or around 80,000 km per year in other countries in SSA. This raises operating costs significantly and translates into higher transport prices paid by users of such services, negatively affecting the ability of Malagasy companies to compete. Because transport operators know that trucks will run little, they also invest in used trucks with lower financing and fixed costs, but that more

frequently break down (paragraph 140). The impact of the delays at ports is conservatively estimated to cost the economy at least US\$11 million per year in terms of lost efficiency and increased investment costs, with additional downstream costs more challenging to estimate.

Overall, the time needed to prepare and execute import and export transactions remains too long.

Current procedures also generate an uneven playing field as larger companies and those located in Export Processing zones are better able to deal with customs processes. Reviewing regulations and requirements will partially address this issue, but transparency relating to where delays occur needs to increase as this would allow the government to specifically address bottlenecks. Monitoring and publishing clearance times for administrative processes in all Ministries, ideally in real-time, would be important. In parallel, ensuring the customs clearance process is fully dematerialized and can start with the electronic submission of all documentation (not only once all documentation is submitted in hard-copy format) will be essential to accelerate customs clearance and in the fight against corruption.

These and other trade facilitation reforms are included in the WTO Trade Facilitation Agreement which Madagascar should ratify and ensure compliance with the agreement (paragraph 122).

Implementation by all trading partners of the TFA is in Madagascar's interest, as is the implementation of the commitments by Madagascar itself because trade costs disproportionately affect smaller companies. Like all LDCs, Madagascar should identify those commitments it cannot meet immediately and those where it will need additional technical assistance for implementation, and notify the WTO. Setting up the National Trade Facilitation Committee, ideally aligning it with the National Steering Committee for the EIF to minimize duplication of committees, would be important for that exercise. The TFA can be used to rally donor support around a complex but highly relevant reform agenda as this report shows.

Other regulatory policies increasing trade costs

While all regulatory activity serves legitimate policy objectives, current procedures in various regulatory agencies seem to generate high costs and delays to importers without permitting these agencies to achieve regulatory objectives (paragraphs 99-101). Good regulatory practices can contribute to improved consumer welfare by ensuring food and product safety. At least 14 regulatory agencies are involved in regulating imports, and obtaining all documentation and relevant approvals can take days or even weeks, increasing costs and delays to importers and exporters. Despite the fact that 11 agencies are already connected to an electronic system to grant import licenses, physical interactions are frequently required before they are issued, and collaboration between border agencies remains limited and needs to be improved. The government should review existing import requirements and remove or streamline those that do not achieve regulatory objectives following inclusive consultations to reduce unnecessary costs. Regulatory agencies currently also test for product conformity themselves in laboratories that are non-accredited, effectively basing their assessment on unreliable test results. If Madagascar were to ensure that regulatory agencies accept test results from private, internationally accredited laboratories (such as the Institut Pasteur de Madagascar), this could

provide incentives for private laboratories to invest in capacity and accreditation, with positive effects on consumer safety as well as for exporters in need of such laboratories (paragraph 115).

Burdensome regulations also affect exporters, and more than half of the constraining non-tariff measures that exporters face are put in place by national authorities (paragraphs 102-109). This means that in addition to meeting requirements in import markets, exporters also have to deal with extensive bureaucratic requirements in Madagascar prior to exportation. The large majority of these relates to inspection requirements before embarkation, certification, or the issuance of licenses or permits to export. Obtaining all documentation and the export authorization can take a significant amount of time. Obtaining the Certificat de Consommabilité, which is needed for each export consignment, takes on average at least 5 working days when visual controls only are undertaken, and significantly longer if samples are actually tested. It seems that the larger delays originate before the actual customs declaration, with some companies indicating that they were starting document preparation about one month prior to the shipment date, but delays of multiple months prior to obtaining authorization are not unheard of. Such delays effectively prevent companies from exporting. For a number of products, these export licenses are tied to the mandatory testing of export consignments with the objective of ensuring that Malagasy products are perceived as high quality abroad. However, the impact of such measure is doubtful and they should be reviewed. A number of direct export restrictions (public and private) are also in place and should be removed (paragraph 109).

Trade Support Institutions and Transparency

Export Processing zones have constituted a key element of the economic development strategy in Madagascar, but they overly rely on tax incentives instead of providing much needed infrastructure that is lacking. EPZs focus on labor-intensive, low-value, export-oriented manufacturing and their contribution to exports has been and is significant. Since 2011, the sectoral composition of EPZs has shifted away from the textile and apparel industry with new EPZ approvals highest in the apparel, ICT-related, and chemical sectors. Apparel exports have also diversified towards the EU and South Africa in particular, compensating part of the loss of exports to the United States. A number of issues undermine the profitability of the EPZ sector, and some could be addressed through a better designed scheme. Persistent infrastructure constraints that affect the Malagasy economy cannot be addressed through the single-firm EPZ regime while spatially concentrated zones would allow for the provision of currently lacking infrastructure (paragraph 167). Combining such a transition towards spatially concentrated zones with the alignment of tax incentives between EPZ and other companies, could improve competitiveness and linkages with the rest of the economy, while reducing distortions between EPZ and non-EPZ companies. Second, improving regulatory clarity and transparency including regarding which goods can be imported duty free would reduce opportunities for rent seeking. At the same time, day-to-day monitoring and control of the free zone regime which is currently inadequate (paragraph 171), needs to be improved to reduce opportunities for abuse and the leakage of duty-free imports into the economy. Mauritius could serve as an example for such a transition which would have to be carefully managed. The 95 percent export requirement (which is not WTO conform) is inhibiting forward linkages and should be removed (paragraph 177).

Continued support to new and existing exporters and investors will remain critical, but more needs to be done to make institutions such as the ITBM, the EDBM and initiatives such as the GUE effective. To improve the effectiveness of the one-stop shop hosted by EDBM, all relevant agencies again will have to be physically represented at the EDBM, and all representatives of these agencies at EDBM need to have sufficient decision making powers to transform the one-stop shop into a truly functional single window (rather than a front window). All relevant decisions will have to be taken at EDBM, or where impossible, clear maximum clearance times need to be set, and delays be publicly monitored and published. Supporting exporters to ensure their export relationships can continue past the first or second year would contribute to diversification and more successful smaller companies.

Through the planned establishment of the Single Window for Exports (GUE), the Ministry of Commerce aims to reduce the total time needed to about 20-25 days to obtain all documentation for exportation for food products (paragraph 184). While ensuring predictable delays would be a significant improvement, this would still put a significant burden on exporters and hamper their prospects for export growth. All procedures should be reviewed for regulatory effectiveness and whether the same objectives could be achieved at lower costs to exporters. While increasing transparency for export procedures, similar work should be undertaken to also cover import procedures as well as any other regulatory requirements affecting imports and exports, for example by establishing a trade portal that would become a legally binding repository of all relevant regulations. As in the case of EDBM, for the GUE to function effectively, it will have to go beyond co-location and all agents present at the GUE should have decision making powers to sign and approve documentation immediately. Transaction times for each approval need to be made more transparent to ensure agencies can be held accountable for delays.

Policy coordination

The absence of a common harmonizing agenda such as an overarching competitiveness strategy results in a lack of coordination within government, leading to many isolated and non-coordinated measures that negatively affect the trading environment. Overall, the Ministry of Commerce does not fill its coordinating leadership role (key elements of trade policy and competitiveness are managed by other Ministries), but rather reacts to external requests on an ad-hoc basis and coordinates responses accordingly. The recently established National Steering Committee could play the role of effective integrator of all stakeholders, but strong leadership and willingness to collaborate by all parties will be needed for success. A mechanism to hold all members of the NSC accountable to participate, share information, and implement joint decisions taken would be an important step forward.

The Ministry of Commerce, together with the NSC, will have to take the lead in raising the strategic importance of trade policy and streamline critical issues into high-level policy making (paragraph 76). Ways and means to breaking down barriers between Ministries and Agencies, but also among departments within individual Ministries will be needed, requiring nothing less than a fundamental behavioral change in how government business is conducted. It should be complemented by a more frequent, informal, and inclusive dialogue with the private sector to ensure its concerns are rapidly reflected in government priorities, and solutions are being found and implemented. The flow of

information between various regulatory agencies and the private sector needs to be improved to ensure new regulations are discussed prior to their introduction. Information from other WTO members also needs to be more effectively transmitted to stakeholders by the SPS and TBT focal points, and Malagasy regulatory initiatives need to be communicated to the WTO, SADC, and COMESA in line with commitments.

Sectoral issues – agriculture, fisheries, and tourism

Agriculture and livestock, fisheries, and tourism remain important sectors for the economy, but all are negatively affected by the trade-policy issues outlined in the report. Addressing these policies could contribute to re-igniting these sectors, contributing to employment creation.

The chapter on agriculture finds that productivity remains low and has hardly increased over the last decades, while limited access to finance, agricultural inputs, and administrative barriers affect competitiveness overall. Facilitating access to land will be important to allow for new investments and more efficient operations, while increasing access to better seeds and fertilizers will be important to increase yields. Outgrower schemes and collectors are already playing an important role in providing or permitting access to such inputs but the government could collaborate and make better use of existing private sector operator networks to facilitating access and the provision of extension services (paragraphs 237, 242). Reviewing and simplifying the large number of laws and regulations affecting the agricultural and livestock sectors, and reducing the number of levies and charges, while ensuring that remaining regulations can be implemented, will be important (paragraphs 227-231). The recent initiative by the MCC to more strictly regulate collectors in the agricultural sector would add additional costs and procedures open to informal payments, and would be extremely difficult to implement, and therefore should be reconsidered.

The fisheries sector remains dynamic and new opportunities are emerging, including in the Far East, but it is essential that the ASH remains recognized as ‘competent authority’ by the EU. As smaller operators have managed to enter export channels through collectors, increasing potential for growth and poverty reduction, but exports to the EU critically depend on the recognition of the ASH. The government should ensure that sufficient resources are available—and that they are used effectively within the ASH (paragraph 275). Next, cross-cutting factors such as high transport costs and limited (air) connectivity particularly affect the high-value sector for fresh products (paragraph 274). Last, data on the sector is limited and better data on stocks, catch, and products marketed will have to be collected to allow for better management of stocks and licenses and to design policies that could ensure a sustainable exploitation of a sector where stocks have come under pressure.

Tourism remains a sector with significant potential but high costs of getting to Madagascar and to travel within the country need to be addressed by improving air connectivity. Arrivals are recovering following repeated political crises, but limited competition in international air access, as well as high transport costs within Madagascar due to low and limited domestic air services and ground transportation, increase costs of getting to Madagascar and make travel within Madagascar expensive and lengthy (paragraphs 288-291). While tourists usually stay an extended period this is partially due to long domestic travel times, hampering the competitiveness of the sector and limiting the number of

visitors as few tourists can afford long vacations. The government should focus on implementing existing agreements relating to air access by drafting and agreeing on the annexes which operationalize these agreements, and by agreeing on new agreements with markets of high potential impact for the tourism sector by optimizing access to the country through major air traffic hubs. Improving access within Madagascar will also be important, for example by reviewing domestic regulations to facilitate entry and competition on key routes. Addressing skill shortages by facilitating the granting of work permits, a better alignment of training curricula with private sector needs, creating a pool of qualified trainers and encouraging the improvement of existing and entry of new tourism training institutes will also be important (paragraphs 297-300).

Medium- to long-term issues that need to complement reforms

These more specific recommendations will only be effective, however, if complemented with broader, more challenging, and more long-term policy reforms. Addressing these will demand significant further consultation, political economy analysis, coalition building, and strong political leadership to overcome deep rooted opposition from those that benefit from the status-quo.

Most critically, governance issues continue to permeate the economy, hampering competition and reducing opportunities for inclusive growth. Improving governance and renewing efforts to combat fraud and corruption at all levels of government will be important. Enforcing existing rules and applying sanctions consistently will allow to reduce uneven access to benefits such as duty exemptions, tax benefits, access to opportunities in government procurement, faster clearance times, or simplified procedures in the otherwise complex investment and business climate. Improved governance will also be needed to allow regulators enforce mandatory standards, enforce licenses in the fisheries sector, and allow effective customs control. As outlined earlier, the current environment coupled with a weak legal and regulatory environment, an inefficient judiciary system, and endemic governance issues across government and private institutions, make it challenging to do business, unless politically connected. Lessons for customs reform in this context could possibly be drawn from the experience of establishing performance contracts in Cameroon, where they have led to less but better targeted customs controls, faster clearance times, and increased revenue collection.

Access to land remains a critical issue for a number of sectors and the government should review how this issue could be addressed. While access to land is highly political and has led to political tensions in the past, there is a clear acknowledgement in the government that the issue needs to be addressed, and new reform efforts are under way. Broad-based consultations will be essential to address this issue successfully and comprehensively and development partners might be able to assist.

Madagascar already benefits from increased regional market access, but regional markets seem to offer more potential. Barriers to regional integration persist and Madagascar should continue to remove barriers to regional integration. It should include the movement of people and services trade where Madagascar has made hardly any offer so far to COMESA, as well as regulatory collaboration with neighbors. Madagascar could consider joining the Accelerated Program for Economic Integration (APEI), an initiative founded by Malawi, Mauritius, Mozambique, Seychelles, and Zambia, aimed at accelerating

existing regional processes to reduce barriers to regional trade with the view of fostering investment and regional integration.

As traffic volumes grow and infrastructure reaches capacity, the government should also strengthen competition between the road and rail sectors, and develop a multimodal transport platform to decongest Toamasina port. Given limited space at the port, containers could be moved under bond (by rail or road) to a dry port located inland outside but close to Antananarivo, allowing the seamless flows of containers and other goods from origin to destination inland, and reducing transport costs significantly. Goods would be scanned upon arrival at the dry port, and stocked for clearance according to the allocated customs channel, avoiding the long delays for trucks in Toamasina which reduce overall truck cycle time. All border services would be present and undertake their control functions at this location. A similar mechanism could be applied for exports with goods cleared at the dry port and being sent directly to the port without further controls. An added benefit would be the decongestion of Antananarivo, while the central train station could continue to be used for passenger traffic. The dry port should be managed by a concessionaire, similar to the one for the container terminal in Toamasina to ensure its efficient management.

Summary and Conclusion

The Action Matrix presented below is based on a draft Action Matrix initially proposed by the authors of this report and has been adapted following the validation workshop to reflect comments and suggestions raised. It outlines the key obstacles identified that hamper the integration of Malagasy companies and consumers into global and regional markets but should be read in conjunction with the main report. It presents the recommended policy reforms identified in this DTIS Update and that have been outlined in this section. An effort has been made to categorize them along the three dimensions of 'priority', 'difficulty', and 'payoff', to help further prioritization, but the authors are aware that actual challenges and impact will depend on how the proposed reforms will be addressed and implemented. Addressing these issues consistently, coherently, and effectively will be essential to allow Malagasy enterprises, farmers, and consumers to benefit from market opportunities abroad. However, transparent and inclusive discussions prior, during, and after implementation of the proposed policy reforms will be critical to success.

Proposed DTIS Update Action Matrix

Identified Constraint	Action proposed	Responsible Agency/ies	Priority/Difficulty/Payoff
<i>Economic and trade policy</i>			
Limited access to energy hampers the productive sector	Revise legislation to allow independent power producers to provide electricity, and overhaul the energy sector and JIRAMA	Ministry of Energy, Nat Assembly, Private Sector	High/Difficult/High
Duty exemptions at ports are lacking transparency, affecting competition and disadvantaging some companies	Simplify and publicize the eligibility criteria for various exemptions Use existing data to monitor how they are applied and to minimize abuse	Ministry of Finance, Customs, Ministry of Commerce	Medium/High/High
Tariff reforms are not transparently communicated although a move to the COMESA CET will affect prices substantially	Discuss and communicate transition schedule to implement the COMESA CET with private sector to allow companies and consumers to adjust, consider discussing with other COMESA members potential revisions to the CET, for example to ensure zero tariffs for capital goods, raw materials, and basic commodities	Ministry of Finance, Customs Ministry of Commerce	Medium/Low/Medium
Use of services inputs by companies is limited, partially because domestic supply is limited	Take stock and promote services trade in Madagascar. Review regulations of key services sectors and foster regulatory coordination with neighboring countries, for example through the Accelerated Program for Economic Integration (APEI)	Ministry of Commerce, sector Ministries, NSC	Medium/Low/High
Infrastructure is insufficient	Continue to improve maintenance processes, allocate additional resources, and enforce regulations regarding overloading, to ensure existing infrastructure does not further deteriorate	Ministry of Public Works	Medium/Low/Medium
Tax policy is not transparent enough	Adopt a simple and transparent tax policy. Undertake overall evaluation of the of fiscal and customs administration. Assess overall taxation framework and its appropriateness. Disseminate current legislation widely.	Ministry of Finance, Private Sector	Medium/Medium/High
<i>Trade Facilitation</i>			
Customs controls at ports are poorly targeted	Improve risk management procedures and criteria, allowing results to feed back into those selectivity criteria, and undertake independent post-clearance controls	Customs, MCC, DGI, jointly with other agencies	High/Medium/High
Inefficient procedures at ports congest the port, generate delays and reduce truck cycle time	Improving management processes around the flow of goods and align operating hours to the container terminal to reduce unnecessary wait time between various control points	Customs, port, MICTSL, freight forwarders	High/Medium/High
Time to prepare and execute import and export transactions remains too long, and dematerialization of customs processes is not yet completed	Measure time for clearance needed by all agencies and publish these data prominently in near-real time, including for procedures prior to the submission of customs declarations Finalize process of eliminating paper trail in customs declarations and adjust systems to permit pre-arrival clearance of shipments, including full dematerialization of customs processes and including at Banks	Customs, all other agencies involved in regulatory controls, GASYNET, commercial banks	Medium/Low/High
Madagascar is not meeting its WTO commitments regarding trade facilitation	Ratify Trade Facilitation Agreement and notify WTO of classification of commitments	Ministry of Commerce	High/Low/Medium
<i>Other regulatory policies</i>			

Regulatory policies generate costs and delays to economic operators without permitting regulatory agencies to achieve regulatory objectives; collaboration among border agencies is limited generating delays and duplication	Review existing domestic product and process regulations and norms that might function as non-tariff barriers to ensure they achieve regulatory objectives, and remove/streamline such requirements where feasible, following inclusive consultations	Regulatory agencies, bureau de norms (BNM)	Medium/Low/Medium
Regulatory agencies base their conformity assessment on test results from laboratories which are not accredited	Review legislative texts to ensure that regulatory agencies accept test results from internationally accredited laboratories	Regulatory agencies, BNM	Medium/Low/Medium
Burdensome regulations affect importers and exporters	Review existing import and export requirements (NTMs), and especially review current mandatory export testing requirements	Ministry of Commerce and NSC, concerned line Ministries	High/Low/High
<i>Policies and Institutions supporting trade</i>			
Limited availability of geographically delineated and equipped zones destined to host Free Zone enterprises, and strong reliance on fiscal incentives	Develop geographically dedicated zones destined to host Free Zone enterprises. Phase out special financial incentives for EPZ companies and modernize the regulatory framework for EPZs	MIDSP, MCC, MFB, MEPATE, MTP, Private Sector, GEFP	High/High/High
Regulatory framework for EPZs lacks clarity and oversight is limited, allowing for abuse and leakage	Allow all goods used in EPZ production to enter duty free without relying on yearly defined list, while improving control of inventory and usage of such inputs	EDBM	Medium/Medium/Medium
Investment and export support institutions still have deficiencies	Review operations of EDBM and ensure all agents have the necessary powers to take decisions for their institution at the One-Stop Shop	EDBM, MCC	Medium/Low/Medium
Current fiscal and customs-related legislation, and trade procedures are not always transparently published and clearances take too long	Operationalize the GUE in tandem with significantly reducing clearance times and publish them for monitoring and increased accountability. Develop a "Trade Portal" providing access to all legislation and make it a legally binding repository of all relevant regulations for imports and exports	Ministry of Commerce	High/Low/High
<i>Policy coordination</i>			
Coordination around trade policy issues is limited because an overarching competitiveness strategy is missing, resulting in conflicting policy initiatives	Develop a competitiveness strategy based on the recommendations of this report and improve policy coordination among all involved Ministries and Agencies, using the NSC as a central point under the oversight of the Ministry of Commerce Re-enforce the consultative platform and the Public-Private dialogue to allow for timely discussions of new legislation relating to fiscal and customs processes, new regulatory measures, and regulatory changes, among others.	Ministry of Trade, NSC, Private Sector	High/Low/High
<i>Sectoral issues</i>			
Use of inputs and productivity in the agricultural sector remains low	Facilitate access to inputs and production technologies and practices	Ministry of Agriculture	High/Medium/High
A large number of administrative procedures hamper the agricultural sector	Review and simplify laws (as well as new legislative initiatives) relating to value chains in the agricultural and livestock sector to avoid overlap in competencies. Review local tax issues to ensure these are transparent, can effectively be implemented, and achieve regulatory objectives without creating undue costs for economic operators.	Ministry of Agriculture and Livestock	Medium/High/Medium
The recognition of 'competent authorities' is under threat	Ensure sufficient resources are available and they are used effectively by the competent authorities. Ensure technical knowledge is available and	Ministry of Fisheries (ASH), Ministry of	High/Medium/High

	strengthened to ensure sector recognition (especially of the ASH) can be maintained	Agriculture (DPV), Ministry of Livestock (DSV)	
Limited connectivity in terms of air access does not permit market diversification	Implementing existing agreements relating to air access by drafting and agreeing on the annexes which operationalize these agreements, and agreeing on new bilateral agreements with markets of high potential impact	Ministry of Tourism, ACM	High/Low/High
Limited internal mobility and reliability of connections, non-competitive prices	Facilitate new entry and competition on key routes, using existing legislation	Ministry of Tourism, ACM	High/Medium/High
Limited skills at the commercial and operational level in the tourism sector	Support training centers in the tourism sector in the training of trainers, curricula, and equipment to better align their curricula to business needs Develop a program to improve capacities Standards/Certification, e-marketing	Ministry of Tourism, BNM, Ministry of Professional Education	Low/Medium/Medium

Chapter 1 - Background and Economic environment (setting the scene)

1. **With a newly elected government, Madagascar is emerging from years of political trouble.** The new government has set national reconciliation and the launching of the economy as key priorities. It aims to achieve these objectives through political inclusiveness, respect for human rights, good governance, and strategic decentralization. A set of structural reforms to improve the budget management, state owned enterprises, and the reform of business environment are integral parts of the approach outlined in the National Development Plan (PND). The size of domestic demand is limited, therefore foreign markets represent a key growth opportunity for domestic producers, but companies seem to struggle in reaching such markets. Trade costs remain high and the trading environment unpredictable. However, foreign markets are critical as the domestic market remains fragmented (only 30 percent of the population lives in the capital) and small. With 22 million people with an average income of US\$ 447 in 2012, back at its 2001 level, Madagascar's total economic size remains small and access to export market will be essential to allow companies to benefit from economies of scale and sustained growth.

2. **The Government of Madagascar has asked the World Bank to update of the Diagnostic Trade Integration Study (DTIS) that had been prepared between 2001 and 2003 with a view to identifying key barriers to integrating into global markets.** This Update of the Diagnostic Trade Integration Study (DTIS – referred to also as “this study” going forward) identifies the trade related constraints that prevent Madagascar from increasing trade, diversifying and deepening its production base, and identifies key priorities for actions and reforms. Implementation of the reforms proposed in the first DTIS has been limited and this update aims to learn from that experience in order to formulate a prioritized and high-impact matrix of proposed policy reforms that could help re-ignite growth if implemented.

3. **Trade openness can play a critical role in the fight against poverty but cannot deliver on its own.** Reduced trade costs can generate new opportunities for growth and employment creation, as countries can specialize in products they have a comparative advantage producing. Greater integration also allows for higher specialization, allowing companies to benefit from economies of scale. Exposure to world markets also allows companies to access intermediate inputs from abroad (goods and services) and can foster innovation, increasing firm productivity. Overall, a strong export sector can be a driver of economic growth, which in turn is a key ingredient for poverty reduction, and while the relationship is not automatic, there is no evidence of negative consequences for growth. However, trade openness does not automatically and unequivocally benefit the poor as a recent report¹ is analyzing in greater detail, and other evidence suggests that the quality of regulations, the depth of the financial and education sector, and the quality of governance are important factors to allow a country fully benefit from trade.² Addressing these issues as part of trade policy is therefore essential as will be argued throughout this report, and behind-the-border reforms need to complement what has been rationally

¹ See World Bank Group and World Trade Organization (2015) “The Role of Trade in Ending Poverty”, World Trade Organization, Geneva.

² See Le Goff, M. and Singh, R. (2014) “Does trade reduce poverty? A view from Africa”, Journal of African Trade, Vol 1(1) pp. 5–14.

described as trade policy. Additional policies such as safety nets and support for job transition might be needed, while making sure that such policies do not generate new rigidities but rather protect citizens/workers, and not specific jobs.³

4. **This study will focus on those areas where policy changes can generate quick economic change.** The experience from other DTISs has shown that ambitious, broad, and all-encompassing list of recommendations which lack focus have not led to significant policy changes in most countries. This DTIS therefore will present a more focused Action Matrix around which the government and development partners can build dialogue and support reforms. Particular focus will be on policy changes aimed at reducing trade costs that could be quickly implemented but might need strong political support. It will also look at those regulatory behind-the-border issues that are critical contributors to ensure that trade can benefit the poor as outlined above. While Infrastructure constraints are also particularly important in Madagascar, the recommendations of this study will focus on fixing policies (rather than physical investments) that are essential to maximize the impact from such investments, or which can mitigate the effects of insufficient infrastructure by ensuring its efficient usage.

5. **To respond to the government's request, this study will first take stock of the current economic and business environment before assessing progress made since the last study was completed.** This introductory chapter will broadly identify key macroeconomic constraints and give an overview of key doing business indicators. It will then evaluate the implementation of the 2003 DTIS Action Matrix and identify key factors that contributed to success and failure with implementing key recommendations.

6. **The second chapter will present current trade policies affecting global and regional trade flows, and describe how these policies impact trade flows.** The chapter will focus on MFN tariffs under the WTO as well as preferential tariffs, and provide an overview of regional integration commitments which Madagascar has undertaken, including assessing the degree of their implementation. The section presents the structure of trade flows at the aggregate level but also presents performance at the firm level, demonstrating that very few firms account for the bulk of exports. That analysis shows that regional integration processes have allowed Madagascar to expand exports to South Africa and looks at policy issues related to regional integration processes. The second chapter also presents key challenges to the efficiency of trade policy making in Madagascar as coordination among various ministries and agencies remains weak and suggests how coordination mechanisms and capacity could be increased.

7. **Chapter 3 of this study looks at greater detail at the issues of border management and non-tariff measures that affect the flow of goods across borders and their role in trade facilitation.** While customs has made significant progress, the use of parallel clearing systems on paper and the embryonic nature of the risk management system contribute to significant delays, as does the (lack of) coordination among various agencies (and their links to customs systems). This chapter also provides an overview of existing regulations that function as non-tariff measures (NTMs) and show how the measures, and especially the way they are being implemented function as barriers to trade. More effective application

³ See World Bank (2007) "Global Economic Prospects: Managing the Next Wave of Globalization"; Chapter 4: New Pressures in Labor Markets: Integrating Large Emerging Economies and the Global Sourcing of Services.

of existing regulations could lower trade costs while at the same time increasing regulatory efficiency and impact, allowing agencies to better achieve their stated policy objectives.

8. **Chapter 4 of this study then looks in greater detail at transport and logistics services and the factors generating delays and costs for importers and exporters.** The analysis focuses on processes at Toamasina port, where more than 80 percent of all traffic passes and shows that the way policies and processes are administered leads to significant delays which could be reduced through relatively simple administrative changes. It also shows that these delays are magnified by poor road conditions and a lack of security along the Toamasina-Antananarivo corridor. Both factors effectively reduce total truck usage time (to about 40,000 km per year), increase operating costs and prices paid by users of transport services. A number of reforms are proposed which could bring down internal transport costs significantly and facilitate the emergence of integrated supply chains – as well as their access to international markets.

9. **Chapter five looks at Export Processing Zones, export support institutions, and services as key intermediate inputs needed by all economic sectors (including manufacturing) to compete globally.** EPZs have been an important vehicle in the past to expand exports and reach overseas markets, particularly for apparel exports in the USA. Madagascar was granted preferential market access under AGOA again in June, 2014 and EPZs could play a renewed role in exploiting opportunities for rapid export growth. The assessment of the regulatory framework of EPZs indicates that the current framework hampers backward and forward linkages, does not allow the government to address fundamental issues such as improve access to infrastructure and services that should be part of a modern EPZ regime, while granting discretionary and generous tax incentives. The chapter suggests ways to address this issue by shifting to a regimes based on Special Economic Zones and away from a reliance on fiscal incentives. The chapter also looks at export promotion agencies and describes the role that services play in export diversification, including how they support exports in the manufacturing sector, and broadly assesses their use in Madagascar.

10. **The last three chapters assess how the identified barriers impact specific growth sectors: agriculture and livestock, fisheries, and tourism.** They identify how the cross-cutting reform priorities would affect those sectors and thereby help in prioritizing these reforms. The chapter on agriculture finds that productivity remains low and has hardly increased over the last decades, while limited access to finance, agricultural inputs, and administrative barriers affect the sectors competitiveness further. The chapter on fisheries demonstrates that the lack of available data are posing significant challenges to the long-term sustainability of the sector and better enforcement of existing rules and regulations will be needed to ensure sustainability of fish stocks and even access to this important natural resource by all. The tourism chapter looks at the critical barriers affecting the sector and singles out the need to improve (air) access to Madagascar and improving the availability of workers with the right skills.

The Economic and Business Environment

11. **Madagascar is beginning to emerge from a long political crisis, whose economic costs have been substantial.** While growth in 2014 improved modestly to 3 percent, economic growth between 2009 and 2012 averaged 0.6 percent per year, lower than population growth (estimated to be around

2.9 percent), and as a result income per capita in 2012 fell back to its 2003 level (around US\$ 400). The government projects growth to accelerate to around 3.4 percent in 2015 and to around 4.6 percent in 2016, supported by restored stability and implementation of economic reforms, but risks remain as markets appear to be still waiting for economic and political uncertainty to clear up.

12. **However, macroeconomic stability was maintained during the crisis, as fiscal and monetary policies remained prudent despite weaknesses in revenue collection.** Inflation in 2014 was 6 percent as a result of weak domestic demand and declining international prices. The 2014 current account deficit is projected to narrow due to growing mining exports and increasing aid flows aided in part by the resumption of donor budget support in 2014. Between April 2014 and April 2015, the Malagasy Ariary depreciated by 19 percent against the USD (while appreciating 2 percent against the EUR) and international reserves continuously declined throughout the year but by the end of 2014 regained their end-2013 level of 2.2 months of imports equivalent, largely due to budget support disbursements. The currency continues to be under pressure in early 2015 and the central bank continued buyback operations in the interbank foreign exchange market which influences the published average exchange rate to stem the depreciation of the official interbank market exchange rate. This has created a wedge between the official interbank market exchange rate and the exchange rate at which genuine interbank transactions take place. Total debt is estimated at 36.3 percent of GDP at end-2014, a level considered sustainable as long as trends in borrowing do not accelerate.

13. **Policies to modernize the economy since the 1980s were disrupted by at least two political crisis but have overall continued.** These policies reformed key sectors of the economy such as the banking sector, the oil sector, logistics, telecommunication, the railroad, and distribution sectors. These measures were accompanied by reforms that reduced barriers to trade in goods and services, and a liberalization of the current and capital accounts to allow free circulation of people, goods, services, and capital. A new Investment Law and Free Zone Law were adopted in 2007 and 2008 respectively. As open economy, Madagascar attracted increasingly FDI, which significantly increased after 2000. The policy reforms catalyzed the emergence of dynamic tourism, garment, fisheries and ICT sectors as FDI inflow went from 3 percent of GDP to 12 percent of GDP from 2006 to 2008, concentrated in mining, oil distribution and textile. Growth in FDI has been interrupted during the 2009 crisis. Foreign direct investment declined from 5.2 percent of GDP in 2013 to 3.6 percent in 2014, as a few large mining projects are maturing with construction close to completion. Overall, with the exception of mining, investment activity remains weak but is not declining.

14. **Nevertheless, the recent political crisis has severely affected the private sector and led to quasi-stagnation between 2009 and 2014 when a weak recovery started.** Complemented with exogenous shocks such as the global financial crisis, the deterioration of governance and the state of security has reduced the competitiveness and market opportunities for Malagasy firms. The suspension of AGOA (African Growth and Opportunities Act) in late 2009 affected market access in the US, affecting particularly textile value chains whose exports fell by nearly 50 percent between 2008 and 2010, including dependent sectors such as distribution, catering, and transport activities. FDI inflows fell from 12 percent of GDP to 8 percent of GDP in 2012, and a significant reduction in donor support affected the economy and particularly infrastructure investments, with strong secondary effects. Many Malagasy investors and professionals have voted with their feet and sought economic opportunities abroad and

large numbers of formal enterprises closed, inducing important formal jobs losses (some companies also moved into the informal sector). An estimated 335,000 formal jobs were lost between 2009 and 2011, while informal sector activity increased.⁴ However, a number of sectors were remarkably resilient during the crisis, especially the extractive industry, the agribusiness, and the banking sector. A number of apparel producers also diversified into new export destinations, particularly Europe and South Africa. Firms producing for the national market also performed relatively well.

15. **Poverty has increased and poverty rates are among the highest in the world.** Between 2001 and 2012, poverty rates have increased, fuelled by political crises. In 2012, 90.6 percent of the population lived below the international poverty threshold of US\$2.0 per day, and 78.2 percent below the extreme poverty line of US\$1.25 per day. With population growth estimated to be around 3 percent, the poverty rates are not expected to decline rapidly in the next years. At the same time, the severity of poverty has slightly declined. Consumption growth was generally higher for the poorest 3 quintiles since 2001, while the top 40 percent experienced negative consumption growth. Still, poverty in rural areas, where close to 80 percent of Madagascar's population live, is nearly twice as high as in the urban areas. Agriculture, which occupies 70 percent of the working population, barely grew, by 0.8 percent in 2014.

16. **The return to constitutional order has sent a strong signal but the political situation remains fragile and uncertain and private investors remain hesitant.** The unstable political environment has strongly influenced the pattern of economic environment in the past, and continues to do so. Weak governance and expansive elite capture are threats to inclusiveness of growth. In addition, continued and evolving hostile meteorological conditions present additional challenges to the economy. The government is promoting dialogue with the private sector to provide insurance for return to local and international business, but policy reforms will have to accompany such laudable initiatives. Some sectors such as construction, food and agro processing, textile are starting to take off, and Madagascar is since June 2014 eligible for preferences under AGOA again.

17. **The new National Development Plan (PND) 2015-2019 defines the orientations and priorities of the government aimed at national reconciliation and the launching of the economy, but trade does not play a prominent role.** The new strategic orientation of the government policy is aimed to consolidate the national reconciliation for a better and sound political inclusiveness to launch the economy, based on (i) democracy, rule of law, respect of human right and good governance, (ii) strategic decentralization policy for an effective transfer of resource at the collectivities; (iii) a set of structural reforms to improve the budget management and state owned enterprises (such as the utility company and the air transport company, that are key for private sector development and improve the tourism) , and (iv) improving labor productivity including through a reform of business environment. The PND is divided into five strategic axis centered around governance and inclusive growth and development at the local level, preserving the macroeconomic stability, inclusive growth, developing human capital, and valorizing the natural endowment and strengthening resilience to support to development. However, trade and competitiveness policy seems not to be among the key priority of the government in the PND, few references are made in the document for trade strategy and export promotion.

⁴ According to a national survey conducted by BIT/PNUD, the "industry" (126,211), "services" (111,234), "infrastructure" (46,688), "tourism" (16,739), "mining" (12,945), "crafts" (11,587) and "fisheries" (10,232) sectors were most affected.

Main constraints to private sector development and investment

18. Economic recovery will have to be driven by a strong private sector, but a number of cross-cutting challenges present hurdles to strong growth as the economy remains small and undiversified.

An analysis of the top 100 Enterprises in Madagascar reveals that the largest formal enterprises are found in the mining and energy sectors followed by the construction and fisheries sectors and then agroindustry and textile. Agriculture, tourism, and construction are the key employment-generating sectors, but their size remains limited. Especially the agribusiness sector seems to perform below its potential. This lack of diversification is also found at a spatial level, the main big enterprises are concentrated around the area of Antananarivo (the capital of Madagascar) and around Tamatave (East) and Mahajanga (West), the first and second largest port of the country, largely where qualified labor can be found and employed. The result of the World Bank enterprise survey has shown that the economic tissue is constituted mostly by small and micro enterprise of less than 5 employees. The following section outlines the main challenges the private sectors operating in Madagascar is facing, and additional information can be found in the background chapter on the economic environment.

19. A weak legal and regulatory environment affects the private sector, and governance issues are endemic. While Madagascar overall is one of the countries ranked highest in Sub-Saharan Africa for starting a business, issues remain with many other procedures. Madagascar's Ease of Doing Business ranking had dropped to 163rd out of 189 countries and places Madagascar in the bottom quintile and points that the pace of business regulation reforms has decelerated in recent years. Madagascar's weakest performance on the Doing Business index relates to difficulties in getting a construction permit (177), getting electricity (189); and getting credit (180). Madagascar has also regressed in terms of enforcing contracts (146), paying taxes (65) and registering property (153).

20. An inefficient judiciary system, and severe governance issues across government and private institutions make it challenging to do business, unless politically connected. The country's ranking in Transparency International's Corruption Perceptions Index is sobering: in 2008, Madagascar ranked 85th out of 180 countries while in 2013, the country had slipped to 127th out of 177 countries. 'Crime, theft, and disorder' and 'political instability' were rated as the third and fifth more serious impediments to the private sector respectively in the Madagascar Enterprise Survey 2009. Corporate governance issues affecting almost all state-owned enterprises, in particular the main water, electricity and air transport companies make matters worse, and many firms claim to be victims of fiscal harassment. As a result, smaller firms have particular challenges in getting access to key (state-provided) inputs, and to avoid issues with fiscal authorities, companies are said to remain small, preventing them to benefit from economies of scale.

21. Access to physical infrastructure, and particularly energy, remains a critical concern. Half of enterprises surveyed in the World Bank's Madagascar Enterprise Survey (2013) identified political instability as the main obstacle to business, but electricity was identified as the second biggest obstacle to business. The state-owned monopoly in the energy sector is blocking the manufacturing sector, in particular those outside the capital and is lowering investments in other productive sectors such as fisheries, tourism and agro-processing. Electricity access is limited, and power interruptions frequent, increasing operating costs, particularly in processing sectors and those that work with fresh products,

such as agro-processing and fisheries (see below). The 2009 enterprise survey found that firms experienced 14 power outages in a typical month, resulting in an estimated loss of 8 percent of sales. The neglect of basic maintenance of Malagasy roads has left many regions landlocked. ADEMA, the national airport company, controls too many regional airports that lack basic equipment to allow flights to operate in darkness or in poor weather conditions. The telecom infrastructure is not serving the country's many regions effectively in terms of internet and fixed telephony services, and there are some concerns that access to strategic infrastructure in the sector is not competitive.

22. A recent analysis of firm performances in Madagascar revealed that average labor productivity in Madagascar is low, although large differences exist at the sector and regional level.

While wages are low in Madagascar compared to other countries, labor productivity is even lower in comparison, resulting in relatively high labor costs per unit of output. Value-added per worker of the median manufacturing firm in the sample (of at least five employees) is about US\$1,600 in Madagascar while it is ten times higher in South Africa (about US\$19,000 per worker) and close to ten times higher in China (US\$15,000 per worker) according to a recent study.⁵ However, labor productivity is lower for the median firm in the wood and furniture, garments, and food sectors, where labor-intensive production could generate significant jobs, while it is much higher in energy intensive sectors such as mining, chemicals, or printing. Labor productivity is nearly 50 percent higher in the median exporting company compared to non-exporters, as is labor productivity in foreign-owned firms compared to national ones (but this is less pronounced than for exporters). Labor productivity in micro-enterprises, which make up around 95 percent of enterprises in Madagascar) are likely to be significantly smaller, but data are lacking. A study in 2009 found that Malagasy firms did significantly worse than firms in the average Sub-Saharan country in terms of capacity utilization, annual sales growth, employment growth and labor productivity growth. This is unlikely to have changed during the recent crisis.

23. The supply of workers with vocational skills or professionals with specialized skills is limited, especially outside the capital, and access to land is a challenge. Madagascar is ranked 129 out of 145 countries in terms of the broadly defined "knowledge quality" measure in the World Bank's Knowledge Economy index for 2012. Land access is another serious constraints in many sectors and generally more so for foreign investors and manufacturers. The land titling system has improved over time in many regions but it is still a burdensome and risky engagement for investors. Poverty and underemployment has created a market for professional squatters who occupy land where there is interest by investors.

24. Competition is hampered both by the practices of informal firms as well as by strong incumbents. In the Madagascar Enterprise Survey 2009, practices of the informal sector were rated as the second biggest constraint to the growth of firms in the formal sector. By avoiding VAT and other formal charges including import duties, firms that use such informal practices can undercut other firms that comply with the legal and regulatory framework – and such practices are strongly linked to the weak governance environment (see other chapters). It prevents effective competition from newcomers and allows companies that benefit from such practices to make large profits on the domestic markets,

⁵ See Buba, J., Clarke, G., and Engman M. (forthcoming) "Firm performance in Madagascar", World Bank. Value added per worker is calculated by subtracting the cost of the raw materials and intermediate inputs from the sales value of output and dividing that amount by the number of workers. Labor productivity at the man firm across all manufacturing sectors is, however, higher than in some of the comparator countries such as Indonesia (about US\$1,000 per worker) and Ghana (about US\$1,300 per worker).

generating an anti-export bias as they settle into cozy and well-protected domestic markets and niches, thereby reducing incentives to grow and create employment. The complex investment climate in itself may contribute to this outcome as it directly acts as barrier to entry for new formal enterprises and limits competition.

25. **Madagascar also suffers from weak competition in a number of sectors that are important inputs to other economic activities.** The energy and domestic air access markets are occupied by state-owned monopolies. The national de facto air access monopoly severely affects growth in the tourism sector and non-competitive air cargo services are impeding exportation of fresh produce and high value goods by air. While reforms have been undertaken, effective barriers to entry remain high and grant the state-owned company Air Madagascar a de facto monopoly on domestic routes, where service is unreliable and costly. Several agricultural commodities are dominated by small cartels of traders and operators that control export volumes and prices at the farm gate. Petroleum prices and costs for accessing telecommunication infrastructure are high compared to international benchmarks. A single company serves almost the entire mineral water, soda and beer market.

26. **The financial sector is small and highly risk averse and access to credit remains an important constraint to private sector development.** In the Madagascar Enterprise Survey 2013, access to finance was rated as the fifth most severe constraint to growth, and a smaller share of firms had access to Bank loans than in other Sub-Saharan African countries. The size of the banking sector remains small and the level of intermediation weak. The financial sector is dominated by 10 banks but assets are highly concentrated in few banks: the 3-bank asset concentration index for 2013 remained above 93 percent. The banking sector gross loan portfolio has been relatively flat while deposits have grown at a fast rate of 33 percent in 2008-12. Non-performing loans have been on the rise, but the capital adequacy ratio is 15-16 percent compared to the required minimum of 8 percent, reflecting a high level of government instruments and liquid assets which have zero risk ratings. As a result of this demonstrated risk-averse lending culture, banks are currently hardly lending to certain sectors of the economy, in particular SME clients, and the banking sector is therefore not facilitating investment and job creation in broad segments of the Malagasy economy. Credit to private sector remains small at 16 percent of GDP in 2016, limited long-term funding is largely unavailable, and the cost of lending is also very high with a lending-deposit spread of 49.3 percent (versus an SSA average of 11 percent) at end-2013. At the same time, foreign exchange regulation impose additional constraints to exporters, since export revenues have to repatriated and cannot be directly used to funding purchases of imported intermediary inputs.

Lessons Learned from the first DTIS

27. **The first DTIS presented an Action Matrix in 2003 that covered a wide range of issues.** While some progress has been made 10 years later, many of the activities proposed as priorities have not, or only partially, been implemented. Proposed reforms in the last DTIS focused on i) promoting and securing investments; ii) maintain and strengthen EPZ performance; iii) Facilitate financing of firms namely SMEs; iv) adopt a transparent and simplified taxation policy; v) enhance performance of customs administration; vi) opening external markets; vii) promote tourism; viii) diversify agricultural production; ix) the cotton industry; and x) promoting fisheries and livestock.

28. **An assessment of progress made shows that only 16 out of 59 activities proposed have been mostly or fully implemented.** 19 have not started (or initiated without results), and 24 have only partially been completed. The volatile political environment and the crisis following the events in 2009 have certainly contributed as priorities shifted, but the slow speed of implementation can also be observed in other countries where original DTISs have been evaluated. This section aimed to shed light at the underlying issues that have prevented some reforms to succeed, and others to stall.

29. **Following the adoption of the action matrix in 2003, the identified challenges have only insufficiently been internalized by the administration, development partners, and even less by the private sector.** A large number of stakeholders were interviewed to assess the progress made with the implementation of the 2003 Action Matrix. Many government officials, development partners, and private sector representatives were unaware of the 2003 Action Matrix, demonstrating limited dissemination of the past study and a lack of ownership by key stakeholders and decision makers that would have ensure its continuous use as guide posts for necessary policy reforms. This lack of ownership and government commitment (or ability) to use the recommendations prevented many of the proposed reforms to successfully be integrated into government programs, and the former study's overall priorities are not well reflected in past and current government strategies. No accountability mechanism was in place to hold the Ministry of Commerce accountable for the (lack of) implementation.

Table 1: Progress with implementing the 2003 Action Matrix

	not undertaken	some initiative, no impact	limited impact	notable positive impact	objective mostly achieved	total
promoting and securing investments	1	1	3	2	1	8
maintain and strengthen EPZ performance					1	1
Facilitate financing of firms namely SMEs			4	2		6
adopt a transparent and simplified taxation policy			3			3
enhance performance of customs administration		1	5	1		7
improve the internal market		3	2			5
opening external markets	1	3		2		6
promote tourism			4			4
diversify agricultural production			2	5		7
the cotton industry	4	1				5
promoting fisheries and livestock	4		1	2		7
	10	9	24	14	2	59

Source: based on interviews undertaken for the DTIS

30. **Progress has been uneven across the priority areas and a strong bias has been towards the conclusion of studies rather than the implementation of reforms.** The areas of securing and promoting investments, access to finance, and the conclusion of studies relating to the opening of external markets and the diversification of the agricultural sector are most noticeable (see Table 1) Significant work has been initiated to enhance the performance of customs, taxation policy, and promoting tourism, but progress has been limited and often stopped at the development of guidelines or strategies, instead of following up with actual changes in their implementation (or the way laws and regulations are effectively being applied). At times, progress made has also been reversed, for example with the withdrawal of the representatives from the land office and for tourism from the one-stop-shop at EDBM who have moved back to their respective Ministries. While progress has been made in terms of

reviewing the tax policy, issues with its application (including the continued need for physical submission) and the perceived harassment of operators remain a critical concern.

31. **The lessons from the evaluation provide only limited guidance for the way forward, as the specific political circumstances affected its implementation.** Relatively strong progress has been made where the former action matrix called for additional studies which have frequently been undertaken, but their dissemination generally remains very limited, putting their usefulness into question. Progress with the development of strategies and policies (such as the Tourism Master Plan or for customs valuation) has been made, but the application of new (and existing) laws remains a challenge, frequently due to resistance from specific stakeholders or political struggle for influence. While a competition law has been promulgated in 2005, its application remains pending—10 years later—due to political struggles regarding the composition of membership at the Competition Council (Conseil sur la Concurrence). A number of stakeholders stated that influence by large enterprises and traders has been an important determinant of which policies advanced and which did not. This is particularly worrisome as new and small companies have no similar voice and influence.

32. **What seems to be clear is that the new Action Matrix should be more focused, more results oriented (to allow monitoring of impact), and focus on those activities where political opposition due to conflicts of interest can be avoided or managed.** It should be complemented with a transparent mechanism for monitoring that would allow the Ministry of Commerce, the National Steering Committee, and the community of development partners through the donor coordinator to monitor progress. Activities should focus on those issues that could realistically be addressed through the leadership of the National Implementation Unit in the Ministry of Commerce and with support from the development partners in the context of the Enhanced Integrated Framework. They should focus on policy reforms rather than infrastructure investments. Last, the NIU will have to actively work to ensure the updated Action Matrix will be endorsed by the highest levels of government and ensure it becomes integrated into strategic documents. The NIU will have to play an active role in ensuring effective dissemination of the recommendations, passing formal boundaries through informal exchanges and informal coalition building, before addressing key challenges formally through legislative or administrative processes. This will demand a fundamental change in the way Ministries interact.

Priority recommendations

33. **The government will have to address a number of issues affecting the business environment, but fixing the power sector and improving good governance are of primary concern.** Taking concrete and credible measures to strengthen governance and uphold the rule of law with support from the highest political level should be of primary concern. Linked to this agenda will be the promotion of genuine competition in product and service markets, including reforms in the remaining portfolio of struggling SOEs where increased private sector participation could be sought, as necessary. Improving access to (and reliability of) energy will be critical, and allowing independent power producers to provide electricity could help access by manufacturing and energy-dependent services sectors, allowing them to invest and grow. Challenges with air access also need to be urgently addressed as the chapter on tourism argues.

34. **To ensure that the findings of this study effectively translate into policy action, strong ownership by key decision makers independent of further political changes will be needed.** The newly established National Steering Committee (NSC - see also chapter 3) could serve as a body sufficiently independent from individual changes, but will have to have high-level political support. A clear monitoring mechanism to ensure full participation and effective collaboration across Ministries will be needed to make the NSC effective. A key task of this committee would be to ensure that trade policy issues get sufficient attention in all Ministries and are looked at from a strategic, rather than reactive perspective. The Ministry of Commerce will have to skillfully manage expectations, build coalitions, and broker compromises, using the high-level support to ensure such compromises are implemented not only on paper, but also through administrative processes.

35. **To achieve this, the government will have to develop a competitiveness strategy based on the key recommendations of this report.** This strategy that will have to go beyond the newly proposed 'export strategy' as it would look at broader competitiveness issues, including the importance of access to relevant skills, imported and domestically produced intermediate inputs, and a level playing field that allows transparent and consistent treatment of enterprises and individuals, regardless of whom they are. Levelling the playing field in Madagascar will be essential for renewed, sustainable, and inclusive growth. The Ministry of Commerce, together with the NSC, will have to take the lead in raising the strategic importance of trade policy and streamline critical issues into high-level policy making.

Chapter 2 - Trade Policy, and the role of Regional Integration

Trade structure, trade policy, and regional integration

36. **Export performance has been very volatile over the last 10 years, affected by domestic political as well as international crises. Exports doubled between 2005 and 2008, declined during the global recession and political crisis and since 2011 have shown strong signs of recovery.** The rapid expansion of trade from 2000 ended with the 2008 global financial crash and the subsequent political crisis in Madagascar (2008-2010) which resulted in the suspension of AGOA preferences from January 2010 and significantly reduced exports to the USA. The successful democratic election in 2013, and the subsequent reinstatement of AGOA preferences in June 2014 have encouraged export growth. Preliminary information from the Central Bank of Madagascar indicates that in 2013 the value of exports grew by 15 percent.

37. **Exports of minerals/mining products, vegetable products and apparel and textiles account for more than two-thirds of total merchandise exports.** In 2013 apparel and clothing products accounted for 29.7 percent of total exports down from a peak of 60 percent in 2008. Minerals and metals (27.6 percent by value in 2013) are the second largest category, followed by vegetable products with approximately 18.5 percent of total exports. The relative decline in the share of apparel exports has resulted in slight decline in export concentration, however, 10 products still account for 56 percent of total merchandise exports. Shrimps, vanilla, titanium, tuna cans, some clothing articles, and chromium ores represent the bulk of exports. Table 2 shows the sector breakdown of exports from 2007-2013.

38. **Trade in services has been increasing faster than trade in goods. In the three year period 2005 to 2008, exports of services more than doubled to US\$1.2 billion, which was 42 percent of total exports. During the same period imports of services increased by 143 percent.** The rapid growth in services trade was largely driven by the tourism sector, which experienced a large reduction following the global recessions and the subsequent political turmoil, but recovered subsequently.

39. **The recovery of global demand in 2010/11 enabled Madagascar to increase mining and agricultural exports and to partially diversify its exports of apparel, primarily to the EU.** Agricultural products, including vegetables, spices and groundnuts, account for one third of total exports and new exports have largely been destined for new markets in the Asia and Pacific –principally China and India. Sugar grew more than tenfold and exports of leather products grew more than fivefold albeit from a relatively low base. Exports of titanium ores expanded more than fourfold. Total vegetable exports, dominated by cloves and vanilla beans, increased by almost 50 percent in the five years ending 2012 to meet the growing demand in India and South East Asia.⁶

Direction of Imports and Exports

40. **The geographical pattern of Madagascar's exports has diversified over the past decade reflecting the rapid growth of demand for mineral ores in Canada and Asia.** Between 2007 and 2012 the relative share of the European Union (55 percent) and the United States (26 percent) declined by

⁶ Traditional spice exports, such as Vanilla and Cloves experienced particularly rapid growth, with growth rates of 78% and 76.9% respectively.

37.5 percent from more than 80 percent to 56.3 percent (Table 3). While the EU remains the largest export destination, accounting for almost half of total exports in 2013, large increases in exports to China, Korea, and India have diversified Madagascar's export markets. A shift in exports to Canada, China and Korea has been driven by exports of mineral ores, nickel, and cobalt as demand soared in Canada and Asia for titanium, zirconium and chromium ores. Exports to India and Singapore have been driven by vegetable exports, especially cloves. Between 2007 and 2012 China increased their share of Madagascar's total exports from around 2 percent to 8.4 percent. By 2013, exports to Asia accounted for almost one fifth of total exports. Nine out of twenty of the most dynamic destinations for Malagasy exports are Asian countries. At the same time, exports to Sub-Saharan African countries increased, from US\$33 million in 2007 to US\$148 million in 2013. More than two thirds of these were destined for South Africa but exports to Kenya have also increased to US\$9 million in 2013. The increase in exports to South Africa reflects the improved market access following Madagascar's participation in the SADC Free Trade Area.

Table 2: Sector breakdown of export performance

Sector	average 2007/08 in USD '000		average 2012/2013 in USD '000		growth rate pa
	exports	share	exports	share	
01-05 Animal	161,640	11.7%	146,315	7.9%	-2.0%
06-15 Vegetable	217,641	15.7%	427,801	23.2%	14.5%
16-24 Food stuff	79,230	5.7%	140,564	7.6%	12.1%
25-26 Minerals	48,292	3.5%	169,131	9.2%	28.5%
27-27 Fuels	3,575	0.3%	55	0.0%	-56.7%
28-38 Chemicals	18,750	1.4%	46,839	2.5%	20.1%
39-40 Plastic/Rubber	4,188	0.3%	3,135	0.2%	-5.6%
41-43 Hides, Skins	6,998	0.5%	15,053	0.8%	16.6%
44-49 Wood	29,009	2.1%	21,217	1.1%	-6.1%
50-63 Textiles and Clothing	721,876	52.2%	565,769	30.6%	-4.8%
64-67Footwear	3,488	0.3%	5,031	0.3%	7.6%
68-71 Stone, Glass	29,458	2.1%	40,555	2.2%	6.6%
72-83 Metals	13,505	1.0%	216,374	11.7%	74.2%
84-85 Mach/Electronics	6,126	0.4%	6,526	0.4%	1.3%
86-89 Transport	2,681	0.2%	1,071	0.1%	-16.8%
90-99 Miscellaneous	36,178	2.6%	40,652	2.2%	2.4%
TOTAL	1,382,63		1,846,08		6.0%

source: COMTRADE, using mirror data, latest available

41. Geographic patterns of imports have also changed with the share of Asia increasing.

Official trade data from Madagascar indicates that the past decade witnessed an increase in import sourcing from the Gulf States (primarily UAE and Bahrain), but this is not reflected to the same degree in data from those countries. It is therefore likely that many of the imported inputs (other than fuel) classified as originating from the UAE were originally from Asia and simply transited through the Middle East. At the same time, imports from China, Korea, and

India increased, while those from the EU and South Africa decreased. Just below 10 percent of Madagascar's imports originate from Sub-Saharan Africa and most of this originates from SADC. Surprisingly East and South East Asia do not register increases in their market share of imports. Aggregate imports in 2013 of US\$2.6 billion are unchanged from 2008 as the economy recovered from the downturn of 2009-2011.

Table 3: Madagascar Imports by Country of Origin and Exports by Destination (percent)

Imports			Exports		
Country of Origin	2007	2013	Destination	2007	2013
European Union	35.4	27.4	European Union	55.0	47.4
France	20.0	15.1	France	32.8	24.5
Belgium	2.9	4.3	Germany	6.8	7.3
China	18.8	24.6	United States	26.4	8.9
India	3.1	9.2	China	2.2	8.4
South Africa	9.3	6.5	South Africa	0.5	5.1
Korea	1.6	4.6	Canada	1.3	4.6
Pakistan	3.9	4.3	Japan	1.8	4.6
Mauritius	7.1	2.8	Korea	0.2	3.7

Source: COMTRADE, mirror data

Characteristics of Exporters in Madagascar

42. **Firm level export data revealed that Madagascar is less concentrated than many larger countries of Sub-Saharan Africa.** Year-by-year firm-level analysis showed that export concentration decreased between 2007 and 2012. In 2007 exporters in the top 5 percentile accounted for 82 percent of Madagascar's exports, by 2012 this had decreased to 78 percent. During the same period export concentration in the top 10 and 20 percentile also decreased slightly from 91 to 88 percent and from 97 to 95 percent respectively. The ten largest exporters accounted for more than 38 percent of all exports in 2012, down from 42 percent in 2006.

43. **The total number of exporting firms, at around 1000, has remained largely constant over the past five years, but this headline figures masks significant turnover in the actual enterprises engaged in trade transactions.** The share of incumbent (firms that exported already a year prior) and new firms (firms that were exporting but had not exported the year before) relative to the total remained relatively constant as well, with 65 percent for incumbent firms and 35 percent for new firms. The export recovery in 2011 encouraged new firms to begin exporting and also witnessed an improvement in firm survival rates.⁷ From 2011, with a more politically stable economy and the implementation of government policies and incentives re-activate key sectors of the Malagasy economy, entry rates and survival rates of new firms started to show a solid recovery.

44. **Exports are driven by few, large companies that manage to export more or less consistently. Incumbent firms accounted for more than 90 percent of the total exports in 2012, totaling US\$1.5 billion with an average export per firm of US\$1.4 million.** The same year total exports of new firms accounted to US\$73 million with an average export of US\$135 thousand per firm. Generally, most exporters are small firms, and in 2012 only 47 percent of all exporters exported goods exceeding a total value of US\$50,000.

45. **Over the past 5 years the total number of new products exported annually by all Malagasy firms remained largely unchanged.** Vegetable products recorded the highest growth rate in terms of number of new products –these includes spices, beans, pistachios and peanuts, whose value has also

⁷ Survival rates are defined as the share of firms that export in a given year and continue to export in the following year. For every 10 exporters, between 3 and 4 were first time (i.e. new) exporters while for every 10 firms exporting in any given year between 3 and 4 were not able to export the following year (i.e. did not survive).

been increasing in international markets⁸. Exports of cloves, peanuts, pistachios, lentils and pepper were among the new products that grew the fastest, both in terms of the number of business relationships and value. Peanuts, for instance grew 80.4 percent in terms of the number of new firms exporting and 547.5 percent in terms of value of exports and pistachios also grew rapidly, albeit from a low base of US\$22.1 thousand to US\$636.7 thousand. Cloves remained the most important vegetable product with exports increasing from US\$9.3 million (1.8 percent share) to US\$61.6 million (15.3 percent share).

46. The detailed data also allow an analysis of the number of business transactions⁹ of Malagasy exports which were fairly constant between 2007 and 2012, while new products contributed significant value. While the total number remained constant, the composition of these transactions changed significantly. The largest decrease in the number of transactions occurred in the textile and clothing sector, while exports of vegetable products (especially vanilla and cloves) had the largest increase in the total number of business transactions between (2007-2008) and (2011-2012). Other products including metals also saw increases in the number of export business relationships. Mineral products (nickel and cobalt) and metal products (zirconium) also made a significant contribution (share) to the value of new exports. Exports of nickel accounted for 19.5 percent of the exports of new products or US\$78.9 million, followed by exports of cobalt with US\$10.2 million or 2.5 percent of the total exports of new products. Relatively new investments have contributed to this growth and new exports of metals such as zirconium are increasing in importance as new mines are scheduled to enter into production by 2017.

47. Jointly with the composition of exports, the destination of exports also changed, and a number of new, dynamic, destination markets especially in Asia have emerged. The 20 fastest growing export destinations (in terms of the number of business transactions) accounted for 40 percent of aggregate exports. The new destinations absorbed an increasing number of new products¹⁰ which also accounted for a significant share of value, increasing from US\$46.1 million to US\$171.6 million over the last 4 years. Asian countries represent 10 out of the top 20 fastest destinations for new exports measured by growth in the number of new products. The largest share of new business transactions 2011/12 was with China, accounting for 9.2 percent of all new business transactions, followed by India and South Africa. It is notable that new exports of new products to a number of Asian countries more than doubled in value over the period 2008-2012. Among the African countries, Rwanda, Senegal and Tanzania experienced the highest increase in the number of new exports from Madagascar although value remained very low. The developments demonstrate the potential that lies in diversifying into new markets in Asia and Africa even if for some markets the value of exports remains small in comparison to more traditional export relationships.

Trade Policies and the role of tariff and VAT exemptions

48. Tariff reductions in 2007 reduced trade costs and encouraged export growth. Together with other reforms (see subsequent chapters), the number of documents required to export a product

⁸ Report: What is forcing the prices to rocket in spice world: <http://www.independent.co.uk/life-style/food-and-drink/news/whats-forcing-the-prices-to-rocket-in-spice-world-2218388.html>

⁹ For this analysis, business transactions are identified as exports by a specific firm of a specific product to a specific destination market (firm-product-market relationships).

¹⁰ These destinations absorbed 1,946 new exports in (2007-2008) and 3,124 in (2011-2012).

decreased from 9 in 2005 to 5 in 2013 and over the same period the number of days required for exporting declined from 40 to 22. Currently, the Most Favored Nation (MFN) tariff comprises four bands: duty free, 5 percent, 10 percent, and 20 percent. Virtually all tariffs are applied on an ad valorem basis to the c.i.f. value of the import. The small number of specific tariffs cover primarily relate to petroleum products. The 2015 MFN tariff schedule contains 6,512 lines at the HS 8-digit level and is based on the HS-2012 nomenclature. Overlapping membership in regional organizations SADC and COMESA, as well as the Economic Partnership Agreement (EPA) with the EU adds to the complexity as importers can be classified in one of four different schedules depending on both the origin of the imports and whether the goods conform to rule of origin requirements under the preferential trade agreements.

49. **Approximately 6 percent of the MFN tariff lines are zero with a further 33 percent at 5 percent, 23 percent at 10 percent and 38 percent at the maximum tariff of 20 percent.** Imports are also subject to a Value-added tax (VAT) which in 2008 was set at 20 percent for all goods except rice, agricultural equipment, agricultural inputs and education materials.

Table 4: Madagascar - Tariffs per sector group

Sector Groups	Effectively applied tariff (%)	Simple Average MFN Tariff %	Weighted Average MFN Tariff %	Simple Average CET Rate %	Weighted average CET rate, (constant trade flow patterns)
Animal Products	9.4%	17.1%	10.4%	20.1%	13.3%
Vegetable Products	2.0%	14.1%	4.3%	16.0%	6.4%
Foodstuffs	5.9%	18.2%	11.5%	21.3%	13.3%
Minerals	4.3%	6.2%	7.9%	4.4%	4.4%
Mineral Fuels	0.0%	11.0%	5.3%	2.1%	0.0%
Chemicals	3.3%	7.7%	4.7%	3.9%	2.6%
Plastic and Rubber	6.6%	11.9%	10.3%	9.8%	8.2%
Hides and Skins	18.0%	18.1%	19.8%	21.1%	21.9%
Wood	5.4%	15.1%	14.8%	15.4%	6.4%
Textiles and Clothing	14.0%	17.6%	15.0%	16.2%	16.4%
Footwear	16.9%	17.6%	18.6%	23.0%	21.6%
Stone & Glass	10.7%	15.9%	13.4%	12.1%	8.9%
Metals	5.5%	11.4%	9.1%	10.9%	6.8%
Machinery and Elect.	5.0%	8.1%	7.6%	4.5%	3.7%
Transport Equipment	9.7%	9.8%	11.2%	11.4%	14.3%
Miscellaneous	9.5%	12.9%	11.5%	12.9%	9.5%

Source: Derived from Madagascar customs data, COMTRADE and WTO

50. **The cascading tariff structure increases the price of imported inputs which reduces the competitiveness of firms producing for export markets.** This bias against exports, where it is more profitable to sell into the protected domestic market is partially offset through the widespread use of rebates. Madagascar has a cascading tariff structure with higher tariff rates levied on consumer products and lower or zero rates on non-competing intermediate and capital

goods.¹¹ The maximum tariff rate applies to more than 75 percent of all consumer goods imports and is also levied on selected raw materials, intermediate goods and capital goods. In 2013 the simple average listed tariff for all goods was 12.2 percent. Table 4 summarizes the current tariff structure.

51. **Tariff revenue accounts for approximately one fifth of total government revenue.** Revenue from tariffs and excise duties each account for approximately one percent of GDP. VAT accounts for

¹¹ The simple average for raw materials was 11.9 percent, 9.4 percent for intermediate goods, 16.6 for consumer goods, and 7 percent for capital goods. Using weighted averages, tariffs for consumer goods were actually lower than those for all other categories, putting a burden on domestic production.

approximately half of total government revenue and although levied (as usual) equally on imports and domestic production, collection rates on domestic production have declined since 2008. The use of widespread duty exemptions, evasion and administrative and governance issues within Customs results in effectively applied tariff rates (and customs revenues) being significantly lower than the published MFN tariff schedule. The effectively collected, trade-weighted, import tariff in 2012 was 3.9 percent.

52. **Madagascar also levies several export-related fees which are effectively an export tax.** These include a ‘relevance forestière’ which is levied at 2 percent of the FOB value of the product on vanilla, cloves, pepper and litchi, and 3 percent of the FOB value for wood products. There is also a fee of 2 percent for livestock, 2 percent for essential oils, and 0.5 percent of the FOB value (plus costs for inspection teams to travel) for an export conformity certificate for selected products (see section on NTMs).

53. **Tariff rebates are widespread –on all inputs for large scale mining, and for all imported inputs for apparel exporters.** In 2012, 13 percent of all imports entered with preferences under the Large Mining Law, 7 percent under various Government and Diplomatic exemptions, and the rest under the common law regime. Table 5 shows that in 2012 no duty was collected on imports classified under the Large Mining Category, and virtually all of the customs duties collected in 2012 came from Common Law Imports. Common law imports also benefit from duty rebates due to regional tariff preferences mostly under SADC and COMESA, accounting for 30 percent of the total value of rebates. Oil imports from MENA benefitted from discretionarily granted preferences. The preferences provided through the SADC FTA total about US\$5 million, with another US\$12 million benefitting from COMESA preferences.

Table 5: Import duties for customs and value-added tariffs, by trade regime (US\$ million)

	Customs Duties				Value Added Tax			
	2011		2012		2011		2012	
	\$m.	Per Cent	\$m.	Per Cent	\$m.	Per Cent	\$m.	Per Cent
Expected duties to be paid (A)	148.5	100%	149	100%	296.3	100%	299.1	100%
Common Law	111.1	75%	110.2	74%	225.3	76%	219.9	74%
Government & Diplomatic	13.9	9%	15.4	10%	18.4	6%	22.1	7%
Large Mining	23.3	16%	22.7	15%	52.3	18%	56.4	19%
Other	0.2	0%	0.6	0%	0.3	0%	0.6	0%
Actual duties paid (B)	95.5	100%	93	100%	223.3	100%	219.4	100%
Common Law	95.5	100%	93	100%	221	99%	215.3	98%
Government & Diplomatic	0	0%	0	0%	2.2	1%	4.1	2%
Large Mining	0	0%	0	0%	0	0%	0	0%
Other	0	0%	0	0%	0	0%	0	0%
Duties NOT paid (B-A)	-53	100%	-56	100%	-73	100%	-79.7	100%
Common Law	-15.6	29%	-17.2	31%	-4.3	6%	-4.6	6%
Government & Diplomatic	-13.9	26%	-15.4	28%	-16.2	22%	-18	23%
Large Mining	-23.3	44%	-22.7	41%	-52.3	72%	-56.4	71%
Organizations/Diplomats	-3.5	7%	-5	9%	-4.4	6%	-6.6	8%

Source: Authors' calculations using data from the Exporter Dynamics Database

54. **Rebates on Value Added Duties on imports are larger than tariff rebates. Of the total foregone revenue, 73 million come from foregone VAT payments, while 53 million come from foregone customs duties, a share of which is embedded in regional integration agreements.** Table 7 shows that virtually all of the VAT levied on imports are collected under the Common Law category with less than 2 percent of imports benefiting from remission. All the other import categories receive VAT exemptions on the

total value of their imports with the large mining companies being the main beneficiary. Overall, exemptions under the Mining Law accounted for 41 percent of exemptions of duties, and 71 percent of VAT exemptions, or 58 percent of total exemptions granted at borders.

55. **Madagascar has agreed to adopt the COMESA CET, and to replace the current MFN tariffs. This would increase average tariffs by almost 30 percent.** With the proposed COMESA CET maximum rate of 25 percent Madagascar would have to increase many tariff lines, increasing costs for intermediary inputs and prices to consumers. We use the Tariff Reform Impact Simulation Tool (TRIST) developed by the World Bank to estimate the impact of tariff reforms, to estimate the impact on trade flows and revenues following a move to the CET. The model uses data on actually collected tariff revenues by product and partner country and uses the assumption that as tariffs are changes, the share of imports benefiting from preferences (exemptions) remains constant. It only estimates the impact on border revenues and trade flows, but cannot estimate secondary effects such as changes in production, or the impact that higher (lower) prices for imports have on the cost structure and competitiveness of companies that use imported inputs in production.

56. **The model estimates that as a result of the move towards the CET, imports will decrease slightly (less than 1 percent) while tariff revenue will increase by 30 percent.** The composition of imports will also change. While imports from COMESA and SADC accounted for 12.3 percent in 2012, this share would increase to 12.5 percent if Madagascar fully implemented the CET, while imports from COMESA and SADC countries continued to enter duty free.¹² This ‘trade diversion’ from more efficient producers outside the region to regional producers (whose products would suddenly be cheaper because they do not have to pay high import duties) would be overall welfare reducing. The model further estimates that, as a result of higher duties, prices for food products (the sector most affected) would increase by between 7 percent (for grain mill products) and 10 percent (for other manufactured food products), negatively affecting the purchasing power of consumers. Higher prices for intermediate inputs could also negatively affect the competitiveness of (export-oriented) companies in Madagascar.

57. **Since 2014, Madagascar has also started to implement the EPA with the EU through phasing down their tariffs over the 8 year period, 2014-2022 (see Table 6).** Tariff lines accounting for approximately 19 percent of imports (based on the years 2004-2006) will be excluded.¹³

Table 6: Scheduled EPA Phase-down of Tariffs based on COMESA CET

EPA Tariff Phase Down	2014	2016	2017	2018	2020	2022
COMESA CET Rate 10%	8	8	5	5	3	0
COMESA CET Rate 25%	20	15	15	10	5	0

58. **Estimates using TRIST also suggest that tariff revenue will also increase if Madagascar implements the COMESA CET at the same time as it phases in the EPA with the European Union.** The increase in external tariffs due to moving to the CET will result in tariff revenue increasing by 9 percent even when 80 percent of imports from the EU enter duty free. This assumes that that as tariffs are

¹² Being a partial equilibrium model, such substitution of the origin of goods can only be estimated if prior to the reform, a specific product was imported from both regional trading partners and trading partners outside the region. Currently, this not the case for many products, possibly because such products are not available in regional market (at sufficient quality). As new inefficient producers emerge within the protected regional market, trade diversion could increase.

¹³ EU Official Journal OJ-L-2012-111.

lowered against EU imports the share of imports benefiting from preferential access will remain constant. Trade diversion would be smaller in this case as the share of imports from COMESA and SADC would only increase to 12.4 percent. Simulations were also carried out assuming existing duty exemptions on imports remained constant. Under this scenario revenue implementing the EPA with the COMESA CET would still result in an increase of 8 percent in tariff revenue, while import value would change by less than 1 percent.¹⁴

Domestic processes, regulations, and policies affecting trade flows

59. **As tariffs have come down globally, emphasis has shifted to other barriers to trade, both situated at and behind-the-border.** The role of these behind-the-border and procedural barriers has increased in relative importance when assessing the flow of goods and services across borders, and to the degree that they affect trade flows they are called non-tariff measures (NTMs). Generally, a government's regulatory role focuses on achieving legitimate policy objectives such as protecting consumers and the environment, and to ensure product safety through regulations that attempt to solve market failures. As such regulations affect the marketing and distribution of goods within the national territory, they also affect the import of goods, and at times the exports of goods. NTMs include a wide range of measures, including the licensing of imports (or exports), the application of mandatory standards (such as sanitary and phyto-sanitary (SPS) measures or technical regulations), or labelling requirements. Where these measures generate barriers to imports and exports, they are called non-tariff barriers (NTBs). Chapter three provides additional information on how such measures affect imports and exports in Madagascar.

60. **The application of such NTBs can be discriminatory, but Madagascar has signed up to international agreements that aim to minimize such discriminatory impact of regulations.** As part of its WTO commitments, Madagascar agreed to apply all domestic taxes, charges and regulations in a nondiscriminatory manner (national treatment) to ensure that they affect imported and domestically produced products in the same manner, and also agreed to apply regulatory requirements that are not unnecessarily trade restrictive. As WTO member, Madagascar has also committed to ensuring that new regulatory initiatives are developed in an inclusive manner and are shared with other member states long before their introduction to allow members states to comment, and to notify all regulatory requirements to other member states. As part of these commitments, Madagascar has established enquiry points for SPS and TBT-related questions in the Ministry of Agriculture and the Ministry of Commerce. While all regulatory agencies issuing technical regulations should inform the SPS or TBT enquiry points early on to ensure Madagascar can meet her commitments with COMESA, SADC, and the WTO, the flow of information is limited.¹⁵ Overall, Madagascar has only notified eight regular (and three

¹⁴ Based on actually collected tariff rates, and incorporating the movement to the CET, these results can not easily be compared to those from a recent study by CREAM (2013), "L'impacte de l'APE sur Madagascar: Une analyse empirique des effets commerciaux et budgétaires, utilisant le logiciel WITS, Cahier de Recherche en Analyse Economique N°19, Antananarivo. That study estimated an increase of total imports of 2.6 percent and a loss of tariff revenues of 9.3 per cent. For purposes of comparison, we also ran another simulation that only assesses the implementation of the EPA without moving to the CET and estimate an increase in trade flows of only 0.3 percent but a decrease in revenue of 20 percent. Because the CREAM study did not use actually collected (but rather statutory) tariffs, the total estimated tariff loss in both cases is of similar magnitude, a reduction in tariff revenues from EU imports of estimated US\$19.5 billion is smaller than the one estimated by CREAM of US\$21.8 billion.

¹⁵ A change in the focal point in 2008(!) within the Ministry of Commerce to the "Service de la Qualité et du Conditionnement" (SQC) has not yet been communicated officially to the WTO and SADC.

emergency) SPS measures to the WTO, the last one in 2010. No TBT or SPS notifications have been sent to SADC and COMESA over the past years.

Coordination and Constraints in Domestic Trade Policy Formulation

61. **The Ministry of Commerce and Commercialization is charged with developing, coordinating, follow-up and evaluation of Madagascar's trade policy.** According to Decree 2014-296, the Ministry is specifically charged to implement the country's policies as far as export promotion, competition policy, and the overall competitiveness strategy are concerned.

62. **Due to the cross-cutting nature of trade issues, some key components that affect Madagascar's trade policy and competitiveness are managed by other Ministries.** They include infrastructure investments, transport policies, tax policies including import duties and exemption schemes, issues affecting the business environment, planned industrial policies, immigration policies, sector policies and regulatory functions of products and services undertaken by a large number of Ministries (see above). A number of Ministries directly participate in international negotiations, but communication among them is generally limited and exchanges are infrequent and re-active. For example, while the Minister of Finance declared that Madagascar had already started to move to the COMESA CET during the Thirty Second Meeting of the Council of Ministers of COMESA (in February 2014), the Ministry of Commerce said it was not aware and does not seem to be fully informed regarding the transition to the CET which will be submitted to the National Assembly together with a new Finance Law (loi de Finances).

63. **An effective and coherent mechanism to consult and coordinate trade policy issues is absent in Madagascar, leading to a lack of consistency and governance issues for trade policy.** Madagascar is rich in committees tasked to coordinate a large number of issues, including those related to trade, but information flows and shared decision making remains limited. Trade facilitation committees exist at ports but not at the national level although the government is planning to establish such a national Trade Facilitation Committee. The Ministry of Trade recently established a National Steering Committee as part of the Enhanced Integrated Framework, but it will still have to demonstrate its effectiveness. A number of other working groups and task forces are also in place, but all of these do not result in an effective mechanism to coordinate policies affecting the trading environment in Madagascar, and consultations are frequently absent before individual Ministries implement trade-related policy changes. For example, the Ministry of Livestock recently increased the export fee from 1.5 percent to 3 percent without prior consultation of the Ministry of Commerce or the private sector.

64. **Communication between Ministries and other stakeholders is weak, but departments within individual Ministries are also often compartmentalized.** Barriers to the flow of information between different departments within Ministries persist, resulting in a lack of coherent approaches within Ministries. Open conflicts over competencies between Ministries and rivalries among all agencies and departments concerned generate barriers to collaboration as Ministries try to amass responsibilities to gain influence.¹⁶ Overlaps in responsibilities and tasks and political interferences are the result. While consultation meetings with the private sector are frequently organized, they seem to target larger

¹⁶ The lack of sufficient budgetary resources at all levels contributes to this struggle for responsibilities.

enterprises raising the questions whether smaller companies, or the informal sector, can adequately participate in these consultations. Concerns are raised at times that government participation in such meetings is frequently at administratively too low levels for binding decisions to be taken during these meetings.

65. **The absence of a common harmonizing agenda such as an overarching competitiveness strategy contributes to the lack of coordination within government, leading to many isolated and non-coordinated measures that affect the trading environment.**¹⁷ A large number of Ministries and Agencies are linked to the trade policy environment because of its cross-cutting nature, but many do not engage with the Ministry of Commerce because no overarching framework exists that clearly links their activities to a high-level government objective related to competitiveness and trade. As a result, government agencies respond to urgent requests or individual interests in an ad-hoc and activist manner, rather than acting systematically and strategically. Such an overarching framework would also allow a more structured engagement with the private sector who currently seems to be interacting with policy makers on very specific, short-term issues as they arise.

66. **Overall, the Ministry of Commerce does not achieve to fill its coordinating leadership role as far as trade policy issues are concerned.** A key constraint is the fact that many ministries frequently do not recognize the coordinating role the MCC has to play, partially reflecting the struggle for responsibilities outlined above. This is particularly relevant in the context of international negotiations, negatively affecting the strength and consistency of Madagascar's negotiation positions.¹⁸ In addition, the Ministry does not manage to maintain a continuous flow of information to and from other Ministries and with other stakeholders, reducing the amount of information available to the MCC. At the same time, it reduces the amount of (early) feedback on own initiatives from other stakeholders, potentially complicating their implementation later. Whatever the exact reasons in each individual instance, policy coordination is very limited and needs to be improved if Madagascar is to use trade as an engine for growth.

67. **Rather, the Ministry largely reacts to external requests on an ad-hoc basis and coordinates responses accordingly.** No effective coordination and consultation mechanism with other Ministries and the private sector exists that would be needed to ensure inter-temporal and inter-sectoral consistency of policies, their successful implementation, monitoring, and necessary adjustments where policy reforms do not achieve their stated objectives. A central coordination with a transparent, well managed, and consistent information exchange with all other stakeholders is needed to effectively build consensus around critical issues with all Ministries strategically and inclusively involved.

68. **The recently established National Steering Committee could play the role of effective integrator of all stakeholders, but strong leadership and willingness to collaborate by all parties will be needed for success.** This would mean that Ministries will have to agree to listen to the concerns and different viewpoints presented by other Ministries, as conflicting policy objectives will certainly arise

¹⁷ Issues relating to trade are only marginally reflected in the National Development Plan and do not figure as a central element to drive the economy.

¹⁸ The Ministries involved in negotiations are primarily the Ministry of Commerce (MCC), the Ministry of Foreign Affairs (MAE), the Ministry of Economy, Finance, and Budget (MEFB) and the Ministry of Agriculture and Rural Development (MADR), but other Ministries are involved as well.

that need to be conjointly evaluated and a decisions taken. This also means breaking down formal barriers to communication among Ministries as effective coordination will, to a large degree, have to take place through informal exchanges first before becoming formalized. It further means to break down internal ‘silos’ in each Ministry to ensure an efficient flow of information among departments as well as departments and representatives of Ministries at coordination meetings. It lastly means breaking down barriers to communication with other stakeholders to bring them to the table early-on in decision making processes. Only then can they participate in the discussion and analysis of proposed policy reforms in terms of their impact, costs, expected benefits, and effectiveness, before reforms affecting the trade policy environment (or any other policy arena) are taken. This is a complex process that frequently does not even work in very advanced economies – but achieving it is essential to increase transparency and predictability of the business and trade environment in Madagascar.

Capacity building, better administrative process, and increased funding are needed

69. **The MCC is well structured to achieve its objectives, but significant challenges in terms of continuity of its mission and staff, qualification, monitoring of results, and access to funding exist.** The ministry has been re-structured and re-named five times in the last twelve years, and eleven Ministers have been at its helm. This has negatively affected continuity of policy and coordination across the various strands managed at one point or another by the Ministry. In addition, frequent changes at the Ministerial level and senior management levels in the past have led to a repeated re-evaluation and changes of priorities and approaches, negatively affecting the continuity of policy implementation and generated uncertainty regarding future policy orientations. Because a predictable trade environment is essential to allow the private sector to grow and export, this likely has negatively affected the outcome of past policies. The lack of continuity also does not permit the Ministry to focus on long-term strategic objectives to improve the trading environment and helping companies become more competitive, but could contribute to focusing on more short term or protectionist measures. Observers also claim that the frequent changes have also negatively affected institutional memory.

70. **Technical qualification of staff is generally sufficient, but softer skills are missing at times, and specific technical capacity is lacking.** Departments are led by senior experts but knowledge transfer within departments could be increased, and younger staff be entrusted with higher responsibilities earlier on. Staff are generally concentrated in Antananarivo, with few staff in regional offices.¹⁹ While a large number of staff received training over the past years and have led to some being hired by regional or international organization, there are some concerns how well available training opportunities are targeted to the most appropriate staff within the MCC. Following completion of individual trainings, newly acquired knowledge could also more effectively and broadly be shared with other staff within the Ministry. Overall, softer skills regarding effective administration, team management, team work, policy development, managing consultative processes, and how to build consensus need further strengthening for the Ministry to evolve into a modern and effective public administration. Access to funding is limited and generally arrives late, severely affecting operations and planning at the Ministry, and reducing the clout that the Ministry has to compel other Ministries into action.

¹⁹ Here, means of transport, work space, and communication equipment are frequently lacking to adequately support enterprises and complete administrative tasks in a timely manner.

71. **The current focus on control policies and ad-hoc responses to challenges contrasts with the need to focus on longer term objectives and measure outcomes, not outputs.** Skills are skewed towards control policies related to prices, licenses, and regulations rather than analysis of economic data, policy development, or identifying priorities. There is also no clear mechanism in place that measures performance of staff or the impact of government policies/activities. It will be important improve the strategic planning of the Ministry to ensure its actions can contribute to facilitating the integration of Malagasy companies into international supply chains, administrative burdens can be reduced, strategic policy issues be addressed comprehensively inside the government with strong participation of the private sector, and the impact of any activities are measured, allowing to improve policy making and the internal efficiency of the Ministry.

Priority recommendations

72. **To simplify the trade environment, the government should simplify and publicize the eligibility criteria for various exemptions, and ensure these are transparently applied and accessible by all companies that qualify.** Ensuring exporters get access to imported inputs at world prices through effectively managing the temporary import scheme is important for promoting export competitiveness. Reducing discretionary exemptions for imports and simplifying the process to allow even access by all economic operators to existing preferences based on clearly defined criteria would also reduce domestic distortions to the economy that currently persist and largely benefit larger and well-established companies. Where such criteria are clearly defined, they should be publicized more transparently to ensure that all companies eligible for such preferences can effectively benefit from them. This includes improved customs control and more effective sanction mechanisms for non-compliant companies and colluding border agents (see subsequent chapters as well).

73. **At the same time, the government should clarify how it will transition to implement the COMESA CET to minimize the number of existing tariff rates.** The research team could not obtain information regarding the transition process towards the CET but transition processes in the past when duties for COMESA or SADC imports were removed had significantly complicated the tariff scheme. Products declared as 'sensitive' by Madagascar seem to cover largely petroleum products where duties could be transformed into excise duties, especially with limited domestic production. This would allow for a fuller alignment with the CET while keeping revenues constant. With tariff rates increasing as Madagascar moves to the CET, the government should communicate the coming changes early to allow consumer and companies to adjust to these changes which could raise consumer prices, or increase operating costs for companies as inputs become more expensive. The government should engage potentially affected companies and consumers to discuss the proposed changes. This would allow a more detailed assessment of potential impacts for key commodities, or affecting specific companies, and allow for the formulation of transition or mitigation measures. These discussions should be undertaken already, even while the approval of the transition to the CET by the National Assembly is still pending. Being a small economy, increasing tariffs across the Board will not be in Madagascar's interest and if still possible, the government could consider discussing with other COMESA members potential revisions to the CET, for example to ensure zero tariffs for capital goods, raw materials, and basic commodities as also recommended by the IMF.

74. **Further deepening the engagements with regional neighbors will offer significant opportunities to Madagascar, which companies already exploit.** The government should continue to reduce barriers to trade including non-tariff measures such as explicit and implicit export taxes that negatively affect the competitiveness of domestic exporters, and notifying all regulatory requirements to the WTO, SADC, and COMESA. It should also continue to implement commitments made to COMESA and SADC including opening up services sectors through an active participation in the services negotiations and making substantial offers. Opening up key service sectors such as transport, air traffic, electricity and telecoms is likely to increase investment and competition, strengthening Madagascar's comparative advantage in tourism, agriculture and labor intensive manufacturing as outlined elsewhere in this report.

75. **To improve the consistency, predictability, and effectiveness of trade policy in Madagascar, an overall competitiveness strategy needs to be developed, and coordination mechanisms need to be strengthened.** This issue has been raised in Chapter 1, stressing that such a strategy will have to go beyond the newly proposed 'export strategy' and industrial policy as it would look at broader competitiveness issues, including the importance of access to relevant skills, imported and domestically produced intermediate inputs, and a level playing field that allows transparent and consistent treatment of enterprises and individuals, regardless of whom they are. Without access to high-quality intermediate inputs at low costs, Malagasy companies will find it challenging to compete in a global environment and to participate in global value chains where product characteristics are set by large buyers and to which producers need to adhere. Levelling the playing field in Madagascar will be essential for renewed, sustainable, and inclusive growth.

76. **The Ministry of Commerce, together with the NSC, will have to take the lead in raising the strategic importance of trade policy and streamline critical issues into high-level policy making.** Ways and means to breaking down barriers between Ministries and Agencies, but also among departments within individual Ministries will be needed,²⁰ requiring nothing less than a fundamental behavioral change in how government business is conducted. It should be complemented by a more frequent, informal, and inclusive dialogue with the private sector to ensure its concerns are rapidly reflected in government priorities, and solutions are being found and implemented. A mechanism to hold all members of the NSC accountable to participate, share information, and implement joint decisions taken would be an important step forward. The flow of information between various regulatory agencies and the private sector needs to be improved to ensure new regulations are discussed prior to their introduction. Information from other WTO members also needs to be more effectively transmitted to stakeholders by the SPS and TBT focal points, and Malagasy regulatory initiatives need to be communicated to the WTO, SADC, and COMESA in line with commitments.

²⁰ This will include improved targeting of available trainings, even if that means passing a training opportunity to staff in another department, facilitating the internal sharing of knowledge across departments, and more consistent participation in negotiations—and effective sharing of outcomes across Ministries and departments.

Chapter 3 - Border Management and Regulatory Policies

Customs and Border Management

77. **The customs authorities have implemented a number of important reforms over the past decade, but significant room for further improvement remains.** Customs has migrated to ASYCUDA++ with a view to accelerating and facilitating the processing of customs declarations. At the same time, the Malagasy government together with SGS, established the Malagasy Community Network Services (Gasynet) to establish and manage an electronic data exchange platform that will connect all stakeholders (TradeNet) and will eventually permit the dematerialization of the customs clearance process. A number of procedures that importers had to complete have also been eliminated, bringing their number from 30 to 18. According to the Doing Business indicators, the time to import (export) has fallen from 48 (49) days in 2005 to 21 (22) days in 2014. However, significant room for further improvement in the customs administration remains. A key issue is that despite the progress made, the customs clearance process only starts once all documentation is submitted in hard-copy format, even if all documentation has been submitted electronically before. While the dematerialization act was adopted in 2014, its implementation is still pending. Customs has taken initial steps to implement it but work remains to be done.

78. **The current practice of focusing on combatting fraud and illicit trade results in delays and additional costs (with limited impact).** Significant emphasis is put on the physical control of goods. While the effectiveness of this approach is far from proven it is clear that it generates incentives also for formal enterprises to look for alternative methods of avoiding what they perceive as overly complex procedures and long delays. Information obtained in interviews indicates that it is possible, especially for well-connected enterprises, to bypass customs control nearly entirely. Enforcing existing procedures consistently in tandem with less but better targeted controls could therefore at the same time facilitate the movement of goods across borders and increase customs revenue by closing loopholes.

79. **While the current approach generates significant delays, it does not contribute to high revenue collection which remains low.** Despite the focus on revenues, the share of customs revenues collected remains among the lowest in SSA. At the same time, cumbersome controls put significant burden on traders, while additional controls hardly result in recording of fraud – the share of income derived from fines is less than 1 percent of collected customs revenues.

80. **Gasynet plays a critical role in customs control as the company validates customs value.** Gasynet validates cargo tracking notes (BSC - bordereaux de suivi des cargaisons), for each shipment. Before goods arrive in Madagascar, the importer has to submit all documentation in scanned format and Gasynet validates the BSC, including the value of goods based on reference values. Based on pre-defined selectivity criteria essentially focusing on the value of goods, a customs channel is selected, determining the degree of subsequent controls.²¹ Gasynet is remunerated in function of the value of goods that are imported and exported, rather than for the real value of the service rendered, and has a direct interest

²¹ However, the result of the assessment does not automatically enter the electronic customs clearance system (SYDONIA) but are communicated by mail, leaving it open to the agents to follow or not follow these instructions.

in revising upward the value of declarations. Fees are paid on an ad-valorem basis by importers and exporters, and directly increase the costs of trade.²² In addition, Gasynet charges for a number of additional services, including the control of value of imported second-hand vehicles and technical support to IT systems at customs.

81. **Risk analysis remains embryonic.** While there is a Risk Analysis unit within customs, risk analysis continues to focus entirely on individual transactions instead of assessing risk according to other criteria such as the origin of goods of shipments, sectors, specific products, or operators. As a result, the assessment does not allow to identify trends and coupled with the absence of comprehensively evaluating past assessments does not allow to reduce the overall rate of controls for compliant operators, and improve targeting of shipments.

82. **Selectivity criteria are very restrictive and generate long delays, serving as incentives for traders to avoid formal channels or find alternative solutions altogether.** Customs aims to physically control all flows of goods with the result that they hardly control anything effectively. In 2014, around 32 percent of all containers were classified in the red channel and sent to the scanner. Another 2 percent of all containers that were originally classified for document check were subject to physical check. Of all containers scanned, 83 percent were marked for physical inspection, but only 6 percent of the containers inspected were subject to fraud records. These figures show that risk selection criteria and controls are badly targeted, or that informally negotiated agreements at the point of physical inspection result in such low confirmed cases of fraud. While customs claims that high inspection rates are meant to be dissuasive, modern customs administrations aim to scan and inspect a very low number of containers, but to confirm a high share of non-compliance among those. The dissuasive effect is reached as well targeted controls identify the majority of fraudulent cases, while facilitating the movement of compliant traders' goods. An inspection rate of 32 percent overall (and few confirmed cases of erroneous declarations) is not well compatible with the objective of trade facilitation. Delays resulting from such inspections are significant and affect the larger economy because trucks are delayed and stand idle while goods wait to be inspected (see next section for more). In March 2015, Customs were instructed to increase the share of containers at import that are being scanned to 100 percent, reportedly leading to a significant increase in overall clearance times and delays. Controls are also very cumbersome for exports as 100 percent of containers are scanned. Overall, the targeting of inspections could be significantly improved.

83. **Results of the risk assessment do not feed back into the system to allow improvement in targeting.** Reports of customs controls do not contain sufficient information on motives for additional controls, neither are they electronically archived and readily available for analysis to allow a review of the system's efficiency. As a result, assessing the results of specific selection profiles or to assess the efficiency of individual customs agent is currently not possible. Revising criteria based on past outcomes of selective controls would allow improving the risk targeting profiles and prevent fraudulent operators from developing evasion strategies to avoid controls. The weakness of the current system and lack of continued improvement therefore contribute to increasing the number of scanned containers and

²² Gasynet is said to focus in its efforts at revising values of all large transactions, but could focus particularly on those attracting higher duties or VAT payments where revisions would translate into increased revenue collection by customs.

physical controls without good justification. This generates additional delays and costs to economic operators – without significantly increasing revenue.

84. **The system of ex-post evaluations needed to complement increased use of risk management criteria is only used exceptionally.** While customs at times reviews declarations post-clearance, these assessments are undertaken internally and cannot rely on additional risk criteria for selection. In addition, post-clearance controls of importing enterprises that would permit significant sanctions for fraudulent traders, are not undertaken. A unit has been set up for this purpose but only comprises few customs agents, and internal and external communication channels to target interventions remains missing. Such controls are necessary to compensate for lower controls at the border to ensure that fraudulent declarations can be detected. To ensure ex-post evaluations fulfil their control function, these could be undertaken at a higher level (regional or national) and should be fully independent.

85. **The limited use of data and analysis of past outcomes negatively affects efforts to facilitate trade flows, but also hampers the fight against corruption and fraud.** Successful trade facilitation ensures that legal trade flows can enter and exit the country seamlessly and safely, while restricting controls to transactions of risky operators. At the same time, this approach permits an optimal collection of revenues and an efficient protection of consumers and citizens. The limited use of data and analysis in Madagascar is problematic in this regard.

86. **While there is a strong focus on preventing the trade of prohibited goods,²³ activity is concentrated at borders while surveillance at the interior of the countries remains little developed.** Such products originate in various parts of the island and their trade is often broadly known, but existing services such as the Brigades de Surveillance Mobile, do not seem to sufficiently focus on these areas, or not to act on findings.

87. **Fraud remains a key problem and informal practices seem endemic.** While data to quantify the degree of undervaluation is missing, there is general acknowledgement that undervaluation is the norm, rather than the exception. The low overall share of customs revenues as a share of GDP also lends support to this finding. There have been frequent reports of intermediaries offering services to get containers cleared for a fixed amount, indicating that informal practices permit to have containers cleared without effective customs control. The new DG has moved about a quarter of personnel between positions to address the issue of informal practices, and a reward system for inspectors to discover fraud is being put in place. However, in the absence of also reviewing sanction mechanisms for those committing fraud (and impartial enforcement), entrenched corruption will not be addressed. The experience with performance contracts that have been introduced for customs agents at the port of Douala in Cameroon and which has led to less but better targeted customs controls, faster clearance times, and increased revenue collection could provide interesting lessons for reform if adapted well to the Malagasy context.

88. **Reports of collusion between politicians, business people, and certain customs agents also abound with negative effects on competition in domestic markets.** This collusion is said to permit the clearance of shipments by larger, well-connected businesses with hardly any customs controls, and

²³ Such as protected species, Bois de Rose, or smuggling.

racketeering of smaller firms that are not well connected leading to higher costs and longer delays.²⁴ Such differential treatment generates competitive advantages for well-connected businesses and likely contributes to reducing competition in domestic markets, leading to high profits for 'insiders' and higher prices for key commodities on the domestic market. It also leads to significant leakages and revenue losses for the government.

89. Larger companies and those located in Export Processing zones also complain significantly less about customs procedures than smaller companies. Such larger and well-established companies are said to benefit from preferential treatment, and hardly complained about delays and procedural obstacles during interviews. However, many were taking mitigation measures to reduce the discretionary powers of customs, likely resulting in less complaints. Interviews with large exporters indicate that these companies seal their shipments at their premises to avoid repeat inspections at ports which smaller companies complained about frequently. A large apparel exporter generally brings an additional lawyer when shipments are inspected prior to departure to have another witness that all inspections were satisfactorily completed before the container is sealed. As a result, containers from this enterprise are no longer re-opened in Toamasina and re-inspected (which should not have happened in the first place). Small companies do not have the means to do the same (or only at higher costs), effectively generating a competitive disadvantage to them and explaining why smaller companies are disproportionately affected by informal practices at customs.

90. While the customs code has been modernized in 2006, a number of practices that do not conform to WTO provisions remain in place. Instead of using transaction values, customs authorities at times determine the value of goods using minimum values, for example for some used vehicles and selected agricultural commodities (although this practice is supposedly being phased out since March 2015). The customs code also foresees the use of exit rights.²⁵ Although customs confirmed that such export rights are currently not imposed, a number of export taxes are levied by individual Ministries as outlined elsewhere in this study. Last, the Gasynet fees also do not seem to be WTO-compliant as fees for the service are not related to the cost of the service, but rather to the value of the goods controlled.

91. Customs and Freight Forwarding Agents (CFAs) contribute to high costs, often perceived as rents, as they are de-facto gate keepers. While the use of CFAs is voluntary in Madagascar, the complexity of the trade regime and interactions with various agencies de facto makes their use mandatory, and few companies have the capacity to clear their own shipments in the current environment. CFAs have developed packages that can range from including transport services, to financial intermediation, to completing a wide range of administrative requirements. At the same time, access criteria for CFAs remain opaque and it does not seem that their professional qualifications are verified upon certification, nor that CFAs need to prove that they keep up to date with changing procedures. The control of the profession by customs remains limited and allows CFAs to extract economic rents that are not related to the services they actually provide.

²⁴ At the same time, data from the NTM database (wits.worldbank.org) indicate customs processes relating to **obtaining** trade preferences as an important NTB, especially for smaller companies, an issue confirmed by Imani Development (2007).

²⁵ Article 260 of the 2014 customs code foresees the use of exit rights "droit de sortie" (certains produits originaires du territoire douanier déclarés pour l'exportation sont soumis quelle que soit leur destination, à un droit fiscal dit "droit de sortie").

92. **In addition to changing the overall approach, short-term benefits could be achieved by improving current processes within the customs administration, particularly regarding the use of the scanner.** Generally, challenges to trade do not originate from the type of controls undertaken by customs, but by the manner in which these are actually undertaken. Currently, the scanner at Toamasina presents a veritable bottleneck at the port. In 2013, nearly 38,000 of the 84,000 containers passing the port (imports and exports) were scanned. Operators frequently complain about long wait times at the scanner, effectively operating only a few hours per day. Aligning the hours of operating the scanner and undertaking related customs inspections with operations at the port could already reduce delays significantly (see below). At the same time, building capacity in customs remains critical to allow them effectively play its role. While Gasynt's services have undeniably contributed to the customs modernization, the current arrangement has led to a partial loss of direct control by customs and it seems that the two partners have not been able to assure a common understanding on how to transfer competence from Gasynt to Customs.

93. **An integrated border management strategy is missing, and other agencies risk selection criteria are not integrated into customs efforts.** Coordination between customs and other agencies is largely absent, and transparency regarding procedure for all agencies is limited. While there is general consensus that efforts have been made to strengthen private sector consultation and cooperation mechanisms (for example, through the Observatoire du délai de dédouanement (ODD) process)²⁶, far greater levels of communication and stronger participation by all stakeholders will be required to address identified challenges to facilitate trade. As a result, multiple inspections are frequent, generating additional delays. The lack of coordination, especially regarding areas of risk management, also negatively affects how other border agencies can achieve their public policy objectives (see also below on NTMs). Improving communication structures within all border agencies, but also between these border agencies and the outside world (for example with banks, where confirmation of payments is frequently identified as a bottleneck in the customs clearance process) will be essential to improve transparency and reduce opportunities for rent seeking. There is currently no service available or able to advise companies regarding legal issues or to provide personalized support services for trade transactions.

Non-tariff measures, technical regulations, and quality infrastructure

94. **The impact of domestic regulatory policies on trade flows continues to increase, especially as the importance of tariffs decreases, frequently resulting in Non-Tariff Barriers (NTBs).** These behind-the-border and procedural barriers have an important impact on the flow of goods and services across borders as the section on customs already demonstrated. The analysis in this section therefore aims to present how these barriers generate unnecessary costs that affect trade flows and reduce the competitiveness of domestic enterprises, but also how regulatory effectiveness can be improved to ensure consumer welfare. Similar to the issues raised in the section on border management, the

²⁶ While the ODD includes delays for processes during the clearance process, it does not cover delays originating from processes prior to submitting declarations, an issue further described in the section on non-tariff measures in this report.

objectives of improved control and trade facilitation are by no means contradictory but should be seen as complementary.

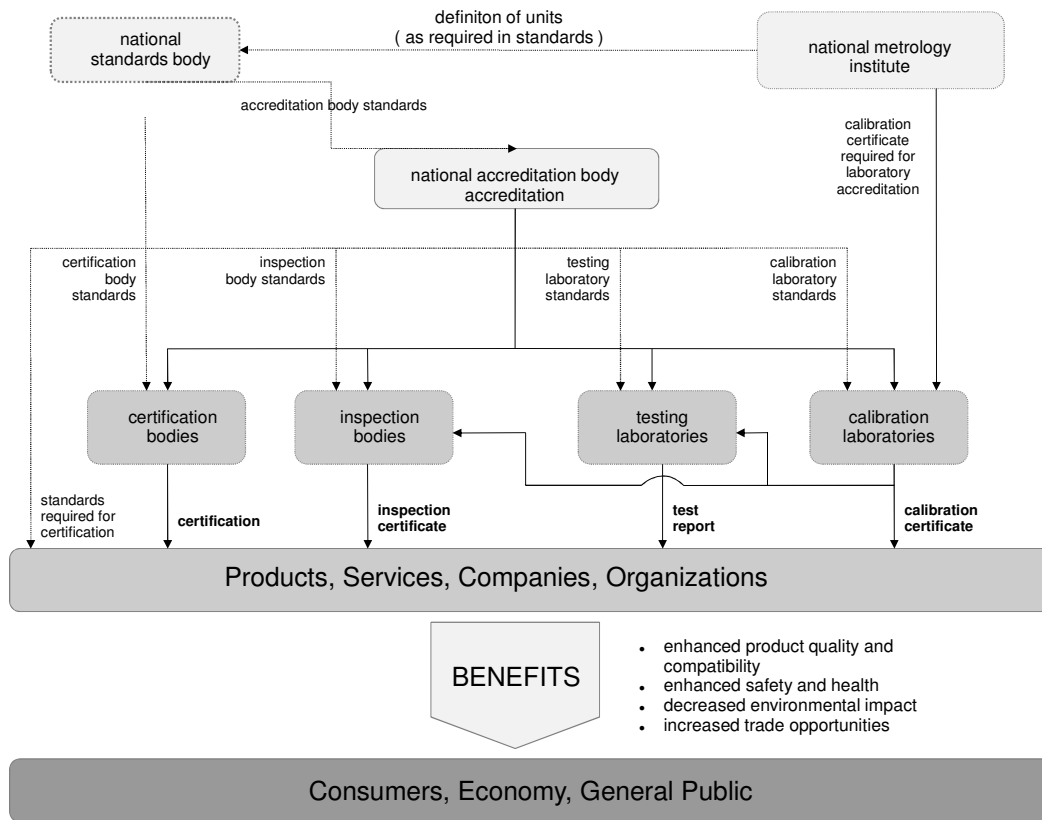
95. **A well-functioning system would need to be in place for standards and technical regulations to be developed and applied in a transparent, consistent, and reliable manner, but the current elements of the system that are in place in Madagascar could be improved.** The elements of such a system are jointly called the **‘National Standards Infrastructure’** and would have to cover the ensemble of standardization, testing, certification, metrology and accreditation. All functions need to work seamlessly together to ensure that products or services meet public policy objectives such as public health and safety, but in Madagascar, the current system and applied practices result in multiple NTBs. The relationship between the different components of the National Quality Infrastructure is shown in **Error! Reference source not found.** and further explained in the background chapter.

- a. **Standards are voluntary, while technical regulations are mandatory.** Standards are formal documents outlining the requirements that a product, process or services are expected to meet for a product to conform to that standard. Standards can be set by companies or standards bodies, are voluntary in nature and permit coordination among companies and users by defining criteria that allow interactions among different actors.²⁷ **Technical Regulations** are often referred to as mandatory standards and are based on regulations issued by regulatory bodies that must be complied with.
- b. **Conformity Assessment includes testing, inspection and certification services.** Testing refers to either public or private services which determine certain product characteristics against the requirements of a standard (voluntary or mandatory). Inspection services are provided by private or public institutions to ensure that entire consignment is equivalent to the product sample tested. Certification is the formal confirmation by a public or private certification body that a product, service, organization or individual meets the requirements outlined in the standard it is certified against. **Accreditation** provides independent²⁸ conformance as to the competence of conformity assessment services (testing, inspection, and certification). And **metrology** (the technology of measurement) is needed to ensure measurements are accurate.

²⁷ The paper size DIN A4 is an example of a voluntary standard that is widely used, although not everywhere as the continued use of the ‘letter’-size for paper in the US demonstrates.

²⁸ Accreditation services are offered by National Accreditation Bodies (NABs), regional accreditation bodies and the international network of accreditation bodies under the umbrella of the International Laboratory Accreditation Cooperation (ILAC) and the International Accreditation Forum (IAF).

Figure 1: Elements of a National Quality Infrastructure



Source: Based on Guasch et al. (2007) and Racine (2011)²⁹

96. **Mandatory standards and other regulations for imports and exports are issued by a large number of regulatory agencies (at least 14), usually at short notice and without sufficient consultations with stakeholders including other Ministries.** Technical regulations are usually not well publicized and no comprehensive list of regulations in place by product exists. There are also no clear criteria in place regarding how Ministries decide which products to regulate and how to regulate them in a way that allows meeting clearly identified policy objectives at minimal costs. Regulatory agencies (ministries) often rather transform existing voluntary standards (which are frequently outdated) into technical regulations in their entirety. This contravenes international best practice and international agreements regarding the setting of mandatory standards (technical regulations).³⁰

97. **The various regulatory agencies issuing technical regulations are also enforcing them, basing their assessment on unreliable test results and potentially generating conflicts of interest.** They generally approve certain laboratories to produce test results for the conformity assessment with mandatory standards, but these laboratories are not accredited and test results are therefore not reliable, creating risks for public health and security. Because most of these laboratories form part of the

²⁹ See Guasch, J.L., J.L. Racine, I. Sánchez, and M. Diop (2007) "Quality Systems and Standards for a Competitive Edge", The World Bank; and Racine, Jean-Louis (2011) "Harnessing Quality for Global Competitiveness in Eastern Europe and Central Asia", The World Bank.

³⁰ For example, the Ministry of Commerce issued a decree in 2005, transforming the Malagasy voluntary standard for soap and detergent in its entirety into a technical regulation, leaving it ill-defined for regulatory purposes. Its introduction is seen by some as the outcome of private sector lobbying to use the technical regulation for protective purposes, stressing the need for transparent discussions prior to introduction to avoid such claims or the actual use of technical regulations for protectionist purposes.

regulatory agency, potential conflicts of interest exist as regulatory agencies set rules which they enforce and receive payments for. The background chapter on NTMs provides additional information.

98. **Madagascar has been a member of the International Organization for Standardization (ISO) since 1966.**³¹ As national body in charge of implementing the national policy on standardization, certification, and quality assurance³², the Bureau de Normes de Madagascar (National Standards Bureau - BNM) develops and promotes voluntary standards which can be transformed into mandatory standards (technical regulations) by regulatory agencies. So far, about 60 voluntary Malagasy standards have been developed by technical committees, covering mainly food items. No national accreditation body currently exists in Madagascar.

The current environment negatively affects trade and regulatory objectives

99. **While all regulatory activity serves legitimate policy objectives, current procedures seem to generate high costs and delays to importers without permitting regulatory agencies to achieve these objectives.** Effective and clear regulations are essential to allow government to achieve legitimate policy objectives. Good regulatory practices contribute to improved consumer welfare by ensuring food and product safety. However, in the case of Madagascar, many requirements are applied in such a manner as to generate costs without achieving overarching policy objectives. Agencies issue import authorizations based on questionable test results obtained from laboratories that are not accredited, while test results from internationally accredited laboratories are usually not accepted. This contravenes international best practice, generates costs, and does not permit the regulatory agencies to achieve their policy objectives as they cannot effectively distinguish conform from non-conform products. Test results from laboratories are also at times not communicated to regulatory agencies, forcing them to operate in a vacuum without adequate information.

100. **The granting of relevant approvals can take many days, increasing costs and delays to importers.** This is despite the fact that 11 agencies are already connected to MIDAC,³³ an electronic system to grant electronic import authorizations. However, the research team repeatedly heard complaints that while licenses are issued electronically, visits to relevant Ministries are still needed where payments to facilitate the issuance of documents are informally demanded. This undermines the potential efficiency gains that the system could provide. For example, all food imports need to obtain an authorization to commercialize (mise a la vente et mise à la consommation) from the Ministry of Commerce. That authorization is issued based on a certificat de consommabilité (from the Ministry of Public Health) and a Certificat de Non-Contamination Radioactive (CNCR) (issued by the Institut National des Sciences et Techniques Nucléaire - INSTN). Data from MIDAC indicate that it took on average nearly 5 working days, i.e. frequently nearly one calendar week, to obtain a certificat de consommabilité from the Ministry of Health between May 2014 and April 2015. However, these five days only account for the

³¹ Madagascar was temporarily suspended during 2014 because the country did not pay contributions.

³² However, such a policy currently does not exist. While the Ministry of Commerce is developing this policy, its absence has led to some overlap in roles and activities among existing elements of that future National Quality System.

³³ MIDAC (Ministères, Départements et Agences de Contrôle) is linked to GasyNet, and 11 Ministries/Agencies are already connected : Customs, the Office Malgache de l'Hydrocarbure, the Institut National des Sciences et Techniques Nucléaires, Ministère des Affaires Etrangères, l'Office Malgache de l'Études et Régulation des Télécommunications (OMERT), the Ministère de la Santé Publique (Agence du Médicament de Madagascar (AMM) and l'Agence de Contrôle de la Sécurité Sanitaire et de la Qualité des Denrées Alimentaires (ACSQDA)), Ministère de Transport, the Commission de Conciliation et d'Expertise Douanière (CCED), the Finance Ministry, and the Ministry of Commerce.

time between the full submission of all documentation and granting the Certificat de Consommabilité, but do not account for the additional time needed to prepare the request. Between May 2014 and April 2015, the issuance of CNCRs took 9.4 days on average (with a maximum of 96 days).

101. **In principle, customs release the goods only once the authorization to commercialize has been issued.** However, in practice, importers can request an exceptional authorization to transfer (autorisation exceptionnelle de transfert - AET), allowing customs to release the goods, and giving companies 30 days to deliver the authorization from the Ministry of Commerce retroactively. While this practice is certainly trade facilitating, goods are put onto the market and can be sold without ensuring their safety. Between November 2014 and January 2015, 1310 AETs were issued, 78 percent of those in less than two days. However, the average time for issuing AETs increased from less than a day to 2.5 days over the time period, and in January 2015, more than 8 percent of requests took longer than 5 days (with a maximum of 92 days).

Non-tariff measures applied in Madagascar affect exporters more strongly than product requirements in destination markets

102. **The International Trade Centre (2013) demonstrated that more than half of the constraining non-tariff measures that exporters face are put in place by national authorities.** About 80 percent of NTMs relate to inspection requirements before embarkation, certification, or the issuance of licenses or permits to export. Not only the number of requirements, but also their application poses challenges. Depending on the type of product, procedural obstacles relate mainly to large number of required documents, administrative delays, frequently changing rules, exceptionally high charges, informal payments, the large number of controls, and the large number of organizations involved. The same report also found that legislation is frequently not well defined and exporters report differences between published legislation and their application, especially at customs (ITC, 2013). This leaves room for interpretation, and companies frequently complain about informal payments to customs and Ministry agents when there are differences in opinion regarding the interpretation of existing regulations. Available data from 2011 indicates that nearly 40 percent of products were affected by a type of non-tariff measure, accounting for nearly 30 percent of the import volume.³⁴

103. **For exports, a large number of products³⁵ requires additional documentation linked to regulatory controls before obtaining an export authorization document ('autorisation de sortie')** that is needed to export and issued by the relevant line Ministries. For the case of food products, these include a sanitary and phytosanitary certificate from the Ministry of Agriculture, a Certificat de Consommabilité (for processed food products) from the Ministry of Health, and the Certificat de Contrôle de Conditionnement et d'Origine (CCCO) from the Ministry of Commerce. Data from MIDAC indicates that obtaining the CCCO in Antananarivo in the six months to January 2015 took 1.7 days on average for 416 certificates that were issued. This likely is a small fraction of those issued in Madagascar, but no data are available for other regions where the dematerialization process has not yet been completed and no

³⁴ Data accessible from the NTM-database at www.wits.worldbank.org –this source lists 21 Ministries and agencies as involved in the regulation and administration of NTMs in Madagascar although the data does not seem to be complete and measures are frequently classified in an incorrect manner.

³⁵ They include all wood and forestry products, essential oils, all livestock products, agricultural and food products, vanilla, honey, and all artisanal products.

information on the delays with issuing the CCCOs is available. For a large number of products, export fees are linked to the issuance of documentation and some outright export taxes are in place as well.³⁶

104. Obtaining all documentation and the export authorization can take a significant amount of time and costs that exceed the delays encountered during the actual customs declaration process.

Interviews with economic operators in Toamasina indicated that obtaining the Certificat de Consommabilité (CC), which is needed for each export consignment, takes on average at least 5 days when visual controls only are undertaken, and significantly longer if samples are actually tested. Reports of 'lost samples' in these cases are frequent, generating additional delays and costs to companies. For high-value commodities, the value of these lost samples can at times be significant but such losses are accepted by exporters to ensure relevant certificates are obtained. Overall, putting together all documentation takes a long time, time that is not captured in the customs system (ODD) which only counts the time to export from the time a complete documentation is submitted until it is cleared. It seems that the larger delays originate before the actual customs declaration, with some companies indicating that they were starting with document preparation about one month prior to the shipment date. A regional exporter of wooden furniture reported that the company had been waiting to obtain export licenses for more than eight months in two consecutive years and had not yet received the license in the second year, indicating that such delays are not isolated cases.

105. Where firms use imported inputs, their competitiveness suffers twice as a result of the currently applied system. Delays when importing necessary intermediate inputs raise financing costs and lead time as imported inputs also need to obtain a Certificat de Consommabilité and other clearances, generating similar delays as when exporting. This and lead time to prepare export shipments binds working capital and increases inventory cost. As a result, companies that could enter international value chains by specializing on specific parts or tasks become less competitive. Generally, larger companies are better placed to manage complex procedures and multiple relationships, putting a particular burden on small and especially new companies which are known to generate most of the new employment growth. This partially explains the continued high concentration of exports among few companies and the limited success of smaller companies in entering—and remaining in—export markets.

106. Initiatives to increase transparency and reduce the time to obtain all relevant authorization prior to export are under way, but more remains to be done. Through the planned establishment of the Single Window for Exports (GUE), the Ministry of Commerce aims to reduce the total time needed to about 20-25 days for food products. While ensuring predictable delays would be a significant improvement, 20-25 days to obtain all documentation for exportation still puts a significant burden on exporters and hampers their prospects for export growth. It also seems that the GUE will only provide a platform to process request but will not change the manner in which authorizations are granted. Without effective delegation of decision making powers from line Ministries to those officers working at the GUE, delays are unlikely to fall. While increasing transparency for export procedures, similar work should be undertaken to also cover import procedures as well as any other regulatory requirements

³⁶ Fees for obtaining the relevant documentation are 2 percent for livestock, 3 percent for wood products, 2 percent for essential oils, and 0.5% of the FOB value (plus costs for inspection teams to travel) for the CCCO.

affecting imports and exports, for example by establishing a trade portal that would become a legally binding repository of all relevant regulations.

107. **For a number of products, these export licenses are tied to the mandatory testing of export consignments with the objective of ensuring that Malagasy products are perceived as high quality abroad.**³⁷ In practice, however, this requirement duplicates costs as exporters need to demonstrate compliance with import requirements in any case. In addition, because Malagasy laboratories are not accredited, test results are not accepted and exporters also need to obtain certificates of conformity from internationally accredited laboratories. Where exporters do not meet required standards, they would not be paid and will not be able to continue competing in export markets, so incentives to meet buyer standards are high.

108. **The value added of mandatory export control and testing is not clear and this requirement should be removed.** The Service des Normes et du Conditionnement (SNC) (and its regional bodies) control the quality of coffee and vanilla, issuing the Certificat de Contrôle de Conditionnement d'Origine (CCCO). The private sector repeatedly stressed that payments related to this certificate are high and delays can be significant, confirming the findings of ITC (2013). Both products, like other food exports, also need to obtain a SPS certificate to obtain an authorization to export. While the SPS certificate is meant to certify compliance with SPS measure in export markets, these are usually not accepted because the laboratories used by the phytosanitary service are not accredited. UNIDO (2008) also reports that certificates are often issued without controls and simply following payment of related fees. While official fees are moderate, exporters complained that they frequently had to pay for the transportation costs to allow officials to inspect consignments.

109. **A number of direct export restrictions are also in place.** While the export of bois de rose and other plants is prohibited by the government,³⁸ cartels of exporters for specific high-value crops have set artificial export restrictions. In the case of the litchi, the Litchi exporter association (Groupement des exportateurs de litchis - GEL) is functioning as a monopoly and imposes artificial export quantity limits, using the customs authorities to enforce their export quotas. While this policy likely increases the price of the commodity for exports in a given year, the allocation of quotas among its members is said not to be fair and the policy effectively restricts the entry of new operators. It also negatively affects attempts to increase productivity by operators as they would not be able to sell the increased yields to Europe. Experience with other crops such as vanilla has shown that competitors abroad continue to improve productivity while Malagasy exporters do not increase productivity and do not manage to expand levels of production and overall productivity, potentially with detrimental long-run effects for such industries. Similar threats exist for the litchi sector as Mozambique is expanding production and entering the European market.

³⁷ All agricultural and food products, vanilla, litchi, and spices are the most notable of these products.

³⁸ These are partially based on international agreements. However, despite export restrictions, significant exports of bois de rose are estimated to leave the country each year, especially during the crisis, and there is widespread understanding that at least local and regional government authorities are tolerating the exports of these products from minor ports as the beneficiaries of this trade invest heavily in the regions (see for example documentary prepared by Radio France International (RFI - <http://www.rfi.fr/emission/20141006-madagascar-traffic-bois-rose-antalaha>)).

Priority recommendations

110. **Reducing regulatory barriers and the functioning of border management processes is critical to reduce trade costs and allow Malagasy companies to participate in international supply chains in regional and international markets.** Delays at borders for imports drive up the costs of products sold in Madagascar, negatively affecting disposable incomes of households and contributing to poverty, and they also increase the prices for intermediate inputs that Malagasy firms need to produce final goods, for domestic consumption or for exporting. At the same time, these delays drive up the costs of landed goods of Malagasy exports in regional and global markets. Global estimates indicate that on average an additional one day delay in transit drives up the price of exports by nearly one percent (Hummels, 2001). Other estimates show that a one day delay has the same effect of adding 70 kilometers to the distance of a journey – with the consequence of on average reducing export volumes by one percent (Djankov, et al, 2006).

111. **Madagascar should improve the use of risk management and reduce the share of consignments and improve targeting.** When scanned, wait times between the scan, the assessment of the image, and actual physical inspection should be significantly reduced, allowing goods to be released with shorter delays. Post-clearance controls should be undertaken independently to assess the effectiveness of control procedures and risk targeting, allowing lessons learned from these processes to feed back into the selection process and improve targeting. The increased use of data and analysis will play an important role in this regard. As part of this process, responsibility and capacity should be transferred from the private service provider back to customs. Ensuring the customs clearance process is fully dematerialized and can start with the electronic submission of all documentation (not only once all documentation is submitted in hard-copy format) will be important to accelerate customs clearance and in the fight against corruption. Collaboration with neighboring countries on risk management practices could offer strong opportunities for learning and knowledge transfer, and Madagascar could consider joining the Accelerated Program for Economic Integration (APEI) set up by five neighboring countries³⁹.

112. **The government should review existing import and export requirements to see if they achieve the regulatory objectives, and possibly streamline or remove some of the existing requirements that most strongly affect trade.** The number of domestically imposed controls and procedures can be overwhelming and might in itself present a barrier to a more successful commercialization of some of these export products. While individual documents might require a limited amount of time each to obtain, the number of requirements results in significant overall delays. In addition, delays to obtain relevant documentation are unpredictable, as are frequently the processes to follow. This review should identify and review priority NTMs. Engaging with regional partners, including through the APEI, that have already experience with reviewing and streamlining NTMs could offer significant opportunities for learning and knowledge transfer. By increasing the inclusiveness in which regulations are drawn up (for goods and services), the government could also ensure that they achieve targeted policy objectives and are not hijacked for protectionist purposes. The recent initiative by the MCC to more strictly regulate

³⁹ The founding and current members of the APEI are Malawi, Mauritius, Mozambique, Seychelles, and Zambia.

collectors in the agricultural sector would add additional costs and procedures open to informal payments, and would be extremely difficult to implement, and therefore should be reconsidered.

113. **Transparency regarding existing procedures needs to be increased and collaboration with other agencies should be improved, for example through integrated risk management, clearance processes, and joint inspections.** As transparency increases, the role of 'gate-keepers' of CFAs could be reduced, and in tandem the criteria for their accreditation should be made more transparent and better enforced. Transparency should also be increased regarding the time that Ministries and Agencies need to issue permits to accelerate the processing of existing requirements. The Ministry of Commerce's initiative to install a Single Electronic Window for exports (GUE) is a positive development, but effective delegation of decision making powers from line Ministries to those officers working at the GUE will be needed to effectively reduce processing times.

114. **Efforts to combat fraud and corruption at all agencies involved at borders needs to be renewed to ensure all businesses in Madagascar participate in a level playing field.** Lessons for customs can possibly be learned from the experience of establishing performance contracts in Cameroon, where they have led to less but better targeted customs controls, faster clearance times, and increased revenue collection. More generally, the government should ensure that rules are followed and common informal practices to bypass them are reduced.

115. **Last, the government should ensure that all regulatory agencies accept test results from internationally accredited laboratories.** Allowing the private sector to provide testing and accreditation services would increase incentives for private laboratories to upgrade and make it easier for companies to obtain internationally accepted certificates of conformity with technical regulations in export markets. In a transition period, these results could be accepted in addition to those by the currently approved laboratories. Separating the issuance of regulations and their enforcement would also reduce potential conflicts of interest within regulatory agencies.

Chapter 4 - Trade Infrastructure, management, and logistics

116. **The efficient movement of goods from the place of production to the place of consumption is a critical part of any value chain.** To reach a market, all transport costs from production to final sale, domestic or foreign, have to be priced into the final product and therefore co-determine the competitiveness of a product. All fees and charges that economic operators incur in this process enter the equation, and delays contribute to costs through the need for higher inventory, higher financing costs, and increased uncertainty. Reducing transport, logistics, and administrative costs and delays therefore is an essential element in increasing the competitiveness of domestic production. While the classical view of trade facilitation focused on the removal of barriers at the border, the modern view goes beyond 'fixing borders' and includes Logistics and Transport Services, physical infrastructure, and overall competitiveness.⁴⁰

117. **Total transport and logistics costs for manufactures in low income countries on average account for as much as 250 percent of the value of the goods transported.**⁴¹ Reducing overall transport costs therefore can have a larger economic impact than tariff preferences in destination markets. While changing market access conditions in destination markets or reducing freight rates for maritime shipping is generally outside the control of governments in exporting countries, improving the logistics environment and reducing transactions costs domestically actually is in their control and should represent a central element in any government's competitiveness strategy.

118. **High transport costs also affect the price of goods that are sold domestically, reducing purchasing power of consumers.** This particularly affects the import of basic commodities. For example, road transport prices alone for the import of wheat flour, rice, and sugar in Madagascar account for 6.6 to 8.7 percent of the value of these commodities, increasing consumer prices correspondingly. Reducing transport costs would also reduce the price of these commodities in national markets, allowing consumers to buy more with limited incomes.

119. **This chapter presents key elements of such a facilitation strategy that need to be put in place to improve the flow of goods.** The strategy will need to remove bottlenecks and prevent new ones from emerging (sooner than necessary) as traffic and trade volumes increase. Efforts have to focus on policy changes that can improve the situation in the short term, and need to be complemented by long-term investment in physical infrastructure. But without policy reforms, returns from investments into physical infrastructure will not be maximized as inefficiencies will persist.

120. **While Madagascar has undertaken a number of important reforms in the past, much remains to be done.** The establishment of port authorities like SPAT in Toamasina, and the improvement in operating conditions at major ports where concessionaires now undertake the handling has been an important step to improve the trade and logistics environment. The establishment of a mechanism for road maintenance involving private enterprises and the introduction of a fee for road maintenance are important elements to address the critical condition of the road network. And the privatization of the

⁴⁰ See Rippel, B. (2011), "Why Trade Facilitation is Important for Africa", Africa Trade Policy Notes 27, World Bank.

⁴¹ See Arvis, J-F, Duval, Y., Shepherd, B., and Utoktham, C. (2013), "Trade Costs in the Developing World: 1995-2010", Policy Research Working Paper 6309, World Bank.

management of the rail network has helped to revitalize the rail network and increase competition between the rail and road corridor, especially for heavy loads, although there are some concerns that links in ownership structure between the rail concessionaire and trucking companies might affect competition.

121. **A number of factors continue to negatively affect the transport and logistics environment in Madagascar.** Three factors are particularly important for high trade and transport costs. They relate to the quality and efficient use of existing infrastructure, the operating conditions related to the means of transport such as trucks, trains, and boats, and a complex regulatory environment that does not facilitate the movement of goods. As outlined in the introduction, the focus will again be on policy changes that could help in mitigating challenges in the short term.

122. **As WTO member, Madagascar has signed on to the Trade Facilitation Agreement (TFA), and should urgently submit a list of those commitments to the WTO that it will not be able to comply with when the TFA enters into force.**⁴² The TFA recognizes the critical role that trade facilitation plays in reducing trade costs which disproportionately affects smaller companies. It covers not only customs but the operations of all border agencies, recognizing that an increasing share of border-related delays globally are originating within border agencies other than customs.⁴³ Once the TFA enters into force, it will be binding on all member states. Because WTO members recognized that some members might need additional time (and assistance) to become compliant, each LDCs has agreed to classify all commitments into three categories: A) those it will have fully implemented upon entry into force; B) those implemented following a transition period; and C) those implemented following a transition period and where additional technical assistance will be needed. Identifying those commitments Madagascar will not be able to meet immediately, and notifying them to the WTO, should be a high priority, as Madagascar will be deemed to meet those it does not notify. To that end the government is already working to establish a Trade Facilitation Committee, but these efforts need to be continued and should avoid duplication of committees, so linking or integrating this committee (in)to the National Steering Committee should be considered. At the same time, Madagascar should also proceed to ratify the TFA to ensure its exporters benefit from the agreement in destination countries as quickly as possible.

Trade infrastructure remains limited and is poorly used

123. **More than 80 percent of foreign trade passes through Toamasina port, located at 370 km from Antananarivo.** Total traffic at the port has grown strongly since 2005, reaching more than 4.5 million tons in 2013, an annual growth rate of 14.8 percent. After 2009, traffic growth accelerated to 22 percent per year, despite the fact that very large ships (mega carriers) do not call in Toamasina as they only access a number of large ports such as Port Louis and Durban in the region. Toamasina is served by maritime feeder routes that link it to neighboring ports in the region such as Port Louis, Maputo, or La Réunion. In 2013, more than 350 ships called in Toamasina, as did 40 ships carrying petroleum products.

⁴² The TFA will enter into force once two thirds of WTO members have ratified it.

⁴³ This largely reflects significant progress to speed up clearance processes in customs organizations around the world which has not been replicated in other agencies.

124. **Port Louis has become the hub port in the region due to his capacity to handle very large ships and his excellent management.** With the increase in the size of container ships, and with changes in global patterns of trade flow as Asia emerges, the configuration of international shipping routes has changed, and the large freight lines only call at Port Louis and Durban in the region. From there, containers are transshipped to other destinations such as Madagascar on smaller vessels. As a result, the time for containers from Madagascar to reach Europe or Asia has increased from 25-35 days in 2005 to 30-50 days today. While the port in Toamasina aims to expand its capacity as part of its master plan for 2035, the underlying traffic growth projections can only be met if an overarching strategy can be implemented successfully to facilitate the movement of overseas goods to and from Madagascar, to attract transit traffic through the port, as well as along the corridor Toamasina-Antananarivo. Toamasina is only likely to develop into a hub if domestic trade increases significantly as well.

125. **The main secondary ports are located in Mahajanga (in the North), Taolagnaro (in the South), Antseranana (in the far North), and Tuléar (in the South-West).** These secondary ports are mainly served by two companies, MSN and CMA-CGM, who operate two small container vessels of 1500 TEU, calling every 20 days or so in Mahajanga and less frequently in other ports, including at times Langoni in the Comoros or Port Louis. Smaller ships of 50 to 100 tons also circulate among secondary ports, transporting mainly goods of local production. Cabotage traffic remains limited although data indicate that the North-East around Vohémar, capital of the vanilla, is well connected by sea as it cannot be reached by road during the six months of the rainy season. Roughly 50,000 tons of petrol are distributed annually with tanker ships. Prices for cabotage at about 8.8 cents per ton/km for petroleum products, or around 15 cents for raffia, seem to be relatively high, in contrast with the experience in other countries. The new port development in Fort Dauphin could generate new export opportunities as traffic increases but the port layout and wind conditions constrain its use for cabotage.

126. 89. **Rail and road infrastructure have deteriorated over the past decades and need to be improved to cope with current and future trade flows.** The overall network of roads is small with 31,600 km and a density of 11km/1000km², compared to 31 for the average of SSA. Only 10 percent of the network are in good condition, and due to the lack of maintenance, the network especially of rural roads has been shrinking by 2000km per year recently as the share of communities accessible year-round has decreased from 63 percent in 2011 to 40 percent in 2013. The mediocre state of roads rarely permits speeds higher than 60 km/h on good sections, and average speed is often below 15kmh on other sections. Maintenance remains limited due to limited finances but needs to be increased to ensure road and rail quality does not further deteriorate. Often, roads would have to be rehabilitated before they could effectively be maintained. Quality and physical capacity of roads and railways are likely to be soon insufficient as traffic increases.

127. **Overcharging of trucks is frequent practice, further contributing to the deterioration of road quality.** National regulations in Madagascar limit the overall weight of trucks to 25 tons on the national road network (and 16 tons on the provincial), using a maximum axle weight of 10 tons. According to data from APTR, however, total loads along the corridor Toamasina-Antananarivo frequently reach 44 tons for semi-trailers with three axles of 13 tons each, a broadly accepted standard in Africa and Europe by now. Overloading of trucks is the response by truckers to a large number of factors limiting the use of trucks (see below) in order to increase incomes. In the past, enforcement of axle load limits has been

limited, although ARM has started to improve enforcement of existing regulations and sanction non-compliance, although with lower fines than legally foreseen which ARM plans to bring into full compliance soon. This initiative should continue.

128. **The rail network is also very limited with a principal axis of 670km linking Toamasina to Antananarivo and Antsirabe.** Here, maximum speeds are around 45 km/h but only around 20km/h in zones that still require rehabilitation. A branch between Moramanga and Lac Alcoa is used to transport chrome from a mining site. The southern line comprises 163km between Fianaransoa and Manakara in a region that is partially inaccessible by road. The line and rolling stock are managed by a state enterprise, while for the northern network a concessionaire, MADARAIL, is the operator since 2003, initially for a renewable 25 year period. Between 2005 and 2010, 195km have been renovated and bridges, wagons, and locomotives been rehabilitated, but more rehabilitation work is required and rolling stock is not sufficient. The government is aware that moving more (heavy) goods by rail instead of by road could reduce emissions and alleviate traffic on the road.

129. While infrastructure investment will take a long time to materialize, policy reforms can significantly contribute to increasing the overall capacity of existing infrastructure, by ensuring it can be used more efficiently. Needed investments into infrastructure to remove bottlenecks and other constraints are enormous, and they won't be addressed over the short term, even though the government is already developing a National Policy for Infrastructure Development. As a result, the country needs to make better use of the existing infrastructure as it invests in priorities but cannot address all at the same time. Some funding for investments has been identified, and certain investments have started, but policy reforms can significantly alleviate current pressures on existing infrastructure in the short term and should be a priority for government.

Traffic is increasing but overall costs remain high

130. **Port traffic at Toamasina has increased and current traffic levels will soon reach capacity and projections for future growth need to be assessed cautiously.** Growth projections at the port are heavily dependent on an expected growth of transit traffic, but it is by no means certain that the port will be able to attract such traffic, as a number of ports in the region compete for it. There is a real risk of over-investing into infrastructure at the expense of other elements in the transport environment that would contribute to the development of a more balanced transport strategy (see below).

131. **The port in Toamasina is performing well, and costs seem very competitive, particularly due to low port fees.** The port has recently been expanded, service has been improved, and three mobile cranes at quay move 38 to 40 containers per hour, a good performance by international standards. Rail lines have been extended into the terminal area to allow loading onto the trains. Using the import of 20 containers of cement as an example, port handling fees and charges (VAT) for are around EUR 221 for a 20 foot container of concrete, a bit lower to those in Abidjan (235 EUR) and 20% lower than in Lomé, Togo (264 EUR). In addition to the handling fees covering services rendered by the port operator (MICTSL), it collects also port taxes, city tax, a regional tax, a port authority fee and a security fee (for a combined 20 percent of the total bill). While these costs seem low overall, they nevertheless represent more than 16 per cent of the value of the imported goods for a low-value commodity such as cement, and are therefore not negligible (Table 7).

132. **While the port services at the container terminal are of high quality and low costs, other factors erase the good performance.** Using the same example of 20 containers of cement, total taxes and fees amount to 63 percent of the value of the goods. Half of the total fees result from customs duties, VAT, a fee to use the scanner (0.5 percent of the value of the goods), and other taxes. Handling and other fees inside the terminal account for another 28 percent, while 15 percent of total costs occur for hiring trucks and bond fees. While import duties and VAT are an important element for revenue generation, the fees to use the scanner seem excessive and the costs not linked to the service rendered as it increases with the value of the goods. The example also shows, how discretionary or non-transparent exemptions on customs duties and VAT can distort prices and hamper competition in Madagascar.

Table 7: Fees for importing 20 containers carrying cement

133. **Customs clearance time in Toamasina in 2014 averaged four working days for goods in the red channel, 3.6 for the yellow and 2.7 days for the blue, but these averages mask significant variance.**

	Total Hors Tax (Ar)	TVA (Ar)	Total (Ar)	EUR	Pour-cent
Débarquement Conteneurs Pleins	7,863,005	1,572,601	9,435,607	2,972	47%
Droit de port sur imports	812,780	162,556	975,336	307	5%
Magasinage 4 jours	1,828,754	365,751	2,194,504	691	11%
Livraison manutention Pleins	2,140,531	428,106	2,568,637	809	13%
Reception Conteneurs Vides	1,113,127	222,625	1,335,752	421	7%
Pesage automatique	584,820	116,964	701,784	221	4%
Taxes urbaine de Toamasina	400,000	0	400,000	126	2%
Droit de la Région	200,000	0	200,000	63	1%
Redevance APMF Flux Maritime	1,257,530	251,506	1,509,036	475	8%
Redevance de sureté	584,820	116,964	701,784	221	4%
Total pour sortir du Terminal	16,785,367	3,237,073	20,022,441	6,306	100%
<i>Pourcentage des frais de passage portuaire par rapport aux coûts d'importation : 16.2%</i>					

Customs and clearance procedures of other agencies determine how long it takes until containers can leave the terminal, and all agencies contribute to significant delays for imports and exports. While containers are granted a five day period of free stay in the port, more than half of all containers actually remain longer in the port. The average clearance times for Toamasina in 2014 were four working days for the red channel, 3.6 for the yellow (with control of documentation) and 2.7 days for the blue channel, but these averages do not include the time to prepare documentation. They only account for the time after the vessel has arrived and a full set of documentation has been submitted to (and accepted by) customs until the goods are cleared and can be picked up by the transporter (i.e. a 'bon à enlever' has been issued). Where goods need to be scanned, this is only done subsequently and additional delays occur. Some delays in the clearing process also relate from other border agencies, as outlined above, or the untimely transmission of payment information from Banks that is needed to issue 'gate passes' that allow trucks to enter the terminal.

134. **But significant additional delays ranging from 4 to 72 hours also occur before goods can leave the port and are on their way to final destination.** While a container classified as low risk (in the blue, green, or yellow channel) takes about 4 to 12 hours to leave the port after customs clearance, a container classified in the red channel that needs to pass the scanner takes between 32 and 72 hours according to data from APTR and GPTE. This means that overall, the time from the arrival onboard a ship

until a container is on the road to Antananarivo is more than 3 days for a container in the blue channel, more than four for one in the yellow channel, and more than 6 days for a container in the red channel.

135. **To more accurately quantify the delays occurring at various steps when containers enter or leave the port, a survey has been conducted in the context of this study in early March 2015.** The findings broadly support the claims made by the transport operators and are represented here for the container terminal and the port separately. While the actual time to load/unload a container in the MICTSL terminal is only 10-12 minutes, the overall process to enter the port and then the terminal, load/unload a container, and leave the terminal and port again, takes nearly 8 hours on average for a container when imported, and more than three hours when delivering a container for export. Wait times to enter the terminal were around 45 minutes, and an additional 1h15 before a container for export was unloaded. To pick up a container for import, a transport operator had to wait around 2h40 to enter the port, 15 minutes to enter the terminal, 1h30 before receiving the container, 12 minutes before leaving the terminal, and another 3 hours before being able to leave the port.⁴⁴ Delays in loading/unloading containers are related to unavailability of equipment within the terminal operated by MICTSL which provides preference to servicing ships, and because operators are said to demand informal payments from truck drivers before loading/unloading containers. Wait time to enter and leave the port is due primarily to the backup of trucks loaded with export containers waiting to go to the scanner in the customs area and due to the limited opening time of the scanner which often start up to two hours after the normal operating hour at 7am.

Table 8: Average waiting and processing times for import and export procedures for containers

Containers	Import (min)	Import (hrs)	Export (min)	Export (hrs)
Waiting time before port gate	160.3	2.67	42.3	0.71
Registration time port entry	4.3	0.07	4.2	0.07
Waiting time before MICTSL gate	17.6	0.29	44.8	0.75
Registration terminal entrance	3.1	0.05	4.4	0.07
Wait time before loading/unloading	86.0	1.43	75.7	1.26
Loading/unloading time	11.5	0.19	10.2	0.17
Wait time before leaving MICTSL	12.2	0.20		
Registration terminal exit	4.3	0.07		
Waiting time before scanner	44.5	0.74	66.3	1.11
Passage time scanner	2.5	0.04	1.3	0.02
Waiting time before physical inspection	117.7	1.96	103.6	1.73
Time for physical inspection	26.0	0.43	42.0	0.70
Waiting time for inspection results	1397.6	23.29	116.3	1.94
Time for report writing	16.5	0.28	9.4	0.16
Wait time before leaving the port	176.7	2.95		
Registration time port exit	0.0		10.9	0.18
TOTAL	2080.8	34.7	531.4	8.9

Source: Survey of trucks entering Toamasina port, March 2015 – with grey underlay waiting times related to MICTSL, remainder due to port operator and official controls for containers in the red channel

136. **The scanning and physical inspection of goods represents the most important bottleneck at Toamasina, and procedures need to be reviewed.** Where containers need to be scanned and/or physically inspected upon, the actual time to undergo procedures is only 45 minutes, while total wait times in between amounted to nearly 32 hours. Waiting times were on average 2h45 before entering the port, 45 minutes before passing through the scanner, nearly 2h before undertaking the physical

⁴⁴ Trucks also undergo an additional control by fiscal authorities when leaving the port, although these controls only take place during the day, prompting some importers to leave the port only after they have closed.

inspection (which 83 percent of scanned containers need to undergo), and nearly 24h before the inspection report was issued, although physical inspections on average only took 16 minutes. Wait times to leave the port also amounted to 3 hours on average. These averages again mask significant variation as delays vary widely. This means that control functions of customs that involve scanning and physical inspections do not necessarily generate delays because of their control procedures, but because these are poorly organized (See Table 8).

137. While waiting to be scanned and subsequently inspected, containers have to remain on the trucks, holding trucks 'hostage' and reducing their operational efficiency. Due to the deficiencies in risk management at customs (see earlier section), 83 percent of scanned containers are also physically inspected, usually after long delays, while only 6 percent of inspected containers are found to be non-compliant with the customs declaration. The time that trucks have to wait reduces their operating time and has economy-wide implications (see below), but the direct costs of hiring a truck to bring a container to the scanner also generates costs to importers that can account for more than 15 percent of total import costs, or 30 percent excluding duties. The immobilized goods also increase financing costs for goods in containers. A rough estimate for the financing costs for the capital invested in goods contained in a container due to the unnecessary delays of on average 33 hours is about US\$ 14, more than the daily storage fees.⁴⁵ For a company located in the vicinity of the port and transporting a large number of containers to and from the port each day, the total waiting time in and around the port accounted for 65 percent of the total operating time of their trucks. Reducing unnecessary delays could easily double or triple the capacity of the existing trucking fleet in this example.

138. Small delays at the port can delay the departure of trucks to Antananarivo by 12 hours. Trucks cannot circulate after 7pm along the corridor because roads are very windy, condition of trucks is often poor, and insurance companies do not insure goods for travel during the night due to security concerns. Short delays before leaving the port can therefore generate significantly larger delays in the delivery of goods as trucks generally do not leave Toamasina after 2pm in the afternoon due to these concerns. Only one secured parking lot at Brickaville (118kms from Toamasina) exists, but that is principally destined for tankers. The existence of such parking lots along the corridor would allow trucks to travel part of the journey in the evening of one day and continuing the next, which would reduce the total time from leaving the port to reaching Antananarivo.

Operational inefficiencies at the port and border agencies lead to higher transport prices

139. As a result of long delays and the immobilization of goods and trucks, transportation equipment is underutilized, raising costs. About 7,000 trucks operate in Madagascar, and a quarter of these are used by the informal sector. The fleet of large trucks is estimated at 2,500, about half of which are semi-trailers. Two- to three thousand smaller trucks are operated by smaller companies that operate five or less trucks, generally able to carry a load of 16 tons. Trucks operating along the Toamasina-Antananarivo corridor seldom make more than one trip per week and generally do not run more than 40,000 km per year, much less than in other countries such as the EU where trucks run up on average

⁴⁵ Estimates based on an average value of a container of US\$19256 and annual financing costs of 15%.

around 150,000 km per year, or around 80,000 km per year in other countries in SSA.⁴⁶ As a result, fixed costs such as for equipment, working capital, and personnel need to be distributed over a smaller number of kilometers and trips, increasing the actual operating costs to operators, and ultimately, prices for the users of transport services.

140. **Because transport operators know that trucks will run little, they invest in used trucks with lower financing and fixed costs, but that more frequently break down.** Most trucks are imported second hand, and in 2013 half of these trucks were between 11 and 15 years old, increasing maintenance costs and the frequency of breakdowns. Breakdowns further reduce the predictability of transport services with the exception of a few high-quality, high-cost operators. Breakdowns also contribute to increased accidents along Madagascar’s road that take a toll on lives and result in Madagascar’s roads generally being considered unsafe. Overall, costs to operators are high and despite a reasonable level of competition, prices of transport services to end-users remain high as well.

141. **Prices for road transport services in Madagascar are 15-30 percent higher than in comparable countries, negatively affecting the ability of Malagasy companies to compete.** Transport costs along the major axes are between 10 and 16 cents per ton/km in Madagascar. Long delays at charging and discharging and at other control points (including the scanner), the mediocre state of the road which reduces travelling speed and increases the use of petrol and other spare parts such as tires, result in the low utilization of trucks. As a result, transport prices are significantly higher than in other countries (see Table 9). Policy reforms to address the key issues will be needed to reduce operating costs to operators and ultimately transport prices paid by the users of transport services.

Table 9: Comparison of transport prices in US cents per ton/km

Country	Pakistan	Brazil	USA	China	Madagascar Exports Tana-Tamatave
T/km	2	3.5	4	4	10-16
African Corridors	Durban Lusaka	Lomé-Ouagadougou	Mombasa-Kampala	Douala-N'Djaména	Madagascar Imports Tana-Tamatave
T/km	5	7	8	11	12

Source: Le prix et coût du transport en Afrique. S.Teravaninthorn et G.Raballand, Banque Mondiale, et mission Banque Mondiale

142. **Transport costs between smaller economic centers in Madagascar are significantly higher and add significant (and at times prohibitive) cost to export products before they even reach**

major cities or ports. High domestic transport costs are also certain to hamper the development of domestic value chains. Transport prices for domestic transport operations are higher than those along major corridors, and they vary significantly depending on location and product. For a number of products, transport prices are moderate as they range from 10 to 21 cents per ton/km for products such as cloves, raphia, cacao and cinnamon transported from Manakara or Mananjary for long distances. However, they can go up to 60 cents per ton/km for products originating in Soavinendriana, and up to 2 or three dollars per ton/km for vanilla or cloves transported over shorter distances.

⁴⁶ The situation is different for the heavily regulated petroleum tankers that are generally imported new and which manage to complete two rotations between the port and the capital, mainly because they charge loads outside the port and are not subject to the significant delays that other trucks are when entering and leaving the port. This would result in an annual use of around 75,000 km.

143. **Along agricultural value chains, transport prices are also significant.** Rural transport costs from fields to villages can be as high as 10 USD per ton/km, although for very short distances, while transport cost from collection points to consolidating agencies can be between 31 cents and 13 USD per ton/km. Costs between the collection agencies and the ports are lower, but can still reach 1.35 USD per ton/km. While these high transport costs might be acceptable for high value commodities such as vanilla or cloves, they are unsustainable for other products such as cinnamon or raffia where they can account for 15 to 30 percent of the value of the goods. For a number of products, coastal cabotage reduces distances and transport costs, but a number of other fees and charges still strongly affect their competitiveness. For example, the amount of fees and charges that exporters of raffia incur in Mahajanga are around 280 Ariary per kilo, more than 15 percent of the price that farmers receive, which has contributed to the decline of the sector in that region. There are large differences in these fees as they are only 50 Ariary in Toamasina (see Box in background chapter).

Table 10: Rail transport prices are high in Madagascar

Country	Madagascar MADARAIL	Mozambique CCFB/CFM	Tanzania- Great Lakes TRC
T/km	7.3	5.5	4.3
African Corridors	Cameroon- Tchad Camrail	Côte d'Ivoire Burkina- Mali Sitarail	Sénégal-Mali Transrail
T/km	6.3	5.5	5.3

Source: *Schéma d'analyse de la performance du rail en Afrique, SSATP Mars 2013*. V. N. Olievski

144. **Transport prices on the railway are lower than on roads with 7.3 cents per ton/km, but they are nevertheless significantly higher than in other African countries (see Table 10).** While the concession of the rail road could generate strong competition for the road

transport sector, links in ownership structure between the rail concessionaire and trucking companies limit effective competition between both. Overall, the railroad has a market share of 100 percent for chrome, 20 percent for cement, 15 percent for rice and flour and only 5 percent for containers. Total traffic carried by the rail was 407,000 tons in 2012 which compared to a line capacity of 1.2 million tons, shows that the capacity to transport heavy goods is underutilized because of a lack in rolling stock.

145. **The study estimated the overall impact of the delays incurred at the port on operations and transport prices at generating annual losses and additional investment costs of around US\$11 million.**

We find that the costs of the unnecessary wait time related to the poor management of operations at Toamasina port generate costs to transport operators of 22.1 billion Ariary, or US\$8.4 million per year as trucks are stuck and cannot be used.⁴⁷ Reducing unnecessary delays on average from 35 to 2 hours per truck would allow trucks to double their efficiency as they could suddenly complete two rotations between Antananarivo and Toamasina per week. Three quarters of these savings would result from shorter wait times at import operation, while the remainder would result from more efficient export operations (see Table 11). Financing costs for the immobilized goods in containers would also fall. For the containers in the red channel, a reduction in unnecessary delays by 33 hours would generate savings for financing costs of USD\$14 per container, a non-negligible amount that exceeds daily storage fees, and reduce losses due to higher financing costs of 848 million Ariary (or US\$325,000) per year. Allowing for faster overall clearance (including clearance before containers arrive) and reducing the overall

⁴⁷ This assumes that the time required for the trucks to enter the port to load or unload containers and go through the scanning or not would be reduced to an overall time of 2 hours. Similar costs are generated in other ports but these have not been estimated. Given Toamasina accounts for 80 per cent of total traffic, total costs could be around US\$10.5 million per year.

clearance time for all containers would generate additional savings of US\$1 million per year in financial costs.

146. **As a result, operating costs could decline by 13-15 percent, even under the assumption that efficiency gains would be shared between operators and transport service users.** Also, as traffic growth, a more efficient use of the existing park of trucks would avoid new investments as the same number of trucks could transport the container traffic projected for 2025. Higher efficiency per truck would allow each vehicle to carry more goods, allowing the current fleet to carry the estimated traffic loads in 2025. This would reduce the need for investment in more than 360 trucks over the time period (that would have to be added to the national fleet if delays at ports were not reduced), reducing investment costs by 38 billion Ariary or US\$14.5 million over the next 10 years, which would amount to 3,8 billion Ariary or US\$1.5 million per year. These are very conservative estimates as delays at the port frequently delay the departure of trucks to Antananarivo by significantly more time, as trucks cannot depart in the evening if they leave the port after 2pm.

Table 11: Losses resulting from long customs controls and delivery times at MICTSL in Toamasina

	Containers imported and exported	Share	Number of containers (TEU)	Possible time savings per container in hours	Cost savings estimate in Ariary	Fixed costs per hour per truck	Yearly losses for transporters whose trucks are immobilized	
1.	Total number of containers imported, full (1)	81%	67,513				Ariary million	US\$
1.1	Imported containers in red channel, scanned	34%	22,954	33	757,496	18,330	13,885	5,319,885
1.2	Imported containers in blue channel	30%	20,254	6	121,523	18,330	2,525	967,252
1.3	Imported containers in yellow channel	36%	24,305	6	145,828	18,330	2,525	967,252
2.	Total number of exported containers, scanned (2)	19%	15,451	7.5	115,883	18,330	3,156	1,209,065
3.	Total number of full containers at Toamasina	100%	82,964		1,140,730		22,090	8,463,453
(1) In addition, there are 11400 TEU empty, and 1090 in transit								
(2) In addition, there are 68252 TEU empty, and 11648 in transit								
						Exchange rate 1\$ =	2,610	

Source: Estimate of economic losses by the mission team

Priority recommendations

147. **The current approach to trade facilitation in Madagascar, especially at ports, is not compatible with the challenges of companies competing in a globalizing world.** Global production networks and the participation in international value chains are characterized by increasing specialization, as well as the need for faster turn-around times, lower inventories, and predictable movement of goods. While governmental control functions are important, they can be undertaken in a manner that minimizes the impact on the business community by making them more efficient. At the same time, addressing key governance issues, and improving selectivity can contribute to increased regulatory effectiveness, allowing government agencies to achieve their objectives at lower costs: an improvement for all participating stakeholders. A number of contributing recommendations are also presented in other chapters of this report and will not be repeated here.

148. **Improving the way in which border controls are conducted should be of highest priority to the government.** Improving processes around the flow of goods to reduce unnecessary wait time between

various control points such as before entering the scanner, until the image is validated, the physical inspection takes place, and the final report is validated, would significantly reduce overall delays without impacting the overall control exercised by customs. An immediate measure would be to have the customs operation at the port be extended from 8h to 24h as the port handling facility. This also applies to procedures within MICTSL where delays also occur. Reducing delays would reduce the time that trucks are immobilized, allowing them to increase the number of rotations per week, reducing transport costs and ultimately transport prices for importers and exporters.

149. **Such improved procedures should be complemented with smarter controls, including a more efficient use of risk management and improved targeting of high-risk consignments.** Targeting less shipments, but increasing the rates of non-compliance found among those actually targeted would reduce trade costs to non-compliant operators and shift the overall control burden to those that are non-compliant (see also Chapter 3 on Customs).

150. **As infrastructure constraints remain and won't be fixed in the short term, the government should also ensure that existing infrastructure is used more effectively, and does not further deteriorate.** Building on new mechanisms for maintenance involving the private sector, additional funding also needs to be made available. New initiative to enforce axle weights need to continue and be scaled up, with penalties brought to prescribed levels and transparent enforcement to ensure behavioral change among truckers and trucking companies can be achieved – but this will also require addressing persistent governance issues.

151. **Over the medium term, the government should strengthen competition between the road and rail sectors, and develop a multimodal transport platform to decongest Toamasina port.** Given limited space at the port, containers could be moved under bond (by rail or road) to a dry port located inland outside but close to Antananarivo, allowing the seamless flows of containers and other goods from origin to destination inland, and reducing transport costs significantly. Goods would be scanned upon arrival at the dry port, and stocked for clearance according to the allocated customs channel, avoiding the long delays for trucks in Toamasina which reduce overall truck cycle time. All border services would be present and undertake their control functions at this location. A similar mechanism could be applied for exports with goods cleared at the dry port and being sent directly to the port without further controls. An added benefit would be the decongestion of Antananarivo, while the central train station could continue to be used for passenger traffic. The dry port should be managed by a concessionaire, similar to the one for the container terminal in Toamasina to ensure its efficient management.

152. **As WTO member, Madagascar should ratify the Trade Facilitation Agreement and notify which commitments it will not be able to meet once it enters into force.** Implementation by all trading partners of the TFA is in Madagascar's interest, as is the implementation of the commitments by Madagascar itself because trade costs disproportionately affects smaller companies. As all LDCs, Madagascar should identify those commitments it cannot meet immediately and those where it will need additional technical assistance for implementation. To that end, the government should complete setting up the National Trade Facilitation Committee, ideally aligning it to the National Steering Committee for the EIF to minimize duplication of committees. The TFA offers an opportunity to rally donor support around a complex but highly relevant reform agenda as this report shows.

Chapter 5 - Export promotion and access to inputs

The role of Export Processing Zones in the past and future

153. **Until now, Export Processing Zones (EPZ) constitute a key element of the economic development strategy in Madagascar.** The introduction of a special scheme for free zone companies or EPZs in Madagascar in 1989 resulted from the country's decision to opt for an export-led growth strategy under the structural adjustment policies of the late 1980s. Under the legal framework which established this strategy, EPZs must export 95 percent of their production abroad. In return, they benefit from low tax rates (including total exoneration on profit taxes during a period of 2 to 15 years, then a fixed rate of 10 percent); duty exemptions on imports; free access to, and transfer of foreign exchange; and relaxed regulations on expatriate employment and visa matters.

154. **The focus on Madagascar's free zones program remains on labor-intensive, low-value, export-oriented manufacturing⁴⁸.** Under the scheme, individual firms are registered as EPZ-firms and they are geographically dispersed, in contrast with modern best practice approaches of Special Economic Zones (SEZ) that are geographically concentrated, allowing provision of key infrastructure and support. Today, most EPZs are concentrated in the province of Antananarivo, close to large pools of labor, trade nodes, auxiliary business services, and other third-party collaborators. The Economic Development Board of Madagascar (EDBM) is the coordinating body of EPZs in Madagascar. Historically, Madagascar's EPZs success in the textile and apparel sector mainly relied on its trade and economic partnership agreements with the US, the EU, and emerging markets, such as the Southern African Development Community.

155. **In the program's early years, Madagascar's EPZs had a highly significant macroeconomic impact.** In 2004, there were more than 180 free zone firms in business⁴⁹, with over 100,000 employees⁵⁰. By 2008, EPZs contributed 20 percent of the employment in the country's formal sector and approximately 85 percent of employment in the industrial sector. It contributed 5.4 percent of GDP (doubling in value between 2006 and 2008) at a time when the manufacturing sector outside of the free zones was in decline. Its current contribution to GDP is estimated to be between 3 percent and 4 percent. From 1990 to 1993, 100 new companies were established as EPZs, creating more than 17,500 jobs and generating more than US\$ 113 million in foreign investments. Figure 1 shows the employment trends in Madagascar's EPZs from 2001 to 2012.

156. **These growth trends, however, were disrupted by various external and internal shocks,** including the final phase-out of the Multi-Fibre Arrangements in 2005, the financial crisis of 2008, and the US's cancellation of Madagascar's eligibility for AGOA benefits in January 2010. EPZs were also severely impacted by the political crises of 2002 and 2009, which caused the suspension of activities of most of the textile and apparel EPZs selling to the US market⁵¹, as well as a marked slowdown in the activities of the remaining EPZs. EPZ employment fell by approximately 50 percent in 2002, and around

⁴⁸ Madagascar has a relatively competitive labor cost in the garment industry (US\$0.40 /hour)

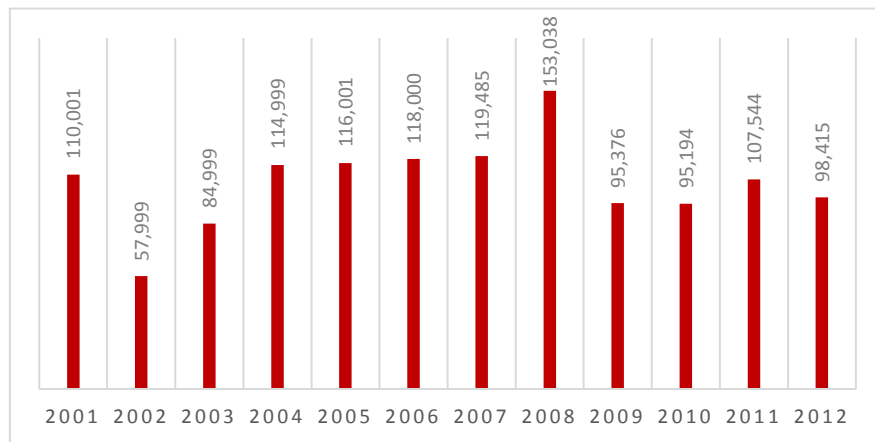
⁴⁹ In 2004, the rate of job creation in the free zone companies was almost four times higher than in Antananarivo's non-EPZ labor market. Of these 180 free zone firms, 124 were textile companies, 12 were in agro-processing, and 12 were specialized in information technology.

⁵⁰ Groupement des Entreprises Franches et Partenaires (the Zone Franche Association), <http://www.gefp.com/>

⁵¹ It is estimated that around 100 firms ceased operations in 2009.

60,000 jobs are estimated to have been lost in 2009 according to INSTAT data (with other estimates putting the loss closer to 35,000 jobs), once again wiping out the huge progress made in previous years. It also dramatically affected long term investor confidence.⁵²

Figure 2: Employment in Madagascar's EPZs



Source: INSTAT (2013 survey)

157. **Some legal developments have proven fruitful in continuing to spur growth in the EPZ sector,** namely the new 2007 Investment Law, providing investment guarantees, shoring up respect of private property, guaranteeing freedom of foreign exchange transfers, launching a One-Stop Shop to facilitate business license

and permit acquisitions, and establishing the right of foreign companies to acquire land, among others provisions. At the same time, reforms and simplifications in the common law (*droit commun*) have reduced the difference between the two systems and reduced the need to maintain a special EPZ regime.

Current Status

158. **Over time, the number of EPZs has fluctuated, and since 2011, the sectoral composition of EPZs has shifted away from the textile and apparel industry.** The number of EPZ companies decreased from 186 in 2004 to 175 in 2008 and then plummeted to only 79 operating EPZs by 2010. Since 2011, when EPZ growth resumed, the number of enterprises has again increased to 134.⁵³ The composition of firms operating as EPZs has shifted as well, as 64 percent of the EPZs were engaged in the textile and apparel industry prior to the 2009 crisis, compared to 55 percent today (the agribusiness zones account for 12 percent and ICT zones for 9 percent of the total). Since 2011, new EPZ approvals have been highest in the apparel, ICT-related, and chemical sectors.

159. **On the other hand, there have been concerns that EPZs have failed to contribute to poverty reduction in Madagascar,** prompting the question of how EPZs might play a stronger role re-igniting economic growth and job creation. A 2013 INSTAT survey⁵⁴ shows poverty intensified between 2008 and 2012 for employees in EPZs (in the garment industry), in line with overall poverty trends in Madagascar.

⁵² On June 26, 2014, the US reinstated Madagascar to AGOA, following “the nation’s return to democratic rule.” However, Madagascar is not yet [as of March, 2015] entitled to the apparel provision, arguably the central aspect to AGOA’s trade benefits. Madagascar’s membership to the Southern African Development Community (SADC) was also reinstated on 30 January 2014 after an imposed suspension following the political crisis of 2009.

⁵³ These data differ from data provided by INSTAT (2013), which present a constant fall in the number of companies after 2007 but also report 133 remaining companies in 2012.

⁵⁴ Enquête socioéconomique sur les employés des entreprises franches de confection, INSTAT, Octobre 2013

Similarly, the labor force surveys conducted by ODRES in 2009, 2010 and 2011⁵⁵ also showed that average wages in the free zones had decreased to levels lower than in the formal industrial sector, other things being equal. However, jobs created in EPZs have generated income to those employed directly, likely at higher levels than workers would have earned from alternative income sources. The same surveys did find, however, that labor standards remained higher in EPZs than in other companies. The IMF reports that the ration of revenue tax to turnover is only around 1.7 percent, compared to 7.7 percent for companies operating under common law.⁵⁶

160. Foreign investment through the EPZs represented important foreign exchange flows which supported the country's balance of payments. Before the 2009 crisis, nearly 80 percent of foreign investment in Madagascar was brought in through the free zone scheme, mostly from Europe and Mauritius. It is estimated that by 2006 the cumulative investments brought into Madagascar (since 1990) by EPZ firms had reached approximately US\$ 430 million, compared to an annual FDI flow of just US\$ 20 million before 2000. Based on GEFP estimates, the investment in EPZs during the last 5 years has been around US\$ 110 million, broadly at its historical levels in terms of value (if not in terms of number of firms and projects). As investments increased in other sectors, it now represents just 30 percent of overall FDI into Madagascar.

161. Contrary to their respectably modest contribution to Madagascar's GDP, the contribution of EPZs in terms of exports is significant. EPZs accounted for most of the boom in Madagascar's goods exports from 1995 to 2006. At their peak in 2008, exports from EPZs reached US\$ 881 million⁵⁷. This marked a drastic shift in composition of exports, given that in 1990, Madagascar exported almost exclusively agricultural products (mainly coffee, vanilla, cloves and shrimps). Today, free zone exports are both lower in the absolute and as a share of the country's growing overall exports, accounting for about a third of total exports.

162. Exports of the biggest sector, apparel, were particularly affected by the 2009 crisis, but the sector adapted to difficult circumstances. Apparel exports had initially been oriented towards the EU while sales to the American market, which were marginal until 2000 when the African Growth and Opportunities Act (AGOA) was approved, drove growth for the next few years (especially from 2003 onward). Following the 2009 crisis and suspension of AGOA preferences, exports of apparel to the US fell by 74 percent and somewhat less to the EU.⁵⁸ Subsequently, however, some of the losses were mitigated by renewed exports to the traditional French and EU markets which now exceed their pre-crisis level, and notably to South Africa as exporters benefit from SADC preferences (see Figure 3). There are also timid signs of recovery as apparel exports to the US in the first quarter of 2015 were US\$6.8 million, 70 percent higher than in the first quarter of 2014.

163. EPZ firms in Madagascar rely heavily on imported inputs as they compete in global markets and need access to high-quality and low-cost intermediate inputs. Imports account for 75 percent of EPZ supply vs. 50 percent for non EPZ companies. This reliance on imports for EPZ production results in

⁵⁵ Enquêtes 2009, 2010 & 2011, ODRES, Institute of Developing Economies (IDE, Tokyo, Japan)

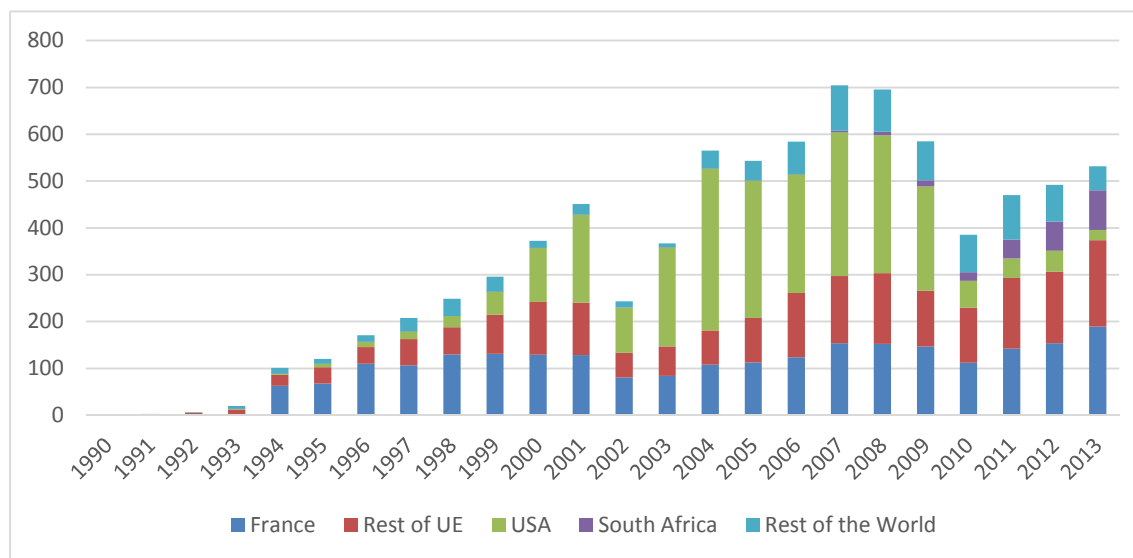
⁵⁶ See IMF (2015), "Diagnostic de la politique fiscale de Madagascar", Département des finances publiques, February.

⁵⁷ Including US\$617 million from the textile and apparel sector alone, accounting for 70% of exports from EPZs and 53% of total exports from the country – a very high share by global Special Economic Zone (SEZ) averages of 25% or so.

⁵⁸ UN COMTRADE

low integration of EPZs in the national economy (and is partially explained by the tax environment which discourages local sourcing – see below) and explains their marginal impact in the creation of economic value-added. Yet, despite the program’s strong dependence on imports, EPZs net contribution to foreign trade is positive.

Figure 3: Direction of Madagascar's clothing exports (in million USD)



Source: COMTRADE

Challenges to Madagascar's Free Zone Program persist

164. **A number of issues with Madagascar's free zones program emerge from the assessment of its past performance and the current situation.** Three main issues have been identified: (i) poor operational competitiveness, (ii) weak integration and linkages with the domestic economy, and (iii) reliance on trade agreements and low sector diversification. The issues are described below, along with possible solutions.

165. **First, poor operational competitiveness undermines the success of the EPZ system.** In particular, high operating costs (particularly electricity), administrative and procedural issues, and labor market constraints affect the EPZs. At the same time it should be noted that possible practices of profit maximization could influence officially reported profitability, as many companies form part of larger international multinationals. The fact that for a large sample of companies declared export values to customs exceeded turnover report to the domestic tax authorities, raises questions.

166. **High operating costs and unreliable power supply make it difficult to do business⁵⁹ in Madagascar and impede economic development.** Factor costs in Madagascar are expensive compared to other countries which compete for the same markets. Most importantly, access to electricity is unreliable, and prices are expensive (0.19 USD/Watt, compared to 0.05 USD/Watt in Mauritius and Sri

⁵⁹ In fact, the literature suggests investors are more concerned with the quality of the infrastructure and the overall investment climate than fiscal incentives. Tax holidays and incentives seem to capture footloose, quota-seeking investment in low value-added sectors instead of more diversified investment. They actually work against attracting more productive investment, job creation, economic growth and transformation objectives.

Lanka) although a more detailed analysis of these factor costs would have to be undertaken. Other factor costs that come into play in Madagascar's competitiveness, compared to Mauritius and Sri Lanka, include water (0.33 USD/m³ vs. 0.29 USD/m³ in Mauritius and 0.36 USD/m³ in Sri Lanka) and rent (5.90 USD/m² vs. 2.5 USD/m² in Mauritius).

167. **Providing access to a stable power grid could be promoted by moving towards an SEZ model,** in an effort to concentrate limited resources in a defined geographical area. Allowing third party access to IPPs and Power Purchase Agreements (PPA) in such zones and its adjacent area could lead to reduced hard and soft costs, better infrastructure and a more conducive business climate. Currently, the electricity sector is dominated by JIRAMA, the state-owned utility responsible for the majority of the generation, transmission and distribution. Currently, Independent Power Production (IPP) arrangements allow private companies to supply power to JIRAMA and feed into the national grid, but private power plants cannot sell electricity directly to another (EPZ-) enterprise. This reduces incentives to invest in private electricity generation which could reduce shortages.

168. **Operating costs and overall competitiveness is also affected by other factors as outlined elsewhere in the DTIS.** Until 2009 EPZ firms had the highest productivity within the manufacturing industry in Madagascar. They were 1.7 times more productive than non-EPZ firms, with an average labor productivity of US\$4,955 (Shah et al. 2005). Subsequent studies show that labor productivity has remained competitive, but that other factors seem to affect the overall competitiveness of enterprises. For example, Fukunishi and Aimé Ramiarison⁶⁰ demonstrate that Madagascar's exporters, regardless of market orientation, are no less productive than successful Bangladeshi firms and that Madagascar's average wage is as low as Cambodia's and lower than Kenya's. This indicates that the drastic reduction in exports after the suspension of AGOA may be caused by factors other than labor cost as outlined elsewhere in the report.⁶¹ These can be overcome, however as increases in exports to the EU and South Africa show.

169. **Second, EPZs suffer from procedural issues and a lack of regulatory clarity that lead to problems with the way inputs are treated and to a system vulnerable to abuse.** These include issues with the one-stop shop hosted by EDBM, spatial development and land procedures, discretionary regulatory practices, and monitoring and control.

170. **The One-Stop Shop only administers business registration and compliance procedures from a single location, as opposed to actually streamlining and harmonizing the underlying business processes.** Currently, there are limitations on expedited permit processing and deemed approvals for bodies other than the EDBM. Representatives from the land office and for tourism from the EDBM have also moved back to their respective Ministries. This is particularly problematic because companies continue to face challenges when acquiring land and obtaining construction licenses as EDBM permissions are needed, a freehold for foreigners is missing, and caps on the permitted duration of

⁶⁰ First draft of paper prepared for Fukunishi and Yamagata eds., "Garment for Development: Dynamism of Garment Industry in Low-income Countries", chapter 7 "Madagascar: Unyielding Growth amid Political Turmoil"

⁶¹ Such factors could include time or costs for the delivery of goods, or inputs, or overall credibility as a supplier. It also suggests that there is potential for renewed exports to the US following inclusion in AGOA (and the likely extension by another 10 years), although it is too early to assess this probability in greater detail.

leases are in place. This issue constitutes an important bottleneck⁶² in the business development process. Reviewing the limitations on the acquisition of land by foreign-owned or managed companies and adopting simple, clear and efficient planning and physical development control rules in line with best practice SEZ regimes would be important to address this issue. Decision making powers also need to remain concentrated at EDBM.⁶³

171. Day-to-day monitoring and control of the free zone regime is inadequate, begging important questions such as who will issue the free zone regulations, and which agency will regulate free zone developers, operators and users. The mechanism of duty-free imports into EPZs is said to lead to significant leakage of goods into the domestic economy, generating distortions and benefitting well-connected importers, and there are also reports of companies claiming EPZ benefits without actually qualifying. Actual controls and harassment in free zones are said to be significant but do not seem to be particularly effective. The quality and effectiveness of such controls (by customs and tax authorities) needs to be improved but should at the same time be kept to a minimum (within rational business expectations) in line with international best practices. Less but better targeted and more transparent controls would reduce current abuses resulting from high discretionary powers and administrative challenges while reducing transaction costs for compliant operators. A single, authoritative government SEZ Regulator or Board is needed to oversee the regime's implementation, monitor compliance and administer sanctions when necessary.

172. Third, while labor costs remain low, skilled workers are lacking. Labor is one of the most important factors companies consider when making investment decisions, particularly for firms seeking low-cost production platforms for labor-intensive industries. The lack of skilled workers represents a severe obstacle for further expansion resulting in a slower adoption of new production technologies and negatively affecting productivity improvements. Yet, EPZ firms in Madagascar are unwilling to invest more in training as this often encourages workers to move to other firms before the original firm can capitalize on its training investment. Government and EPZs should partner to identify skills development needs, create programs to address the gaps⁶⁴, and find sustainable funding sources.

Weak integration and linkages to domestic economy

173. Achieving linkages between EPZs and the domestic economy has been a major challenge in Madagascar, particularly for those investments in low-skill, labor-intensive sectors such as textiles and apparel. The structure of trade preferences in these sectors often works against sourcing from the local market, given the duty exemptions on imports that exist for EPZs.⁶⁵ This has implications on the potential to contribute dynamic benefits to the economy, particularly in terms of facilitating industrial upgrading through knowledge and technology spill-overs from FDI.

⁶² Madagascar ranks 177th on the World Bank Doing Business in 2015 Report's "Dealing with Construction Licenses" and 153rd on its "Registering Property" Indices (i.e., in the lowest global quintile on both).

⁶³ However, the use of the OSS should not be mandatory if investors prefer to deal with the various concerned administrative departments directly.

⁶⁴ Such interventions should focus on those skill sets that are particularly portable (such as management or general skills), where the risk of competitors luring trained employees is highest, and where the private sector is therefore likely to under-invest.

⁶⁵ Annually, lists with eligible products are defined in what can be considered a very discretionary process open to abuse. Large imports are said to enter as inputs for EPZ companies but end up for sale on the domestic market, evading the payment of any import duties and VAT.

174. **The current rules and regulations generate a bias against backward linkages as** current rules do not encourage local sourcing, which is indirectly disadvantaged. Imports can enter EPZs free of duty and VAT, but the same provisions do not apply to the use of domestically produced inputs, representing policy and administrative barriers to local market integration. This particularly affects natural resources-based sectors where Madagascar has a comparative advantages and is therefore particularly harmful. Backward linkages would naturally be stronger in areas of economic activity where there is a well-developed local supply chain, market and skill set. Reducing such barriers to backward integration would place the country in a better position to absorb spill-over from FDI generated by EPZs as links to domestic supply chains would result in greater overall job creation, primarily through indirect employment, as well as greater fiscal revenue opportunities. To address this issue, all categories of inputs and goods required by free zone trading companies should enter free zones duty-, bond- and tax-free. Special EPZ customs procedures should be applicable in this regard. Sales from domestic firms to free zone companies should be considered “constructive” exports.

175. **Some linkages to the domestic economy do exist is in some of the agriculture and natural resources sectors, demonstrating the potential they could hold.** A good example is Lecofruit, a firm that produces extra-fine green beans for the European market, and contracts with 10,000 farmers to produce the crops. The company provides seeds and small quantities of fertilizer to farmers, many of which have since have started to use compost on all of their plots, not just those under contract, leading to higher productivity and demonstrating how contract farming can have a positive impact on production technologies used.⁶⁶ Another example is Bionexx, a company specialized in the extraction and purification of artemisinin, an active ingredient used in Malaria medication, and obtained from *artemisia annua*, which is grown in Madagascar within a fully integrated value chain, from seed to pure artemisinin crystal.

176. **Forward linkages are also affected by the current policy environment as export requirements restrict local sales.** Madagascar’s free zone companies cannot sell more than 5 percent of their production into the Malagasy domestic market, potentially incentivizing investors to set up shop in neighboring countries in order to sell to Madagascar and export goods elsewhere. Madagascar is thus depriving itself of needed investment, jobs, and even exports, from companies with lower export volumes than 95 percent. However, sales to the local market under the current system do not have to pay import duties, contrary to international best practice.

177. **The minimum export requirement of 95 percent and the obligation to domicile EPZs’ export revenues under this free zone regime is not WTO compliant.** It should be replaced by a stipulation that any sales to the Domestic Customs Territory shall be subject to ordinary duties and taxes. While most companies in EPZs are producing for export markets and changes in legislation are unlikely to directly affect forward integration, allowing free zone companies to sell into the domestic economy would

⁶⁶ See Minten, B. with Méral, P., Randrianarison, L., and Swinnen, J. (2010) “Trade Liberalization, rural poverty and the environment: two studies of agricultural exports in Madagascar”: in: Cook, J (et al.) “Vulnerable Places, Vulnerable People – Trade Liberalization, Rural Poverty and the Environment”, World Bank, WWF, and Edgar Elgar. Washington.

permit some producers to also cater to the domestic market. Removing the explicit export requirement would also bring the free zone regime more in line with existing WTO obligations.⁶⁷

178. **Gradually moving towards a more geographically based SEZ-type model would positively affect both forward and backward linkages**, and enable the provision of critical infrastructure-related incentives such as reliable electricity, water and broadband. It would also facilitate the emergence of specialized providers to service such locations. The move to a SEZ-type model would also allow to gradually bring the fiscal incentives in line with the common law regime, as repeatedly advised by the IMF.

Reliance on trade agreements and low sector diversification

179. **Historically, Madagascar's EPZ success in the textile and apparel sector mainly relied on its trade and economic partnership agreements with the US and EU markets.** In addition to leveraging opportunities in its traditional markets, such as the US AGOA market for textiles and garments, and the Economic Partnership Agreement with Europe, Madagascar must simultaneously diversify away from over-reliance on them, so as to better insulate itself against volatility. In this respect, it should target the COMESA and SADC markets, especially for its agricultural output.

180. **Due to the reliance on trade agreements, the program has traditionally been overly focused on the low value-added sectors of garments and textiles.** Eligibility for EPZ status is restricted to three broad sectors⁶⁸ but a more flexible arrangement would allow firms to engage in multiple lines of economic activity and providing prospects for diversification into more sustainable, higher-wage, higher-skill, and more economic value-additive areas. For example, Malagasy companies already exploit opportunities in services industries (data processing, call centers, software development, web design and data entry). These trends should be capitalized upon (wages in Madagascar's ICT sector are higher than in the other EPZ sectors, but remain competitive), as should opportunities for free zone activity in sectors generating more economic value-added through better integration of enterprises in the local supply chain, such as the agricultural sector. To this end, Madagascar's Free Zone Regime should keep the shortest possible list of areas not open to investment (a "negative list"), with all other areas explicitly authorized.

Other Export Promotion Agencies and Activities

181. The International Trade Board of Madagascar (ITBM) was set up in 2010, became operational in 2013, and describes itself as the only export promotion agency in Madagascar set up by the private sector. ITBM follows in the footsteps of the AFD-supported Centre de Ressources pour le Commerce International (Resource Centre for International Trade). ITBM also serves as platform that allow exporters to find the market information, ITBM provides training and guidance on documentary requirements, procedures, and market linkages, and offers a regular exchange of information to

⁶⁷ Subsidies and tax incentives granted under the EPZ regime would likely be interpreted as a direct export subsidy contingent on export performance in the case of Madagascar as a result of the export requirement for EPZ companies; and therefore would be in principle not WTO conform. While Madagascar as an LDC is exempt from the disciplines of the Agreement on Subsidies and Countervailing Measures at the WTO, this issue will become relevant once growth resumes. See Creskoff, S., and Walkenhorst, P., 2009 "Implications of WTO Disciplines for Special Economic Zones in Developing Countries", World Bank Policy Research Working Papers no. 4892.

⁶⁸ Industrial Processing Industries, Service Providing Enterprises and Basic Intensive Production Enterprises.

registered exporters and non-exporters, including through the newly established Club of Exporters. At times, stakeholders raised concerns regarding the capacity of ITBM to fulfilling its mandate, largely due to limited resources that do not permit ITBM to respond to all requests. Some companies further raised concerns that some information on ITBM's website remains out-of-date and that response times to queries can be lengthy at times. As procedures and requirements can change quickly in Madagascar, it is even challenging for ITBM to remain up-to date with them and ITBM therefore at times advises exporters to contact official sources. While this is a reasonable approach given limited resources, it effectively limits the role that ITBM can play in promoting exports beyond functioning as an intermediary between government and the private sector, and results in delayed responses to private operators as ITBM has to obtain specific responses from line Ministries first itself. As outlined throughout this report, this challenge stresses the more fundamental need for government to simplify and publish clearer guidelines for importers and exporters, as clear and predictable rules and procedures set by government agencies are a critical condition for ITBM to play a truly facilitating role to exporters. Setting up a Trade Portal that would contain all relevant procedures and regulations and be always up-to date and become a legally binding repository of all relevant regulations would therefore be important for more effective export promotion activities. The Chambers of Commerce present throughout Madagascar also play a role in export promotion and some companies reported they worked with the Chambers to obtain assistance. ITBM has been supporting the chambers of commerce but further improved coordination between ITBM and the Chambers of Commerce could help to maximize the impact of limited resources available for export promotion activities.

182. **The government of Madagascar is also currently developing a National Export Strategy with funding from the African Development Bank.** ITBM is supporting this exercise which, according to initial information, focuses on supporting a number of specific value chains, but currently does not seem to address the key cross-cutting constraints that are outlined in this study and that affect all sectors of the economy, including sectors functioning as inputs in to export sectors. Complementing the sector specific export strategy with key policy and regulatory changes will be essential if that national Export Strategy is to achieve its objectives of fostering export growth as cross-cutting constraints remain important. As outlined earlier, developing an overall competitiveness strategy for Madagascar would be an important way of supporting increased competitiveness and broad economic transformation rather than a focus on specific export sectors, and would allow the Ministry of Commerce to effectively lead the trade agenda. It would also ensure the large number of other Ministries and Agencies involved can see their contribution to this overarching objective, facilitating coordination as outlined in Chapter 2.

183. **While not a specific export promotion agency, the Economic Development Board of Madagascar (EDBM) has played a critical role in improving the business environment.** EDBM's mandate covers investment facilitation and promotion, and in this context EDBM also hosts the one-stop shop to facilitate the registration of businesses, obtaining work permits, residence cards, and the completion of other administrative processes. The one-stop shop had been set up prior to EDBM's establishment with the aim to make the business climate conducive to private sector development. However, EDBM as host effectively only functions as a front window for these processes, while decision making powers remain at line Ministries (at times with the Minister him/herself). Approvals (and signatures) therefore need to be obtained from those Ministries, instead of being granted

instantaneously following review. In addition, as outlined in the review of the 2003 Action Matrix, some elements of the one-stop shop at EDBM such as those of the land office and for tourism have moved back to their respective Ministries, reverting some of the progress made and contradicting former commitments. Given the importance of land access issues for investment generally, this is troubling and demonstrates the continued inconsistency in policy decisions and their implementation in Madagascar. Instead, what would be needed was a delegation of powers to take decisions and sign documents from line Ministries to agents working at the One-Stop-Shop at EDBM.

184. **The government is also putting in place a Guichet Unique à L'Exportation (GUE) that is meant to streamlining the issuance of all export related documentation.** The objective of this additional one-stop shop is (i) to allow a single window of reliable and updated information on all export procedures for exporters, (ii) to establish a physical place where exporters will undertake all the administrative process to avoid delays, lowering transaction cost; (iii) to establish an effective coordination system among different ministries and concerned entities. The private sector has been calling for the establishment of GUE for several years but so far, the GUE has not been put into place as agreement where to house the GUE could not be reached initially. However, it has now been decided that the Ministry of Trade will be in charge of establishing the GUE. While the GUE was to be one of the new government's achievements with 100 days of power, the complexity of the task ahead will make it difficult to achieve this. The GUE for now foresees the bundling of those services involved in issuing documentation needed for exports and putting them online to increase transparency. To have a meaningful impact on reducing the time to export, however, the GUE will have to generate pressure on all involved government agencies to deliver documentation faster, with less informal payments. This means that decision making power would have to be concentrated in the GUE (or directly linked to the electronic system) and that approval times should be made public. While increasing transparency for export procedures, similar work should be undertaken to also cover import procedures as well as any other regulatory requirements affecting imports and exports, for example by establishing a trade portal that would become a legally binding repository of all relevant regulations.

The importance of intermediate services inputs for export competitiveness

185. **Productivity in services plays a critical role as a strategic driver of economic competitiveness.** Services are traded directly, but they are also a critical and large input into the production of other goods and services. A recent study found that in the EU, services embodied in manufacturing and primary sector exports accounted for more than a third of their sales value.⁶⁹ This means that services are not only an important sector in themselves, as the chapter on tourism and the role of services exports in Export Processing Zones show, but they are also a critical contributing element to competitiveness in the manufacturing sector. This study has argued that access to intermediate inputs is important for the overall competitiveness of the Malagasy economy, and that trade facilitation also for imports has to play an important element in the strategy to diversify exports and broaden the export

⁶⁹ See Cernat, L., and Kutlina-Dimitrova, Z. (2014), "Thinking in a box: A 'mode 5' approach to services trade", Chief Economist Note Issue 1, March 2014, DG Trade, European Commission.

base. This section argues that access to intermediate services inputs, whether locally available or imported, also critically determines (export) competitiveness in Madagascar.

186. The use of services inputs tends to be positively correlated with increased productivity in the enterprises using such services. Where companies do not have access to relevant services, it undermines their productivity.⁷⁰ Recognizing this challenge, the five countries in the Indian Ocean Region participating in APEI⁷¹ also aim to facilitate the movement of professionals among them by revising and aligning regulations related to business visas and work permits. Madagascar could consider joining this initiative.

187. Data on the total value added of services (exports) for Madagascar indicate that services represent important inputs into other areas of the economy, including for exports. Services make up 33 percent of the domestic economy, but more than forty percent of these services are used as inputs into primary production, manufacturing, and other services. The share of services in total exports is only 25 percent, significantly less than in many other Sub-Saharan countries of similar income levels. However, the share of services that end up being exported indirectly (as inputs into other exports) is larger than the general share of services inputs in the domestic economy. This shows that services are particularly important as inputs to the export sector as they contribute to export success and provides an indication how limited competitiveness in the service sector could affect overall exports. A recent study indicates that financial services and other business services (such as personal, cultural, and recreational services) play a particularly important role in supporting other exports from Madagascar, but overall services contribute less to total value added exports than in comparator countries, especially when netting out transport services which account for nearly 30 percent of the total services value added exports in Madagascar.⁷²

188. This demonstrates that services are omnipresent and access at the right price/quality can decide whether a (manufacturing) product can successfully be exported. However, often services are not immediately recognized as such by policy makers and the public. Access to competitively priced utilities (e.g. ICT, transport and logistics services, water distribution services), financial services (e.g. banking, insurance) and other commercial services (e.g. testing, conformity assessment,⁷³ accounting, engineering, consulting, legal, marketing, packaging, printing, etc) are critical but might not be readily available domestically, or are not available at the right quality or price. Getting access to imported services in these instances is essential to compete in global markets and a generally competitive product might not be able to succeed abroad because critical services inputs are not available, or only at too high a cost.

189. New technologies have opened up new opportunities for exports. For example, the use of ICT infrastructure has permitted medical services to be exported from India to the US as physicians review and analyze X-rays in real time. Similarly, workers in Vietnam are reviewing scanned images of postal

⁷⁰ See for example Arnold, J., Mattoo, A., and Narciso, G. (2008) "Services Inputs and Firm Productivity in Sub-Saharan Africa: Evidence from Firm-Level Data," *Journal of African Economies*, Centre for the Study of African Economies (CSAE), vol. 17(4), pages 578-599; and World Bank (2011) "De-Fragmenting Africa: Deepening Regional Trade Integration in Goods and Services". Washington.

⁷¹ The founding and current members of the APEI are Malawi, Mauritius, Mozambique, Seychelles, and Zambia.

⁷² See Saez, S., McKenna, M., and Hoffman (2015) "Valuing Services Trade in Africa", in Galvan, et al., *Africa Competitiveness Report 2015*, Geneva: World Economic Forum.

⁷³ See also chapter on non-tariff measures and the Quality Infrastructure.

letters in the Netherlands in real time, if automatic sorting machines cannot decipher the address written on the envelope, provide information back into the sorting system which can then identify the letters and sort them correctly. Following improved connectivity with two major fiber optic networks (EASSy and LION), Madagascar now has a rather competitive telecommunications sector which serves as input into the export of other services although there are recent concerns that market concentration for strategic infrastructure might affect competition negatively in the future. Companies that export data processing centers and services for call centers have emerged and there has been significant growth in the IT and BPO industry in Madagascar. In 2005, there were 50 companies, 20 of which were in the EPZ scheme, employing 4,000 people in software development, web design and data entry. Growth has continued since 2008.

190. Imported services can also serve as a transmission channel for the transfer of new technologies. Access to improved management practices, design services, or other technologies can positively affect the value added of manufacturing exports, or generate new opportunities in skill-intensive industries. As overall trade in services increases, the productivity of the services sector also tends to rise, further exerting a positive impact on overall productivity and growth over time.

191. In many Sub-Saharan countries, skills shortages and skill mismatches are frequent, services markets remain underdeveloped, and quality can be poor. Overall, the most severe shortages are in the areas of engineering and accounting, and among middle-level and experienced professionals. Skill mismatches are frequent with the result that many professionals are jobless, although their skills are overall scarce. Generally, professional services are less efficient, more costly and less widely available than in many other comparable countries. Often, the quality of auditing and reporting systems remains poor, and this is also the case in Madagascar, as the case of the recent bankruptcy of a large microfinance organization showed, where auditing reports by accredited auditors indicated no problems.

192. In Madagascar, professional services are generally available and are used by exporters. Data from the World Bank's Knowledge Platform on Professional Services⁷⁴ shows that exporting firms are consistently higher users of professional services than non-exporters, and exporters more frequently use externally provided services.⁷⁵ Users of professional services also show a higher labor productivity than non-users. A recent study also found that proportion of women in management of professional service firms is significantly higher in Madagascar, than in neighboring countries.⁷⁶

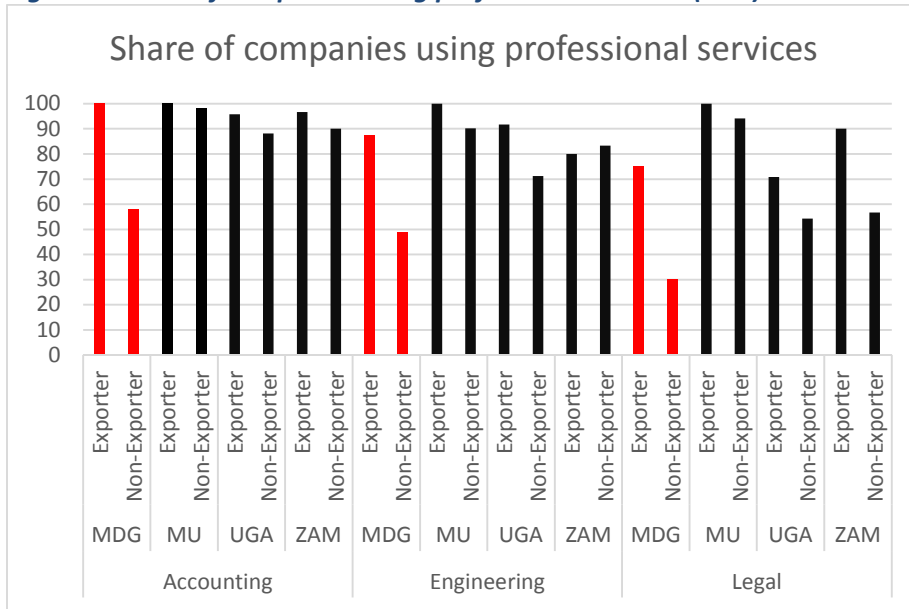
193. The use of services inputs is lower in Madagascar than in comparator countries. While all exporters use accountancy services, only 58 percent of non-users do, less than in comparator countries such as Mauritius, Uganda, or Zambia. Malagasy firms also use less legal services and engineering services than companies interviewed in Mauritius, Uganda, or Zambia (see Figure 4).

⁷⁴ <http://worldbank.fissiondev.com/>

⁷⁵ For example, while 100% of interviewed exporters used accountancy services, only 58% of non-exporters did, despite the fact that non-exporters seem to have higher statutory obligations to use accountancy services.

⁷⁶ Around 16 per cent of most senior employees are women, and more than 30 per cent of the second most senior employee. While still low, this compares to averages of less than 10 per cent globally. See Coste, A., and Dihel, N. (2010) "Services Trade and Gender", in Brenton, P. et al. (2010) "Women and Trade in Africa: Realizing the Potential", World Bank.

Figure 4: Share of companies using professional services (in %)



Source: data from <http://worldbank.fissiondev.com/>

194. **Service providers have a broad clientele, including government, but only accountancy firms are directly exporting services generating 50 percent of their revenue from exports.** As outline above, other firms likely contribute indirectly to exports, but no detailed data are available. Service providers with domestic and foreign ownership operate in Madagascar. While both types of firms provide services to multinational companies and government entities, domestic service providers more frequently have micro firms or individuals as clients than have foreign companies who more frequently supply services to government entities and larger companies. Less than 5 percent of interviewed firms employed at least one foreigner, though in the accounting sector 13 percent of companies did. This compares to 14 (18) percent of firms in Zambia (Mauritius) employing at least one foreigner, and the time to hire foreign professionals on average took more than two months in Madagascar, twice as long as in Mauritius or 1.5 times longer than in Zambia.

195. **Limited information is available on the regulation of services sectors in Madagascar.** Madagascar has made hardly any services commitments at the WTO.⁷⁷ Similarly, as part of the COMESA services negotiations, Madagascar is currently not planning to make any specific commitments regarding mode 3 for communication, financial, and transport services. Firm commitments in these areas regarding market access and national treatment would be important to increase predictability of the regulatory environment and facilitate entry by new service providers that could increase competition. Applied policies affecting services trade seem to be less restrictive as the World Bank’s Services Trade Restrictiveness Index (STRI) indicates that such policies overall are not very restrictive in Madagascar, especially with regard to commercial presence (mode 3) which faces hardly any restrictions for the

⁷⁷ Only covering mode 3 for a subset of technical testing and analysis services, and preparation and control of basic equipment in three sectors, according to the WTO’s database.

sectors covered in the index.⁷⁸ The lack of formal commitment to these policies, however, potentially negatively affects investment decisions. In addition, restrictions remain relatively high for professional services which are important to the overall economy as outline above.

196. Reducing barriers to trade in services are important but they must be complemented with regulatory reform in key sectors increase the availability of services, their quality, and overall competition. Eliminating explicit trade barriers will only be part of what needs to be addressed as entry- and conduct regulations both affect the degree of competition in services markets. The former include requirements that are linked to national institutions such as having the right diploma, being a member in an association, or continuing education obligations, while the latter includes prices regulations (such as minimum or maximum prices), restrictions on advertising, or the absence of quality control instruments. These affect the competition in the sector and therefore the availability of services, their quality and the price at which they are provided. To improve the efficiency of domestic regulation the review process of domestic regulations will have to follow an open and transparent process, informed by careful analysis and an understanding of good practices. Removing restrictions to competition (directly or indirectly) will be critical to avoid practices that could undermine the reform efforts.

197. Madagascar should also actively participate in the LDC services waiver discussion at the WTO to ensure that emerging sectors of interest will be included in such preferences. During the 8th WTO Ministerial Conference in 2011, trade ministers adopted a waiver, enabling WTO members to provide preferential treatment to services and service suppliers of LDCs by releasing WTO members from their legal obligation to provide non-discriminatory treatment to all trading partners when granting services trade preferences to LDCs. The waiver automatically covers certain market access preferences that WTO members would grant, and also foresees the possibility for the WTO Council for Trade in Services to authorize non-market access measures such as regulatory preferences, preferential national treatment, exemptions for quotas or taxes, or others.⁷⁹ Members of the LDC group to the WTO submitted a “LDC Collective Request” for such preferences in July 2014, and WTO members responded to this request in early February 2015, indicating concrete sectors and modes of supply where they intend to provide preferential treatment.⁸⁰ However, prior to the July 2015 deadline to notify concrete preferential market access to LDC services providers, only Canada and Australia had done so in early June and there is still scope for Madagascar to engage in this discussion to ensure sectors of interest outlined in this chapter will be included in such preferences.

Priority recommendations

198. The government should amend the existing free zone regime to a more modern and integrated SEZ model, and towards the application of international SEZ best practices. This would mean to eliminate restrictions on linkages and domestic participation (including removing the 95 percent export requirement) to promote greater integration with the local economy, simplify

⁷⁸ It should be noted that indicator values are inherently subjective due to the methodology of the STRI and should only be used as a first basis for an analysis that should be complemented with a more detailed regulatory assessment.

⁷⁹ Stephenson, S. and Pfister, A. (2013) The LDC waiver beyond Bali. ICTSD Bridges Africa, Volume 2 - Number 8

⁸⁰ LDC Services Waiver Concerning Preferential Treatment to Services and Service Suppliers of Least Developed Countries (S/C/W/356) (the “LDC Collective Request”); and WTO document, S/C/M/121 covering the response by WTO members. All preferences granted will apply immediately and unconditionally to all services and services providers from LDCs and will be annexed to the waiver (WT/L/847).

procedures further, and address infrastructure bottlenecks in well-defined locations to ensure reliable access to electricity, water, ICT broadband infrastructure, roads, and support services. Clustering companies into proper spatial developments permits infrastructure and public goods to be put in place, allows location-specific improvement of the business climate and governance issues, and would permit the emergence of specialized service and input providers as economies of scale can be exploited more easily. Together with simplified and more transparent procedures and entry conditions, this would reduce transaction costs and entry costs for new operators and reduce distortions between EPZs and other domestic enterprises. Support for the investment into (portable) skills by enterprises could also be provided more easily in such geographically concentrated areas.

199. Because such zones would address key operating constraints affecting enterprises, distortionary tax preferences could be phased out and brought in line with common law provisions.

This would further level the playing field directly and by reducing the scope for granting discretionary benefits, while providing significant value added through an improved business environment that could subsequently be expanded to the whole economy. Mauritius, which has applied lessons from best practices and the global experience with its zones over the past 50 years, could serve as an example for how to implement such an incremental transition. These reforms could contribute to the transition from low-skill, low-wage, labor-intensive sectors, to higher-skill, higher-wage, more knowledge—and capital—intensive ones.

200. The government of Madagascar is already considering moving towards an integrated SEZ model and there is a risk that parallel initiatives will generate more harm than good if not well coordinated.

Three separate ministries have begun working on the development of integrated zones through the “Emergence Madagascar” platform of the Ministry of Economy and Planning’s Economic Recovery Program, an Industrial Strategy⁸¹ through the Ministry of Industry, and the “Document d’orientation stratégique”⁸² of the Ministry of Infrastructure and Regional Planning. At this point, greater coordination between all the relevant public authorities and concerned private stakeholders will be critical to build consensus toward an economically competitive program that would include (i) amending legislation, (ii) allowing the private sector to select the most appropriate SEZ locations for their success,⁸³ (iii) committing to providing uninterrupted and stable utilities and other public services, and (iv) ensuring the programmatic regulation and operational continuity which is essential for investor confidence.

201. Several key issues will be critical to the success of this transition. First, the government must develop a transition strategy for existing EPZ companies, especially on the matter of fiscal incentives and locations. Second, when considering SEZ locations, proximity to major trade gateways and to

⁸¹ « Élaboration d’une politique industrielle et divers appuis à la cellule intelligence économique de l’EDBM », Mireille Ramilisoa Ratoaveloson & Olivier Donat Andriamahefaparany, Ministry of Industry, August 2014

⁸² « Schéma National des orientations sectorielles et transversales à 10 ans (2015- 2025) » and « Document d’orientation en vue d’une politique publique territorialisée: pour un programme plus efficace et stratégique au service du développement du Madagascar », Ministry of Infrastructure and Regional Planning, September 2014

⁸³ Location is a critical factor for performance, as the literature has shown that for example in South Asia zones in less-developed regions have generally underperformed in generating employment and exports in comparison with more easily accessible SEZs that are located near major cities (Aggarwal [2005] “Performance of Export Processing Zones: A Comparative Analysis of India, Sri Lanka, and Bangladesh.” Working Paper 155, Indian Council for Research on International Economic Relations, New Delhi.; and Aggarwal, Hoppe, and Walkenhorst [2009] , “Special Economic Zones and Economic Diversification: Some Evidence from South Asia”).

metropolitan areas has been proven to be of utmost importance and the private sector should play the key role in selecting viable locations. The temptation to use SEZs as instruments of regional development policy should be resisted at all costs. Lessons learned from notable failures (for example the Toamasina industrial area) will help to avoid location mistakes. Having a clear and transparent set of mandatory regulatory criteria by which SEZ location and designation decisions are made will be key for success.

202. Continued support to new and existing exporters and investors will remain critical, but more needs to be done to make institutions such as EDBM and initiatives such as the GUE effective. To improve the effectiveness of EDBM, all relevant agencies need to return and all representatives of these agencies at EDBM need to have sufficient decision making powers to transform the one-stop shop hosted by EDBM into a truly functional single window (rather than a front window). All relevant decisions will have to be taken at EDBM, or where impossible, clear maximum clearance times need to be set, and delays be publicly monitored and published. Similarly, for the GUE to function effectively, it will have to go beyond co-location and all agents present at the GUE should have decision making powers to sign and approve documentation immediately and transaction times for each approval need to be made more transparent to ensure agencies can be held accountable for delays.

203. To ensure availability of key services and grow its professional services sector, regulatory coordination at the regional level will be important. Collaborating with other countries in the region in this regard could be particularly beneficial to reduce barriers to the movement of professionals. Madagascar could for example participate in the Accelerated Program for Economic Integration with Malawi, Mauritius, Mozambique, Seychelles, and Zambia. Improving domestic regulations and strengthening domestic regulators could ensure increased competition and the removal of explicit barriers. A first step in this direction would be a detailed regulatory audit of key services sectors where the government is willing to reform. An open and transparent dialogue during this review between regulators, providers, and users of such services will be essential. Madagascar should also participate in the discussions at the WTO level regarding how to operationalize the LDC services waiver to ensure sectors of interest will be covered.

Chapter 6 - Agriculture and Livestock

Importance and role of the agricultural and livestock sector

204. **Agriculture is an important sector in Madagascar with 82.4 percent of households depending on agriculture for their income in 2005. However, the sector faces significant challenges.** Growth in agricultural value added has not kept up with population increases with the result that households, depending mainly on traditional production systems, have become poorer and food insecurity has increased. A low urbanization rate compared to other countries and an increasing rural population have led to the decline in the average farm size with landholdings typically being divided among children during generational changes. During the past 20 years, the number of farms has increased by 60 percent and the average farm size decreased by 30 percent from 1.2ha in 1985 to 0.86ha in 2005 (World Bank, 2011).

205. **Since independence, agriculture accounts for a steady 25-30 of GDP, but the share of agricultural exports (including fish) to total exports fell from 62 percent to 34 percent between 1995 and 2009 (ITC, 2013).** Overall, agricultural GDP has a strong impact on the overall economy and economic performance can be highly variable from year to year because of the rice sector's vulnerability to climatic factors, a direct contributing factor to political instability. In the absence of reliable statistics, the development of the staple food sector looks grim as productivity has hardly increased over the past 10 years, although the export sector has been performing better in the recent past due to positive developments for prices of traditional export crops.

206. **Crop production methods remain for the most part traditional, with little mechanization and limited use of improved seed, fertilizer, crop chemicals and purchased inputs.** Since independence, government has attempted to increase productivity through large investments in irrigation schemes and improved crop production technologies especially rice. Despite these efforts, agricultural productivity remains low with the World Bank (2011) referring to estimates of a decrease of 20 percent in the last 40 years. The use of fertilizers remains extremely low with only 6 percent of farmers applying fertilizer, among the lowest in the world, and prices for fertilizer high. As with other economic sectors, the land tenure system has contributed to the low speed of transformation, but pending revisions of the land law might remove some of the critical constraints, if done well.

207. **The marketing of all crops with the possible exception of sugar and cotton is dominated by the collector (trader) system.** Main collectors will often depend on a network of sub-collectors and towns with populations of between 5,000 and 10,000 would normally have 2 or 3 collectors, each with a network of sub-collectors based in rural areas provided with cash to accumulate stocks until justifying sending a truck. Because of the seasonality of their work, collectors are often found to be prominent local entrepreneurs (commonly big farmers) with substantial liquidity during harvest time. Due to their close contact with smallholders, they are often also catalysts for better agricultural practices, disseminating new agricultural technologies, providers of extension services, and providers of credit/agricultural inputs such as agro-chemicals and farm equipment, as best evidenced in the recent expansion in the production and export of black eyed beans.

208. A warehouse receipt finance system for rice farmers exists, but producers of other crops frequently sell to the first collector to appear after harvest, affecting long-term growth prospects.

Selling immediately after harvests, often at low prices as supply is abundant, undermining attempts to engage in trader advance or off-taker arrangements whereby improved seeds and other inputs are provided on a credit basis to increase yields. A number of sub-sector platforms have been established, originally starting with litchi and vanilla, and the most recent being maize. Platforms bring together all stakeholders (producer associations, collectors, transporters, processors and exporters) to discuss and confront common problems/issues, including attempting to stabilize prices. It is unclear how effective these are.

209. The agricultural sector is dynamic as large investment has been flowing in through Foreign Direct investment, growth in new cash crops, and the emergence of outgrower schemes, which seem to work particularly well.

Chinese investors have driven the revival of the collapsed sub-sectors of sugar and cotton, and have also entered the vanilla sub-sector (though with a more mixed impact) and livestock processing, although an abattoir used in Antananarivo recently closed due to hygiene reasons. The growth of out-grower arrangements between agri-businesses and smallholder farmers has also contributed to the growth in the agricultural sector (for example for green beans, artemisinin, and barley), and can significantly increase productivity as these arrangements involve advance input credits. The custom of *kilaboly* (smallholder side-selling) is prevalent and is having serious ramifications on such schemes and for improving yields, especially in the cotton industry. Last, independent smallholders in some of the more agriculturally productive regions are also benefiting from new cash export crops such as black eyed beans and groundnuts which have emerged as important new export crops.

210. Although livestock statistics suggest that little has changed over the past decade, significant value chain developments are taking place.

The dairy industry, after the collapse of the giant Tiko dairy company (owned by former President Ravalomanana), is slowly recovering and beef is poised to be exported following big beef processing investments in the South if exporters can meet sanitary requirements of destination markets, as conformity assessment could be undertaken by the Institute Pasteur de Madagascar, the only accredited lab in Madagascar (see above).⁸⁴ Bolstered by the increased production of animal feed, the poultry industry (combining industrial producers and a big increase of small scale breeders) is growing rapidly and export opportunities are on the horizon. Expanded production of animal feed has stimulated smallholder production of maize, complemented by mechanize maize production and the construction of silos – permitting the emergence of value chains.

211. Areas under cultivation continue to increase but productivity per hectare increased only moderately, but decreased for some crops.

The area of rice cultivation increased gradually by 4.6 percent between 2005 and 2010, while production increased by almost 40 percent, suggesting a big increase in productivity. Of all crops, rice production statistics are most reliable (but data on area under cultivation is not available after 2010). Between 2005 and 2010, small increases were generally registered for the areas cultivated (and total production) for most crops, including maize (4.6%; 13.5%), cassava (-13.5%; 1.5%) beans (6%; 5.2%), butter (lima) beans (3.6%; - 10%), sweet potatoes (3.9%; 4.6%), potatoes (4.2%; 5.7%), and groundnuts (1.2%; -1.95%). Although the trends were generally positive,

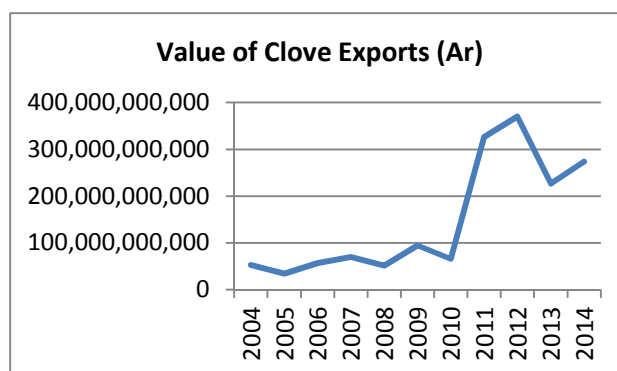
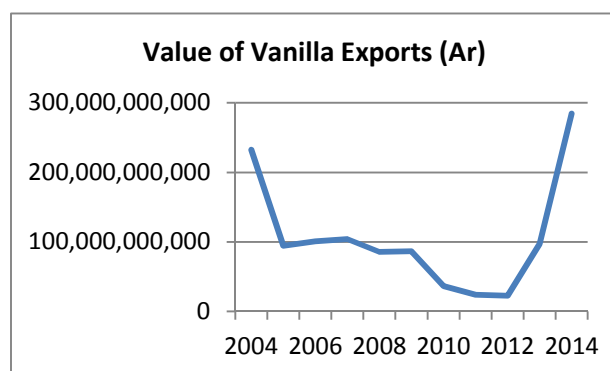
⁸⁴ Including exports to the EU after the embargo of the importation of animal products from Madagascar to the EU has been lifted in 2011.

notable swings in areas cultivated and production were recorded for cassava and maize in large part influenced by the effects of weather, disease and pests. After 2010, the production of rice has increased only slightly (with ups and downs) while the production of maize decreased and fell back below the 2005 production level.

212. Agricultural exports from Madagascar have increased by nearly sixty percent between 2008 and 2013 (see Chapter 2). The share of agricultural exports in total exports has increased from 33 to 39 percent over the same time period. According to data from the ITC (2013), agricultural and marine exports were driven by spices (41%), crustaceans (20%), fish (9%), fruits and vegetables (9%), essential oils (8%), as well as coffee, cocoa, tea and derived products (4%). The main export markets for agricultural and marine products were: European Union (73%) Asia (10%), SADC (1%) and COMESA (1%). Significant price increases in the world spice markets in recent years has resulted in substantial increases in the value of Madagascar’s traditional export crops (vanilla, cloves, pepper).

Key agricultural commodities

213. Madagascar’s Bourbon vanilla is regarded as the highest quality and for many years Madagascar was producing 65-80 percent of the world’s production, but is now falling. The vast majority of Madagascar vanilla is produced in the Sava region. Lesser areas of production include Ambanja and Manakara. Country-wide there are an estimated 80,000 farmers producing on 25,000 ha. Vanilla is a perennial plant providing a minimum of 10 harvests over a 13-15 year period. Following a price spike due to cyclone devastation of the Madagascar crop in 2000 (prices surged to US\$450/kg), production around the world increased. In 2012 Madagascar produced 3,500 tonnes just above quantities produced in Indonesia (3,400), with China producing 1,350. As a result, prices fell to a low of US\$20/kg in 2010, leading to the exit of some producers. Falling global production, continued demand and depletion of stocks in producer countries have pushed prices upwards, now around US\$80/120 kg (making vanilla the second most expensive spice after saffron). Countries like Madagascar have advantages of low labour costs (vanilla is highly labour intensive due to manual pollination) but Madagascar remains vulnerable to climate events. Exports have increased significantly after 2012, largely due to the recovery in price.



214. Cloves are now as important (or more important) than vanilla as far as exports are concerned. Madagascar is the largest exporter of cloves (producing 22,500 tons in 2013), although it is the second largest producer after Indonesia (producing 137,398 tons). In addition to its culinary and cosmetic uses, large amounts are exported for the manufacture of *kreket* clove cigarettes. Cloves are grown by small

about 30,000 small farmers (on 80,000 ha in traditional growing areas on the east coast) for whom it is the main (or only) source of income. The nail (flower buds harvested before flowering) is used as a spice to flavor dishes and sweets, while essential oils are extracted by distillation from nails, crowns and leaves. They are used in the cosmetic and pharmaceutical industries, but also for production of synthetic vanillin.

215. Until about 1976, cocoa production was dominated by plantations but a system of collection substantially increased the role of smallholders. In 2002, 3,000-3,500 tons (or 70 percent of total production) came from smallholders and in 2004/05, organic certification was introduced providing a major boost to the sub-sector which in the past has been affected by highly volatile prices.⁸⁵ Though production has increased incrementally over the past few years from 6,000T to 9,000T, Madagascar remains a small player in the world market but is recognized for its distinctive fruity flavour brought about by its higher level of acidity due to the fermentation process and soil conditions. The Ambanja area is the principal cocoa producing area with some 6,000 producers and about 10 large exporting companies. One big advantage of the Ambanja area is that the cocoa trees have been disease free and strict controls are in place to ensure that disease resistance of imported plants. Exports have increased after 2012 and by 2013 exceeded export values of 2007.

216. Coffee has been an important export commodity for decades following independence, but production is now much lower than at its height in 1992. While production in 1992 was more than 1.1 million 60kg bags, it fell to about a third, recovered to 900 thousand bags, before falling to less than 150 thousand bags in 2001. Production is now around 500,000 bags, driven by price movements and the replacement of coffee plantations with other crops. Madagascar produces mainly robusta coffee of the superior Bourbon variety, exported largely to France. Local consumption accounts for 40 percent, and large food processing companies such as TAF (French company established about 50 years ago) produce vacuum packed ground coffee for national consumption. Attempts to promote Arabica as an export crop have remained limited although some Arabica is also grown and locally processed.

217. Madagascar grows a wide variety of high quality fruit but only litchis grown on the east coast account for a significant amount of exports although potential for other fruit also seems to be large. These fruit are exported fresh from Tamatave port once a year within a narrow window to meet the high Christmas demand. Of the approximately 100,000 tonnes produced by some 80,000 household, only about a fifth are exported, volumes being closely controlled by the *Groupement de Exportateurs de Litchi* (GEL) a cartel of about 40 exporters, keeping the value of exports stable over the past years. However, new countries are emerging as producers (such as Mozambique, for example, who could also supply the very profitable EU Christmas season), threatening the strategy of GEL, which focuses on maintaining high prices rather than increasing productivity and quality in the sector. Litchis are almost exclusively exported to Europe where they account for about 80 percent of the market. Only about 5 percent of litchis are produced on large scale farms, while the rest are produced by smallholders from wild trees providing an average of about 100 kgs per season. Due to sulphur residues, the industry was threatened to be shut out from the European market in the mid-2000s leading to GlobalGAP

⁸⁵ Since a low in 2004 (US\$1,500/t), prices boomed in 2010/11 to US\$3,000-3,500 followed by a sharp decrease in 2011/12 to recover again in 2014 to around US\$3000 where the price currently remains.

certification, restructuring and better controls. Litchi production is vulnerable to cyclones and the reduction in bees due to disease (*varoase*) which has destroyed many beehives (80-90 percent affected in the Houtes Terres and in the East Region) has affected the pollination of the litchi trees which seriously affected litchi production during the 2013/14 season.

218. Pepper, mainly processed as black pepper but also red and green, is an important export commodity produced in the Ambanja area. Prices have increased from around US\$2/kg a decade ago to around US\$9/kg in 2014. On harvesting, smallholders prepare black pepper (picking unripe drupes from the pepper vines, boiling them in drums (futs) and then drying) before selling them to collectors. Various levels of collectors usually handle the pepper from farm gate and eventually to export companies which are likely to put them through another period of drying before shipping. Pepper vines live for about 7 years but only produce during the last 2-3 years. Pepper is grown as a mixed crop in most production areas (typically with cocoa or other forest crop). Vietnam has lately developed pepper as a single crop, achieving very high yields.

Barriers affecting the competitiveness of the agricultural and livestock value chains

219. A number of challenges affect the agricultural and livestock sector, many of which could be addressed through domestic policy reforms. Administrative non-tariff barriers (NTBs) associated with export procedures related to agriculture and livestock as well as administrative impediments linked to domestic economic activities inhibit sector and export growth. At the same time, more entrenched and chronic obstacles affecting the competitiveness of agriculture, including more fundamental policy issues such as land tenure and infrastructure investments. Political instability has led to governance issues which once well established, are unlikely to disappear in the near term. Topographic and geographic features also impact overall competitiveness

220. As outlined earlier in this report, domestic regulations and procedures affecting the exports of agricultural products are adding complexity to an already costly and challenging export process. While certain processes to ensure traceability, quality and hygiene are necessary for exports especially for agricultural and livestock products, they should be implemented in such a manner as to minimize the costs to economic operators. However, this is not the case in Madagascar, and exactly what procedures are in force is frequently not clear. In addition, especially large exporters of tree crops frequently complain about effective export taxes in the form of a redevance forestière of 4 percent FOB.

221. A recent study found that exporters in Madagascar faced more NTBs than exporters in comparable countries. Overall, 53 percent of interviewees (importers and exporters) claimed that they faced an NTB, while 67 percent of those *exporting* claimed to be constrained by an NTB within Madagascar *and in the partner receiving country*, particularly in the agriculture and food sector where 72 percent reported NTBs. Only 33 percent of importers of agricultural and food products were affected by NTBs, less than in other sectors.⁸⁶ However, the relevance and usefulness of the finding that over half the respondents claimed to be constrained by an NTB is questionable as, in effect, *all* exporters would

⁸⁶ See ITC (2013). The ITC sample was drawn from 2,218 enterprises furnished from EDBM from the sample 550 companies selected for phone interview, 393 were conducted comprised of 152 exporters, 148 importers and 93 combined. 210 indicated that they encountered NTB problems of which 158 had face to face interviews (77 exporters, 17 importers and 64 combined). 144 enterprises were involved in the agricultural and food sector of which 104 were exporters and 40 were importers.

be facing some kind of NTBs. A consultant and farmer living in Madagascar for many years commented: *I am surprised that only half of them indicate them as a constraint as any firm has to deal with these factors. It is of course a highly grey area difficult to quantify and only those firms that have established contacts with the various levels of bureaucracies can deal with this effectively.*

222. The same study also demonstrated that about half of the constraining non-tariff measures that exporters of agricultural products face are put in place by national authorities. The most quoted constraints in descending order of importance were: delays in procedures; the frequent changes to the procedures; very high fees and charges; the incoherent and arbitrary way the procedures are applied; informal payments (corruption); the large quantity of documents required; the large number of controls and counters (*guichets*); and information relating to the procedures that are unclear, confusing or not easily available. As argued elsewhere, long delays and high costs affect the competitiveness of enterprises and reduce the income at the farm level (see Chapter 3 and background chapter on NTBs). Most notably, while a large number of ministries and agencies involved in the supposedly faster but still complex MIDAC⁸⁷ Module electronic system, delays to compile documentation and obtaining approvals remain large (and government agencies are not held accountable to speed up processes) and despite the electronic system physical interventions are still required. The large number of documents required is further described in the background chapter on agriculture.

223. Procedures remain complex and lack transparency, even after lengthy investigation with support from government departments in the context of this study, commissioned by the Ministry of Commerce. At the time of writing, obtaining information from the ITBM on procedures was challenging as information about export procedures on the ITBM's website (the only known source of export procedures) remained incomplete and partially out of date.⁸⁸ In addition, procedures are presented with scanned copies of very badly photocopied material at times, making them illegible. For several of the products, the procedures indicated procedures going through a still non-existent 'single window for exports' (GUE) the government is only planning to establish.⁸⁹ Certificates that would be required by various agricultural and livestock related products include:

- **Certificat de contrôle, de conditionnement et d'origine (CCCO) – Ministry of Trade and Consumption:** Information varies whether the CCCO is required for all agricultural plant products as well as processed products (ITBM website, reports from economic operators) or whether the CCCO is only required for vanilla, coffee, and cloves
- **Certificat sanitaire (CS) – Ministry of Agriculture:** foodstuffs derived from vegetable matter mainly to check for presence of pesticides and other contaminants
- **Certificat phytosanitaire (CP) – Ministry of Agriculture:** inspection required for vegetables and vegetable matter mainly to inspect for harmful organisms

⁸⁷ MIDAC is the acronym for ministries, departments and agencies linked the control of exports of which there are at least 14.

⁸⁸ For example, regarding certificates relating to livestock, no mention is made of compulsory proof of payment of livestock levies (FEL) introduced in 2012, or product coverage for the Certificat de contrôle, de conditionnement et d'origine (CCCO) is indicated as compulsory for virtually all unprocessed and processed agricultural products when, in fact, it now only applies to vanilla and coffee and is optional for other products (although economic operators stated that at times it is required for other products as well).

⁸⁹ Where information is made publicly available, it is essential to ensure that such information is always up-to-date to ensure that information made so publicly assessable does not conflict with other official sources.

- **Certificat sanitaire – Ministry of Livestock:** for meat and other animal products, live animals and honey
- **Certificat de consommabilité – Ministry of Public Health:** required for most agricultural and livestock related products for consumption purposes
- **Certificat d’origine – Chamber of Commerce and Industry:** required for most exports even where exporters do not need such a certificate to benefit from preferential market access

224. **Import and export procedures also remain an area of concern for exporters as outlined elsewhere in this report.** Those interviewed for the ITC study particularly complained about informal practices at customs despite significant improvements in terms of customs clearance. In 2014 an online platform linking trade operation with government agencies (MIDAC module) involved in the trade process and customs clearance. In 2011 communication and coordination between customs and terminal port operators improved through the single window system (GASYNET) reducing both the time and cost to export and import. In 2009 the time for exporting and importing was reduced by implementing an electronic data interchange system but issues with the targeting of consignments on imports, a 100 percent scan of export consignments, and congestion at ports remain (see Chapter 3).

225. **Meeting market requirements in export markets, poses another important challenge for Malagasy exporters as the recent ITC study showed.** Following pressure from consumers and retailers, the European regulatory system has, since the mid-2000s, tightened conditions for marketing produce. Various regulations were introduced of which the two most important ones were: i) Regulation (EC) No. 178/2002, implemented in 2005, sets food and feed safety requirements and establishes the responsibility of business operators; and ii) Regulation (EC) No. 854/2004, implemented in 2006, sets obligations in terms of hygiene and requires the application of the HACCP principles (Hazard Analysis Critical Control Point) along the marketing channel.

226. **Although generally seen as having a negative impact on competitiveness, such externally imposed NTBs are applied to all goods marketed in the EU equally.** While meeting such requirements can be challenging, they usually represent consumer preferences (at least to a large degree) and companies have no option but to meet them if they want to export to these markets. However, where products are compliant, proving such compliance can also be challenging as only one laboratory in Madagascar is internationally accredited, meaning that its tests results would be accepted by the authorities of importing industrial countries (mutual regional agreements often allow test results to be recognised by authorities of regional partners). Laboratory capacity is missing and so are incentives for private sector investments as government agencies only accept test results from their own laboratories. If regulatory agencies were to accept test results from accredited laboratories, this would increase incentives for investments into laboratory infrastructure by the private sector as they could serve domestic regulatory authorities (which would get access to reliable test results which are currently missing).

Domestic taxation is cumbersome and lacks transparency

227. **Laws relating to the livestock sector lay out a complex set of regulations (Fonds d’Elevage – FEL) and related fees that, while only partially enforced, generate significant costs to the sector.** Established by law in 2000, decreed in 2006 and enforced in 2012, the Ministry of Livestock introduced a

comprehensive and complex set (running some 450 pages) of regulations relating to the FEL covering a broad range of activities from the movement of day old chicks, to imported animal feed. Only some of the fees are actually enforced but the private sector, unsure about whether dormant fees may be activated, have set aside contingency funds in the event that they will be activated and applied retroactively, affecting cash flows and liquidity.

The case of GlobalGAP certification in Madagascar

An interesting debate on how the application of norms and standards could benefit exporting countries and, ultimately smallholders, has focused on the case study of Madagascar litchi exports.

Subervie and Vagneron (2013) report that in 2006 German and British retailers demanded that the litchis from Madagascar be certified by GlobalGAP⁹⁰ because they faced problems of low quality, high sulphur residues and traceability issues. The pressure for GlobalGAP certification mobilized donors to intervene to help create the necessary conditions. As a result of the efforts focusing on improving the litchi value chain, catalyzed by the importer pressure for GlobalGAP certification,⁹¹ a series of important developments ensued including: the creation of a litchi platform in 2006; the passing of a law relating to the litchi value chain (2006); a Litchi Action Plan; and substantial investments in collection points, sheds and improvements of fumigation and action plans.

Relying on donor support, the *Groupement de Exportateurs de Litchi* (GEL) was more concerned about controlling the marketing of litchis (such as imposing export quotas to maintain prices) than the improvement of the value chain. As a result, as many donors pulled out and prematurely stopped funding for the value chain, operators or the GEL did not fill the gap, leading to a plunge in the number of certified producers from 1200 in 2007/08 to a tenth of that in 2009/10, largely due to the “difficulties of operators to commit thoroughly to market requirements”. However, as Malgache litchis now have a better reputation, exigencies by importers to demonstrate compliance seems to have decreased, indicating that better internal controls lead to less externally imposed controls.

228. **Considerable criticism has emanated from the private sector over the introduction of the *impôt intermittent* which the government introduced to boost revenues.** This tax is meant to operate as a type of VAT for the informal sector applied at the rate of 5 percent on transactions involving formal economic entities paying those which are not registered on line with a Fiscal Identification Number (NIF). The editorial in the April edition of the *Lettre Pays Madagascar* (No 26) produced by the Chamber of Commerce and Industry France Madagascar criticizes the tax because of its unworkability and the fact that, rather than the informal enterprise paying the 5 percent, it will be the formal sector that will be bearing the tax. Additionally, the requirement that all transactions in excess of 200,000Ar (less than

⁹⁰ EureGAP, established in 1997 was renamed GlobalGAP in 200 is one of the most commonly used private agrifood certification labels worldwide an initiative by retailers belonging to the Euro-Retailer Produce Working Group, aware of consumers’ growing concerns regarding product safety, environmental impact and the health, safety and welfare of workers and animals. They then sought to harmonize their own standards and procedures and develop an independent certification system for Good Agricultural Practice (G.A.P.) Harmonized certification was meant to bring savings for producers.

⁹¹ Costs relating to GlobalGAP certification were estimated at between euro 100,000-120,000 for the processing of 500 tonnes of litchis and euro 1,500 only for the certification.

US\$100) must be made through a bank significantly constrains linkages between processors and smallholders (such as informal producers/sellers of maize, limiting the potential for backward linkages.

229. **In order to decentralize revenue collection and public investments for the administrative levels of Regions, Provinces and Communes, a large number of fees and taxes are applied to a wider range of activities.** Referred to as taxes, impôts, frais, redevances, ristournes and prélèvements, these are anchored in law No. 2014-020 relating to fiscal organs for each administrative level which provides details of the different charges applied. Although it is claimed that 2.9bn Ar was collected in 2013 in 17 regions, collection varies considerably from commune to commune and is said to be subject to either **corruption** (both at the level of collection and at level of expenditure) or often very lax application and is blamed for the very poor state of the road network in most areas of Madagascar. Local authorities ranked as one of the worst categories within Transparency International's 2013 corruption barometer for Madagascar.

230. **In particular, ristournes are applied to agricultural, forestry, fish and livestock related products that are being transported outside a commune.** They are intended for *export which is interpreted as* meaning being moved beyond a commune! The rates to be levied on different types of products are to be indicated annually by the Finance Law. Products of this category intended for local sale are subject to a *prélèvement* (discount) which would be determined annually by the Provincial Council. The proceeds from both *ristournes* and *prélèvements* are distributed 50 percent to the commune of origin, 20 percent to the Province and 30 percent to the Region. According to a number of stakeholders, the *ristourne* is commonly said to be 3 percent of the value of the product being transported although they are regulated much more finely by unit through decrees⁹² – but is unclear if these are actually implemented.

231. **While pursuing important objectives of regional financing, the application of this law and its decree seem to be unworkable and should be reviewed.** For example a decree for Region of Vatovavy Fitovinany prohibits transport between the hours 18:00 – 8:00 and sales and purchases outside of purchase centres (*centres d'achat*) are not authorized. This would seem unworkable given that most purchases of these products take place at the farm gate, opening up opportunities for rent seeking by officials as most traders and smallholders will not be able to adhere to such prescriptions. Likewise, the lack of transparency seems to affect international investors involved in agriculture in rural areas as they become easy targets for fiscal abuse and are more likely to go along with fictitious charges than to question and resist them. It is not clear how the application of FEL and the *ristourne* on livestock is applied to avoid double taxation. The recent initiative by the MCC to more strictly regulate collectors and exporters in the agricultural sector would also add additional costs and procedures, would be extremely difficult to implement, and that could invite rent seeking activities. They should therefore be reconsidered and focus be laid on integrating markets first, if even informally, instead of creating additional bureaucratic processes.

⁹² A decree issued by the Ministry of the Interior and Decentralization in 2008 for the Region of Vatovavy Fitovinany provides an exhaustive list of different products and their rates charged by weight or unit (e.g. 25 Ar/kg for paddy, 40 Ar/kg for litchi and 5% of the average sales value of the day per cow with distribution being 60% for the Commune and 40% for the Region.

Other factors affecting the sector

232. **For many, the most serious constraint for large-scale investment in agricultural development are the existing land laws which makes obtaining land titles extremely difficult and very risky.** As a result, very few large scale plantation-types of activities exist, while some outgrower schemes have been successful as they bypass the issue. For example, Socolait would like to produce milk on a large scale to reduce its costs (as had been done by a competitor pre-2009) but has not developed such activities due to the land issue, and foreign direct investment is also constrained. The land law also inhibits the planting of orchards. As a result, most fruit is grown on smallholder plots or in forests (as are litchis which elsewhere are grown in plantations). Land issues are sensitive in Madagascar (the national outcry arising from the Daewoo scandal (given permission to farm large tracts of land) was said to be one of the main factors leading to the 2009 political crisis). Procedures of obtaining land titles are very cumbersome even for local businesses, lengthy and often do not respect the judicial system. Addressing the land issue should be of highest priority.

233. **While corruption has been an issue for a long time, it has significantly increased since 2009 and is now endemic at all levels.** While corruption practiced by public servants who have the capacity to authorize or charge a fee or tax is more obvious, another dimension originates from the economically potentially very disruptive abuse of power by the political elite. According to Transparency International Madagascar placed 133 of 175 in 201 (127/174 in 2013) countries in its International Corruption Perceptions Index. In July 2014 the then Prime Minister Roger Kolo said that corruption cost the country 40 percent of its GDP (compared to a global average of 10 percent estimated by the UN). Most stakeholders expressed concern but it is a reluctantly accepted as the modus operandi which will now be very difficult to reverse. "Informal payments" are used to overcome the multiple obstacles generated by a complex and non-transparent set of regulations that hamper the sector (e.g. transporters are frequently obliged to pay transit police, soldiers and normal police at the very common control checks found along any road in Madagascar).

234. **At the same time, the lack of enforcement of existing regulations (as a result of informal payments) affects companies that are competing with goods imported without the payment of duties and fees, or who do not need domestic regulatory requirements, putting public health at risk.** Although customs procedures now take less time, corruption by customs officials is regularly discussed in the media. There are frequent reports that importers regularly followed the unwritten customs practice of making the importer pay duties to the state on the first container, pay duties to the customs officials for the second container and pay no duties on any other containers in the order. At the same time, the lack of enforcement permits the importation of products that void paying import duties or do not meet domestic regulatory standards as was allegedly the case with the importation of "dairy" products made from palm oil.

235. **Closely linked to corruption, a poor and corrupt judicial system is also considered one of the top constraints to the agricultural and livestock sectors.** An ineffective judiciary was generally linked to the high levels of corruption and land-related issues are the most prone to abuse. According to Transparency International's corruption barometer for 2013 (when Madagascar was first included), respondents cited the judiciary as the more corrupt element of the public sector. The livestock sector is

particularly affected by unsanctioned and large-scale cattle theft in the South of the country which reduces investment and growth of the sector.

236. **These barriers affect the operating environment, compounding already strong internal challenges, as productivity remains low, driven partially by limited use of modern inputs such as seed and fertilizer.** In the milk industry for example, despite the very low labour costs, low productivity has resulted in per/liter costs of fresh milk to exceed those of Europe. Low crop productivity especially in rice remains a challenge. Despite new techniques developed in Madagascar and adopted by some of the major rice producing countries uptake remains very low. Fertilizer use is among the lowest in the world as prices are high (the price ratio of fertilizer to rice is more than twice as high compared to India), access to credit is constrained, and some respondents claim that the quality of chemical products is highly dubious. Very few formal outlets for agro-chemicals, fertilizers or equipment exist and due to their nature (frequently very small) there is unlikely to be effective government control over the quality or toxicity of the products sold (see also Chapter 2 on the national quality infrastructure). At least in areas of fairly intensive livestock breeding, manure is widely used and relatively cheap.

237. **Public extension services are largely absent but private actors are partially filling the gap.** As a result of budget constraints of the central government, extension is provided through locally contracted technicians paid by Communes through the few *Centres de Services Agricoles* (CSAs) that are still operating. Collectors who are often large land owners play an important role in introducing new agricultural products to farmers as agents for agro-chemical and fertilizer suppliers based in Antananarivo. The lack of input finance has been a major obstacle to increasing agricultural productivity.

238. **Despite one of the Africa's most advanced warehouse receipts finance system in Africa, access to finance remains a challenge.** The latest EIU *Microscope* survey of financial inclusion ranks Madagascar as one of the lowest in sub-Saharan Africa. Access to input and investment loans in agriculture remains a major constraint and interest rates for agricultural loans are high (16-36%). The Bank of Africa (BOA) has recently launched a significant initiative agricultural micro loans and the AccèsBanque Madagascar (ABM) is slowly building up its agricultural portfolio with off-taker arrangements in the poultry and dairy industries. Farmers have found it difficult to obtain input loans from off-takers largely due to the prevalence of side selling known as *kilaboly*.

239. **Village-based warehousing *grenier commun villageois* (GCV) have been an important element in increasing access to finance but the system has repeatedly been undermined by government intervention, leading to significant losses for producers storing in anticipation of higher prices.** GCV loans are almost exclusively made against stored rice because of its ease of storage. The system allows farmers to take out loans and to increase incomes by delaying the sale of their produce instead of selling rice when immediate post-harvest prices are low and repaying when prices increase (often more than doubling during the hungry season (*soudure*)). While this system in principle provide access to short-term loans, this type of credit is used more for the payment of household expenditures (including cultural activities) soon after harvest and not for the purchase of agricultural inputs. Although more difficult to store, microfinance institutions, in collaboration with the private sector are contemplating to introduce GCV loans for maize and beans but high price volatility (due to world events and not seasonal ones) has made GCV arrangements with vanilla, coffee and cloves risky. While the GCV has generally allowed to

increase farmer income, they suffered significant losses in 2004 and 2013 when price manipulation and large imports by the government resulted in low internal producer prices.

240. Electricity costs are very high and in terms of obtaining electricity Madagascar ranks the lowest of 189 countries covered by the Doing Business Index. Power cuts are one of the major constraints to industry and the cause of serious protests in Tamatave in December 2014. Lengthy and frequent power cuts affect all economic activity, and is frequently considered as a top constraint to economic development (see other sections of this report). With access limited in economic centers, the situation is even worse in rural areas.

241. Last, high internal and external shipping costs also affect competitiveness of the sector. Freight costs from the ports of Tuléar, Majanga and Tamatave are much higher than from other ports in the region because they are off the main shipping routes and often mean long waits for ships. There are also reports of local transport monopolies at the port of Tuléar.⁹³ Additional wait times for transshipment, and high fees to prepare a shipment, estimated at two and half times the costs in Mauritius, put a strong burden on exporters and reduces producer prices. Limited air cargo options and high prices reduce the scope for the export of high-value commodities by air. And poor road infrastructure and the topography resulting in narrow and windy roads affectively segments the national market and presents challenges to the emergence of national supply chains (see also Chapter 4). Despite competition in the road transport sector, trucks are generally quite small (usually old 3-5 ton Mercedes trucks) due to the nature of roads. The plethora of ox carts also slows transport time considerably.

Priority recommendations

242. To allow growth in the agricultural sector to take off, the government needs to facilitate access to key inputs. Facilitating access to land, while protecting the environment and vulnerable populations will be essential to allow the emergence of larger plantations that could contribute to increased productivity, transfer of technology and agricultural practices, and increase the use of fertilizer and other agricultural inputs (as already observed in the cotton and sugar sectors). Higher and a more broader use of inputs could widen markets for these inputs, increase competition for their provision, and reduce prices, ultimately also contributing to higher use and increased productivity for smaller farms and smallholders. In the meantime, the government could consider to collaborate with the private sector (such as existing networks of collectors) to disseminate agricultural practices and leverage access to agricultural inputs as it is already happening in selected value chains.

243. Second, changes in policies and their application could simplify the business environment particularly for the agricultural sector and also allow informal operators to formalize. The government should review and simplify revenue raising laws relating to the Fonds d'Élevage and local tax issues to ensure these are transparent, can effectively be implemented, and achieve regulatory objectives without creating undue costs for economic operators. Removing 'nuisance charges' and duplicative export control functions should be of particular priority. Ensuring that domestic technical regulations integrate markets and allow wide participation, rather than to bifurcate them into formal and informal

⁹³ See Minten, B. with Méral, P., Randrianarison, L., and Swinnen, J. (2010) "Trade Liberalization, rural poverty and the environment: two studies of agricultural exports in Madagascar": in: Cook, J (et al.) "Vulnerable Places, Vulnerable People – Trade Liberalization, Rural Poverty and the Environment", World Bank, WWF, and Edgar Elgar. Washington.

markets, is of importance as well. Standards should be strict enough to ensure consumer safety without being too strict to exclude large parts of (informal) producers. At the same time, such standards should be effectively implemented rather than bypassed through informal payments as is currently frequently the case. Overall, the transparent and impartial application of existing regulations, and the fight against informal practices, will have to complement regulatory reviews aimed at allowing large participation and supporting informal operators to increasingly meet domestic regulations.

244. **In addition, increasing transparency regarding government market interventions in key staples markets (such as for rice in the past) will be important to ensure producers and buyers can plan ahead.** Setting clear triggers for (price) interventions would allow the government to help ensure food security or certain price levels, while allowing producers and consumers to anticipate such interventions. This would ensure stronger involvement by the private sector in supplying the domestic market, and avoid producers losing out if government imports suddenly depress prices.

245. **Last, increasing transparency regarding domestic regulations, as well as import and export procedures, and the time to obtain relevant approvals is essential.** With work already started, the government should fully implement the Single Window for Exports (GUE), ensuring such a portal remains up-to-date and legally binding. Because of the importance of imported and domestic inputs in final production, such a trade portal should also cover any other regulatory requirements affecting imports and exports. Ensuring that these procedure be accurately followed would be a major step forward, including towards reducing informal practices and payments. However, it will be essential to ensure that the time to obtain approvals be significantly reduced by ensuring agents working on the GUE have directly delegated power to approve submissions, and reviewing and simplifying export procedures following a review of existing procedures for their regulatory effectiveness.

Chapter 7 - Fisheries

246. **Madagascar holds a key position in the South West Indian Ocean fisheries sector.** Madagascar not only possesses an Exclusive Economic Zone (EEZ) of more than one million square kilometers located south of the world’s second most important tuna fishing ground, it is also endowed with an important shelf area, large mangroves and coral reefs, sheltering an extremely rich marine biodiversity. With almost five thousand kilometers of coastline, the island is set to play a major role in managing fisheries at the regional level.

247. **Fisheries are of substantial economic importance to Madagascar.** Officials estimate that approximately 100,000 Malagasy are employed in the fisheries sector,⁹⁴ but this figure underestimates the real number as many rural households were not included in the census and this figures does not include jobs created down- or upstream from the catch sector. In 2012 the fishery sector is estimated to have directly contributed 6 percent of GDP; but its relative importance decreases as the importance of export-oriented agricultural production and the mining sector increases. Fisheries provide the country with an important source of foreign currency; exports earnings in 2013 amounted to US\$170 million.

248. **The fishery sector refers to both catch of wild fish and aquaculture (“fish farming”).** Catch and aquaculture can either be marine or from fresh water, and a large number of actors is involved in production.

249. **Vessels fishing in the Malagasy EEZ can either sail under Malagasy or foreign flags, while aquaculture and inland fisheries can be undertaken by Malagasy interests, foreign interests, or a mixture of both.** Every vessel needs a license to be legally allowed to fish in Malagasy waters. Malagasy vessels fish most exclusively⁹⁵ in the Malagasy EEZ and land their catch in Malagasy ports. Foreign vessels (tuna vessels) also fish outside the Madagascar EEZ and then land their catch in Malagasy ports or other regional ports, in particular Port Victoria, Seychelles. Defining foreign and domestic fishing vessels is not easy as vessels can be flagged in Madagascar, while owned by foreign interests and operating under a Malagasy license (see Table 12). This chapter uses the terms “domestic” and “foreign” in accordance with the flag of the vessel.

Table 12: Possibilities of classifying fishing vessels

	Different possibilities
Flag of the vessel	Malagasy or Foreign
Economic benefits derived from the catch	Malagasy, Foreign, or both
Fishing area of the vessel	Malagasy EEZ only, Foreign EEZ only, international waters, or mix
Is the vessel licensed to fish in the Malagasy EEZ?	Yes or No
Is the catch made in the Malagasy EEZ reported?	Yes or No
Is the catch landed in a Malagasy port?	Yes or No

250. **The actual total volume of the catch occurring in Malagasy waters is not accurately monitored but might exceed 200,000 tons.** Official data estimate a total domestic production (by Malagasy vessels and fishers) of around 100,000 tons in 2013.⁹⁶ A lot of the domestic catch is unreported and possibly

⁹⁴ Enquête cadre national, MRHP

⁹⁵ In the past at least one Madagascan vessel was operating in Gabon waters and ports.

⁹⁶ Apparently, the local administration considers catch by foreign vessels in national waters as national, contrary to international standards and biasing national statistics upward.

illegally caught; Le Manach et al. (2012) estimate that the total domestic catch during the 2000-2008 period was underestimated by at least 40 percent. Beside this Malagasy fishery exists a foreign fishery, primarily targeting tuna. The official data report a catch by foreign fishing vessels of around 7,000 tons a year but other sources suggest this is inaccurate (see below). Estimates by Le Manach et al. (2012) indicate that total catch by foreign vessels could exceed 70,000 tons a year, claiming a significant share could be by Asian long liners operating without licenses. In total, probably more than 200,000 tons a year are fished by both Malagasy and foreign vessels inside of Malagasy waters (Figure 5 displays aggregated statistics excluding the foreign tuna catch and imports).

Figure 5: Estimates of total catch in Malagasy waters

Type of Fishery	Marine Fisheries	Inland Fisheries	Aquaculture (both marine and inland)	
Nationality	Malagasy flagged vessel	Foreign flagged vessel	Malagasy flagged vessel	Malagasy fishers
Official data 2013	62,591 tons	7,262 tons	24,827 tons	9,257 tons
Estimates	>87,627 tons?	>70,000 tons?	>34,757 tons?	9,257 tons

Source: official data from MRHP. Imports of tuna by the cannery taken out of the statistics. Estimates for underreporting based on data from Le Manach et al. (2012), projected to 2013: Estimates in that paper need to be used with caution, but they are the only ones available.

251. **Recently, the total production of fishery products is thought to have been decreasing.** Several factors can explain this trend: it seems that a first collapse in captures occurred in 2006, likely due to changes in climatic conditions, the catch of juvenile fish and crustaceans, and over-exploitation. Then the apparition of the white spot disease affecting shrimps furthered diminished production. Nevertheless, the official data from the MRHP fails to show the decline, partly because they integrate the tuna imports from the cannery in their statistics (see Table 14). Stocks are most likely under pressure, but the lack of accurate data does not allow to verify this with confidence.

252. **Official data classifies different fisheries sectors according to gear and engines used.** As outlined earlier, domestic and foreign operators work together in the sector, and fishers in different sectors focus on specific species in their fishing activities. Table 13 provides an overview. The benefit of this classification is not obvious, particularly because the artisanal fisheries sector is no longer playing an important role in fishing but largely plays an intermediary role.

253. **Industrial fisheries covers large fishing vessels and implies an engine with a power of at least 50 HP.** Domestic industrial fisheries mainly target shrimps and have a strong proportion of by catch fish. Some vessels can process shrimps onboard and therefore sell fully-sized shrimps, with a higher value added. Nevertheless, the industrial fisheries are mostly dominated by international agreements and

conducted by foreign fishing vessels. These foreign fishing vessels largely target tuna and operate under international agreements (for the EU) or through the issuance of fishing licenses by the Ministry of Fisheries. To exploit its fisheries resources, Madagascar has signed fisheries agreements, the most important one with the EU, regulating the amount of fish to be captured by EU vessels, and setting royalty fees for the right to exploit the natural resource.

Table 13: Synthesis of the classification used by official statistics

	<i>Industrial fishery</i>	<i>Traditional fishery</i>	<i>Artisanal Fishery</i>
Gear	Engine > 50 HP, trawlers and long liners.	On foot or pirogue	Engine < 50 HP
Origin	Malagasy & Foreign	Malagasy only	Malagasy only
Species targeted	Shrimps by Malagasy fishers, Tuna by Foreign vessels, important by-catch.	Finfish, shrimps, crabs, Trepangs	Artisanal vessels almost don't fish anymore and serve as intermediaries between traditional fisheries and the market

254. **Traditional fisheries are also called “subsistence fishery” and occur on foot or with a pirogue (dugout canoe).** This sector remains the most important domestic fishery in Madagascar. The size of the sector is difficult to assess but according to data from the MRHP it amounted to around 55,000 tons in 2013 after

volumes decreased from 74,000 tons in 2010. A large share of the catch is sold domestically and the traditional fisheries sector therefore plays an important role in the food security of the local population. Traditional fisheries have recently experienced a major shift since the traditional production is now formally allowed to be sold to licensed collectors which will in turn sell it to conditioning centers, and then export to the European market. Traditional fishers do not obtain licenses as their sales are supposed to be controlled through licenses collectors. Around 85,000 traditional fishers were estimated to be active in 2012, a figure that is likely too low.

255. **Artisanal fisheries can be thought of as intermediate-sized operators working on boats with engines of 50 HP maximum.** Operators in the sector used to have fleets with roughly a dozen of fishers onboard, but the catch by artisanal fisheries has followed a decreasing pattern and most fishers converted their boats as “collectors” and mareyeurs, intermediaries between the traditional fishery and the market.

256. **Collectors and Mareyeurs are critical intermediaries that buy fish from traditional fishers and function as intermediaries to consumer and export markets.** They are licensed to collect fish in a particular area. Frequently they are said to also operate in neighboring districts, making monitoring and enforcement of their licenses challenging.

257. **The Ministry of Fisheries manages the sector and issues licenses that allow exploitation by fishers and other intermediaries.** It issues fishing licenses for the industrial and artisanal sectors, segmenting these licenses into four specific coastal areas, covering the entire Malagasy coast. Ownership of these licenses requires the payment of an annual fee. Catch from traditional fishers are marketed through collectors and mareyeurs who need to be in possession of a collecting license to work. In 2013, 1141 licenses for marine collectors were issued.

Table 14: Evolution of the production (in tons), official data from the MRHP

	2010	2011	2012	2013
Marine production	93,745	98,116	103,184	95,010
Industrial Fishery ⁹⁷	19,636	26,453	31,690	40,654
Traditional Fishery	73,913	64,617	64,309	54,139
Artisanal Fishery	196	167	833	218
Marine Aquaculture	2,000	6,878	6,351	8,937
Inland fisheries (including a marginal rizipisciculture⁹⁸)	33,500	20,890	20,002	25,147
Total production	129,245	119,006	123,186	129,094

258. **Aquaculture and inland fisheries are also important sectors. The Malagasy marine aquaculture production is mainly centered on shrimps.** It experienced a sharp decline due to the disease of the white spot,

reaching a record low of 2,000 tons in 2010 before increasing again to almost 8,000 tons in 2013⁹⁹. This disease is a viral infection whose origin remains uncertain but kills shrimp quickly. The disease can spread over short distances through water but also vertically (from infected mother prawns). It is less clear how it spreads over longer distances but ballast water might play a role, although it seems that Mozambique and Madagascar are hit by different strains of the virus. Information on inland aquaculture and inland fisheries is scarce although these are important sectors accounting for a production of 25,147 tons in 2013.

Production and Trading trends

259. **Between 2010 and 2013, more than 25,000 tons¹⁰⁰ of fishery products were exported on average per year according to official statistics, but these data are also likely to miss exports that have not been reported.** This figure includes both the domestic catch as well as the foreign catch landed in Malagasy ports and re-exported from Madagascar. Nevertheless, the observed difference between the reported landings in Malagasy ports and the reported exports makes it very likely that a substantial part of the exports are not correctly registered.¹⁰¹ For example, reported exports of 8,000 tons from the tuna cannery in Antsiranana (a free zone company) seem very low compared to the 35,000 tons it processes per year.

260. **Reported exports amounted to a total of US\$170 million in 2013.** As noted in Table 15, data include both domestic catch that was exported and foreign catch (predominantly of tuna) that was landed in Madagascar, processed and then exported; according to import data from countries around the World, Madagascar's exports of fish and fish products amounted to US\$210 million in 2013. Export earnings were dominated by shrimp, then tuna and other billfish, crab, octopus, sea cucumber and spiny

⁹⁷ Numbers regarding Industrial Fishery are deceptive. For instance, data for 2013 include 7,262 tons of tuna fished by foreign vessels, 107 tons of tuna fished by Malagasy vessels, 7,673 tons of shrimp and by-catch, and 25,263 tons of tuna imported by the cannery (the latter are excluded from Figure 1). These numbers are highly misleading as catch by foreign vessels (and imports by the cannery) should usually not be included in national production data. Furthermore, according to the fisheries agreement with the EU, EU vessels are allowed to fish 15,000 tons a year, and estimates of illegal and unreported fishing are significant, so 7,262 is clearly an underestimate. Besides industrial fishery, the rest of the official data concerns exclusively Malagasy production.

⁹⁸ A practice where fish farming is combined with rice cultivation.

⁹⁹ Background paper to the 2015 Madagascar Diagnostic Trade Integration Study (DTIS).

¹⁰⁰ Ministère des Ressources Halieutiques et de la Pêche, 2013

¹⁰¹ To get official export documentation, exporters need to provide evidence of the collection license, a copy of the import agreement, sanitary certificates that might include inspections, fees payable for fish caught under agreements, and other documentation.

lobster. The structure of exports has changed significantly over the past years as many exporters learned how to export in the Indian Ocean first, then started to target Asian markets, before managing to export to the European market, which has the more constraining norms. As part of this process, traditional fishers managed to enter the export chain as they sell to licensed collectors which on-sell to conditioning centers where quality is controlled, before products are exported.

261. Malagasy exports are extremely diverse and concern a wide range of species and products.

Prices vary significantly between products but also within products. Export prices vary depending on the destination, the quality (and size) of the product, and the degree of processing. For example, living animals such as crab, are sometimes exported at twice the price of frozen products.

Table 15: Evolution of the main exports from 2010 to 2013

Year	Quantity (tons)				Value (millions of Ariary ¹⁰²)			
	2010	2011	2012	2013	2010	2011	2012	2013
Shrimps	7,696	8,837	8,548	7,673	188,018	186,917	188,877	186,334
Crabs	918	1,276	1,100	1,965	8,258	11,009	10,651	26,685
Lobsters	211	220	171	238	6,691	6,662	5,641	8,065
Trepangs	412	447	384	396	4,180	8,254	4,543	4,287
Squids	56	71	58	54	556	748	578	557
Octopus	1,204	1,515	1,378	1,429	7,767	10,001	9,884	9,609
Eel	39	32	17	62	921	682	457	1,340
Shark fin	31	41	29	33	890	1,265	882	559
Finfish	4,436	1,920	1,093	2,404	45,100	22,709	12,010	38,073
Tuna	N/A	N/A	2,227	N/A	N/A	N/A	33,351	N/A
Canned tuna	N/A	10,410	8,289	7,976	N/A	76,628	86,680	97,225
Others	932	1,750	25	18	399	310	1,190	1,270
TOTAL	15,017	26,519	23,319	22,253	262,780	325,185	354,744	374,004

Source : MRHP and own calculations

262. Even long established companies claim that they are making losses. In the past some companies have been known to sell products below market price to its buyers which are part of the same transnational firm, allowing such integrated companies to move profits abroad and to reduce profit taxes that are due in Madagascar, a process known as transfer pricing. This practice is thought to occur less nowadays, but might still exist.

263. Shrimps is the main domestic fisheries and is mostly export oriented. Until 2012, shrimps was the single most exported Malagasy commodity; it is now behind cloves and mining products in terms of exports value, with 186,334 million Ariary in 2013 (about 84 million USD using the official 2013 exchange rate). It is still a substantial source of foreign exchange earnings, accounting for 7 percent of total exports in terms of value, and more than 50 percent of exported fisheries products. Almost 70 percent of the shrimp's production is exported and 30 percent is consumed by the local market. Most of the shrimp trade is directed towards France (including La Réunion) even though selling to the European market is very constraining in terms of sanitary norms. China and Spain are both becoming more important trade partners.

¹⁰² Ariary has been highly volatile, it has fluctuated roughly around 2,000 MGA for 1 USD between 2010 and 2013. Source: Banque central malgache, accessed at <http://www.banque-centrale.mg>

264. Considering origins, aquaculture shrimps are more valued and therefore sold for higher prices.

The aquaculture shrimps' superior quality is acknowledged with various labels (organic farming, Label Rouge) and these shrimps are sold under their unprocessed form, which also allows for a better valuation of their weight. Conversely, industrial shrimp fisheries process the shrimps directly onboard or after landing for sanitary reasons. Shrimp can be marketed "head-on", "headless", and peeled. Shrimps marketed with heads are generally considered of highest quality (as freshness can be visually verified) and command higher prices. Headless shrimp, and peeled shrimp are considered lower quality and demand lower prices overall. However, given infrastructure constraints that affect the ability to export fresh shrimp in time, processed shrimps is sometimes the only way in which the catch can be commercialized.

265. Tuna fisheries are exclusively industrial and by foreign vessels, but landings in Malagasy ports for processing in the Antsiranana cannery are increasing.

Because domestic operators in Madagascar are unable to fish the entire EEZ,¹⁰³ the government has been selling fishing licenses to foreign operators through fisheries agreements. The most important one is with the European Union. Initiated in 1986, the last set of agreements allows the European fleet to fish a reference tonnage of 15,750 tons a year for around EUR1.6 million per year plus fees for each ton fished¹⁰⁴. Under the EU agreement nearly 100 boats are allowed to fish in the waters of Madagascar. The scope of other fishing agreements is not publicly known but one estimate of the total tuna catch is 80,000 tons of which apparently only 25 percent is reported, raising concerns regarding transparency and sustainability. For example, purse seiners¹⁰⁵ operate with licenses but are suspected of underreporting their catch. The agreement with the EU is the only transparent agreement and the EU fishing fleet is required to report its catch, but since 1986 EU quotas increased by 30 percent while the fees paid by the EU decreased by 20 percent.

266. An important quantity of tuna is being processed by the Antsiranana cannery, whose activities generate around 2000 jobs (including service providers) and who reports exports around 32,000 tons of canned tuna per year.

This figure demonstrates how misleading the official statistics are, as Table 15 displays less than 8,000 tons of canned tuna exported in 2013 while data from COMTRADE indicates that Madagascar exported prepared or preserved tuna valued at US\$64 million, indicating that total exports exceeded officially registered exports. The cannery remains one of the most important Malagasy importer of fishery products, importing 25,263 tons of tuna in 2013.

267. Finfish remains a subsistence fishery, likely to have a tremendous importance but poorly understood.

Finfish is an extremely important fishery in Madagascar as those fish are sold to the domestic and international markets. Some finfish are exported (especially high-quality catch) while a substantial part of the catch is sold for subsistence domestically. Very few data are available concerning the domestic sales of this fish. In 2013, exports of finfish were valued at 38 million Ariary (2,404 tons).

268. Spiny lobsters and crabs fisheries are small in terms of quantity but are highly valued. Spiny lobsters are exploited by hand or spear while snorkeling along the entire south coast of Madagascar

¹⁰³ Indeed, the investment costs of building, operating and maintaining an industrial fishing fleet are extremely high and operators in most developing countries do not have the necessary funding (Namibia is a noticeable exception).

¹⁰⁴ European Commission, accessed on May 12, 2015 at http://ec.europa.eu/fisheries/cfp/international/agreements/madagascar/index_en.htm

¹⁰⁵ According to the FAO, purse seiners use a large net that is eventually closed from the bottom, catching all aggregating species near the surface.

between Toliara and Isandravinany, with a concentration in Fort Dauphin (70 percent of national production). High export-driven demand has driven heavy exploitation for several decades. In 2008, a study in the area of Fort Dauphin highlighted strong evidence of a stock collapse. The current situation is not known due to the lack of scientific monitoring, but according to many local stakeholders, it is unlikely that stocks are recovering despite (ineffective and unenforced) regulations to allow stock recovery and protection of juveniles. Exports in 2013 were valued at 8 million Ariary.

269. **Other diverse “marginal” fisheries provide significant scope for employment growth and new, diversified, sources of revenue.** For instance fishers target all varieties of shark for their fins to supply the export market while the meat is consumed locally. Sea cucumbers are also highly valued but the stocks aren’t properly managed, with suspicions of overexploitation. In 2013, 400 tons valued at 4.3 million Ariary were exported according to official data. Some species such as eels, glass-eels, octopus, bichique (with strong demand in Réunion), or fresh-water shrimp are extremely valued on the international markets and could be further developed, rather than focusing policy interactions continuously on the shrimp sector.

Key challenges to the sector

270. **Production in the Malagasy fishery sector is vastly diversified and challenges abound.** A number of key policy reforms need to be put in place to adequately support the sector and ensure its long-term sustainability. While some issues are very specific to the fisheries sector, other are more general but no less need urgent attention from policy makers.

271. **Overall management of the stock is limited and there is a risk of overfishing.** This issue arises because of a lack of control with licenses, a lack of enforcement and a lack of statistical data. The statistics regarding fisheries production and exports come from various sources and are often incomplete or inconsistent. Especially, data coming from customs and the MRHP demonstrate substantial differences although some can be explained by effects on weight and volume following processing. Efforts have been made regarding the statistical system and still need to be strengthened. A substantial part of the catch in Madagascar (both in the industrial and traditional sectors) is not accounted for. As a result, it is currently impossible to paint a complete picture of the Malagasy fisheries sector and related trade flows. However, data on overall catch and evidence from various studies suggests that at least some of the stocks are under pressure and need to be better managed to ensure long-term sustainability of the fisheries sector in Madagascar.

272. **Malagasy capacity in terms of monitoring and enforcement has improved for the past few years but still need to be strengthened.** Effective enforcement is a necessary condition to the development of the legal framework. After the 2009 political crisis, the Fisheries Monitoring Center (*Centre de Surveillance des Pêches*) in charge of monitoring faces financial difficulties making it unable to carry its monitoring tasks. For instance, high sea monitoring has been completely shut down, at least temporarily. A recent report also notes legislation for integrated coastal zone management (ICZM) has existed since 2010. While on paper the mechanism has received strong political support through the creation of a high-level national ICZM Committee, translation into tangible actions on the ground has been very limited.

273. **The problem is confounded because an important part of the catch is discarded.** Estimates indicate that this discard amounted to a loss of approximately US\$2.5 million per year from the shrimp industry alone – an amount equivalent to Government income from the international agreement in tuna fisheries. Discarded by-catch from the shrimp fishery and others depletes stocks further and represents a threat to food security and sustainability of many fisheries. These losses are in addition to those occurring during processing and transportation. As a result, a significant part of the Malagasy fishery production is either lost at sea or during processing inland. The government and the private sector have long recognized that this is an important issue, and some progress to reduce by-catch has been made although more needs to be done. A decree in 1999/2000 attempted to address this issue by requiring industrial vessels to retain at least 50 percent of the by-catch and to supply it to local markets, but regulating this issue through legislation is challenging and economic incentives to process or minimize by-catch should be expanded.

274. **Operational constraints raise costs in the sector, negatively affecting productivity and options for new market development. The operating costs of the fishery sector remain high.** Energy costs, especially for freezing facilities, are extremely high and access to electricity is unreliable. In a sector that is dependent on functioning and consistent cool chains, this generates significant additional costs, as companies need to rely on generators or risk of losses increase. At the same time, logistics constraints are significant, particularly for the export of fresh products that get better prices at international markets. Poor road infrastructure, and high transport costs lead to substantial economic losses. Bad infrastructure, and limited access to electricity affect value chains as fishery products often have to go through a long logistic chains (traditional fishers, collectors, gatherers then export companies). Supplying by roads can imply losses up to 50 percent of production. Transfer of living animals is particularly subject to important losses. Some products are exported by plane (currently the only way to transfer lobsters from Fort-Dauphin to Antananarivo), but such have limited cargo space, negatively affecting opportunities for companies to export high-value fisheries products (such as live crabs) to emerging markets. Because firms cannot reach markets with fresh products in time, many firms have to treat products and freeze them, which reduces their value. Some operators also expressed concern that the legal framework securitizing large investments, for example for aquaculture projects, is missing. This constraints significant opportunities of reaching new high-value markets that exist, for instance with exports of living crabs to China.

275. **Meeting export requirements in destination markets also provides challenges, although Madagascar has a “competent authority” recognized by the EU, the most demanding export market.** The national regulatory framework for the fisheries sector is a transposition of European sanitary requirements. Some companies are authorized to export to the EU, while others are not as exports to the EU need to meet European standards. The Autorité Sanitaire Halieutique (ASH) is responsible for monitoring and approving facilities that are competent to test products before shipment, and issue certificates of conformity. For these certificates to be accepted in the EU, accreditation of the ASH is of paramount importance. Some facilities are only approved to certify exports to destinations other than the EU because these facilities do not meet EU requirements. Given limited funding for the ASH (and efficiency of their use), concerns exist as to whether it will be able to maintain its accreditation and could prove its competence to ensure the control function on behalf of EU authorities. In the past it

occurred twice that the EU stopped exports from several factories after spot controls that put into question the capacity of the ASH to monitor and implement the relevant EU sanitary norms. Ensuring that the ASH's accreditation does not lapse should be of utmost importance as the nascent small fisheries sector that managed to enter the EU market would otherwise collapse immediately. A strong risk of European embargo still exists.

276. **Revenues to support the governance and administrative framework of the sector are lacking.** Current funding seems insufficient to adequately cover the regulatory functions. However, a number of stakeholders also expressed concern regarding the effectiveness and traceability of spending. Direct fiscal revenues, representing access rights to the natural resource, are estimated to represent around 1.4 percent of the added value generated in the fisheries sector. The government should review the overall framework to ensure that limited resources are spent effectively and governance issues in the sector are resolved, before reviewing the overall fiscal allocation to these important regulatory functions. The fiscal regime would require an independent review, while management expenses should be scrutinized and transparency on revenues and expenses fostered.

Priority recommendations

277. **To achieve regulatory objectives, improved statistics need to be collected using a sound methodology and consistent with international standards.** Having a clear view of the state of the fisheries sector will be essential to design policies that could ensure a sustainable and well-managed exploitation. An adequate sectorial strategy needs to be grounded on reliable data, especially regarding the most basic indicators such as catch, fishing effort, quality of products, quantities marketed, taxes paid, and some economic impact monitoring to understand the contribution of the sector to national development strategies. In line with international best practices, catch by international vessels should be separately reported.

278. **Managing stocks and preserving natural habitats is critical to ensure sustainability of the fisheries sector.** Several stocks are probably already overexploited and natural habitats seem to be under pressure as catch is declining. The surface covered by mangroves is shrinking, and with it the potential economic profits from mangrove crabs. The depletion of mangroves could potentially also increase the vulnerability of coastal areas to climate change. The Malagasy coral reefs are of paramount importance, with the world's third largest coral reefs system being located on the south western coast. They are essential to the global marine ecosystem's health as well as to the potential harvest from future fisheries. Fish stocks need to be reliably estimated and maintained, while natural habitats have to be strongly protected as a national heritage, but also to preserve future economic benefits from exploiting them in a sustainable manner.

279. **This also means that the management and enforcement need to be improved.** Linking more accurately estimated stock levels to sustainable management and the issuing of licenses, which should be strictly enforced, is the first important step needed to implement rational public policy. Stocks have to be duly monitored and the existing legal framework transparently implemented going forward, both with regard to high-seas, coastal, and inland fisheries. Addressing obvious governance issues will be

essential in this task that will certainly face strong resistance from those actors currently benefitting from loose oversight.

280. **Ensuring continued recognition of the ASH by the European Union as ‘competent authority’ will be essential to ensure exporters can access the European market.** Resources and technical knowhow need to be available to the ASH to ensure it can keep up with requirements, but existing resources also need to be used with more efficiency. To ensure that Malagasy companies can continue to export to the EU and the fisheries sector can continue its successful development, including the further inclusion of smaller operators into export operations, this should be the number one priority of the government.

281. **Addressing cross-cutting factors affecting operating costs will also have to be addressed as this report pointed out throughout.** These include access to electricity, improved road infrastructure and air access which is of particularly relevance for fresh products, lower transport prices, and also increased legal certainty for new investments, for example in aquaculture. As fresh products command higher prices, but need to reach markets quickly to stay fresh and minimize expensive transport costs with cooling aggregates, issues related to long border procedures (and other administrative barriers) present critical barriers to the development of more high-value export operations.

Chapter 8 - Tourism

282. **Madagascar holds an undeniable tourism potential but years of political instability and limited reforms in the sector have severely affected the sector's development.** After years of strong growth (between 2002 and 2008), international tourist arrivals plummeted by 57 percent in 2009, or from 375,000 in 2008 to 163,000 in 2009, as the result of the political instability and unrest. While the number of tourist arrivals grew by an average of 8 percent per year over the last five years, showing resilience despite the lack of resolution to the political crisis as well as economic stagnation in Madagascar's principal source markets in Europe, the 222,374 international arrivals in 2014 are still well below the pre-crisis level. With the right policy choices, the tourism sector could function as important contributor to the country's economic revival. The key policy reforms would have to aim at reducing travel costs, including through greater liberalization of air access, reducing operating costs by increasing access to skills and land, reduction of tax harassment, and continued capacity building of key government institutions and coherent strategy development for tourism.

283. **Tourism is an important pillar of the economy, as tourism directly accounts for 8.1 percent of GDP and directly employs 6.4 percent of the country's formal workforce in 2014.** Taking indirect and induced impacts into consideration, these shares increase to 19.7 percent of GDP and 16.5 percent of the formal workforce. The employment is expected to rise by approximately 0.9 percent per annum to 337,000 jobs (4.9 percent of total employment) by 2025. The capital investment for Tourism increased from 8 percent in 2007 to 18.2 percent in 2013, of the total GDP, and the Central Bank of Madagascar estimates the country earned MGA 614.18 billion (US\$ 280 million) in 2012 on tourism (see Table 16).

Table 16: Economic Indicators on Tourism

Economic Indicators	2007	2009	2011	2013
Direct contribution to GDP	5.1%	4.7%	5.2%	5.9%
Direct contribution to employment	4.2%	3.9%	4.0%	4.5%
Direct employment	180,000	170,000	195,000	225,000
Visitors export in MGA billion	1,500	1,250	1,550	1,900
Total Capital investment (MGA billion)	550,000	610,000	700,000	790,000
Capital investment (% GDP)	8%	8.8%	16.1%	18.2%

Source: WTTC (2012 and 2013, 2014, and 2015)

284. **Leisure tourism is the backbone of the tourism industry in Madagascar.** In 2013, 93.2 percent of the direct Tourism and Travel GDP was generated through leisure spending, and leisure spending is expected to continue with 6.9 percent pa compared to

5.1 percent for business spending.¹⁰⁶ Madagascar has a comparative advantage in leisure tourism through the unique flora and fauna and the diversity of activities offered: wildlife viewing, scuba diving, scenic hikes, beach tourism, adventure sports, and cultural encounters. In the 2012 visitor survey, 64.4 percent of tourists indicated that they had traveled to at least one national park during their trip. This is reflected in the relatively long average stay of leisure tourist with 21 days (Seychelles 10 days, Mauritius 9 days and Maldives 7 days) and a return rate of 40 percent.¹⁰⁷ Part of the reason for long trips, however, also relates to long domestic travel times due to infrastructure constraints (road and domestic

¹⁰⁶World Travel Tourism Council: Travel&Tourism, Economic Impact 2014, Madagascar, p.10-12.

¹⁰⁷The World Bank Group: Madagascar Tourism Sector Review, July 2013.

air). This is in fact hampering the competitiveness of the sector and limiting the number of visitors as few tourists can afford such long vacations. As a result, arrivals are highly concentrated on the French market (including La Réunion), which represented 60 percent of total arrivals between 2009 and 2014. While the number of arrivals lag behind its 2009 level, the number of rooms has increased by 62 percent between 2008 and 2014, with an occupancy rate of approximately 58 percent in 2012.

285. Air connectivity to Madagascar is limited, and costs are high and account for a high share of total tourist spending. As an island destination, Madagascar is highly dependent upon air service to bring tourists from key source markets. Madagascar is currently connected with only ten global destinations through flights on Air Madagascar and foreign carriers, and the total capacity of 1.2 million seats per year is limited. Most connections are regional with only two connections to Europe: scheduled service from Antananarivo to Paris/Marseille and charter service from Nosy Be to Milan/Rome. Overall, Madagascar can be considered one of the least accessible countries in the world, with a ranking of 193 (out of 211 countries) in the World Bank's Air Connectivity Index (ACI).¹⁰⁸ Prices of for long-distance airplane tickets are high and even above the regional average, which is already high compared to global standards, and so are the prices of domestic flights, compared to similar countries.¹⁰⁹ Domestic Air transport is unreliable and expensive, as flights are frequently cancelled without notice and there is no adherence to the posted schedule of the airline affecting businesses and tourists.¹¹⁰ Air transport accounts for 25-50 percent of total spending by tourists in Madagascar. High cost and unreliable air transport services are a key constraint to the development of the tourism sector.

286. The lack of adequate and coordinated governance of the sector hampers the development of tourism in Madagascar. The tourism sector is overseen by the Ministry of Transport, Tourism, and Meteorology (MTTM), which is mandated to define, implement, and monitor the national tourism development policy. The mandated of MTTM is to transform Madagascar into a world class emerging and naturally sustainable destination and to reach 1 million tourists by 2020. Absence of such a policy that would capture cross-sectorial issues such as air and ground transport and dated Tourism Master Plan (TMP) which does not have a clear implementation plan, however, hampers the development of needed reforms to lead to a greater tourism development. While most of the issues that the TMP highlights remain relevant, others should be reconsidered and new tourism industry trends taken into consideration leading to a clear implementation plan involving public and private stakeholders. There is a strong need for greater environment protection and the tourism sector, if well planned, has a role to play through the development of a framework for responsible tourism product development, since high rates of deforestation, poaching of precious timbers and other endemic species, and the degradation of coastal environments threaten the natural capital of the county and therefore the base for tourism.

287. Public institutions are weak and lack technical capacities required to lead the development of the sector, linked to a lack of clear roles and responsibilities among tourism institutions cause sector inefficiency. The lack of structured sector governance combined with limited technical capacity and limited financial resources in key Ministries and institutions present a challenge to the development of

¹⁰⁸ Arvis, J. and Shepherd, B. (2011) *The Air Connectivity Index: Measuring Integration in the Global Air Transport Network*, Policy Research Working Paper prepared by the World Bank, June 2011.

¹⁰⁹ ALG: Etude pour l'amélioration de la desserte aerienn vers Madagascar, 2014

¹¹⁰ Using local flights to link to international long-haul is impossible as a result.

the sector.¹¹¹ No functioning effective formal structure currently exist to facilitate the dialogue across key Ministries, the Ministry of Tourism does not fully assume its coordinating role, and the Madagascar National Tourism Office (ONTM - a parastatal body created in 2003 to promote tourism) has at times engaged in areas under the oversight of the Ministry, creating duplication and keeping ONTM from accomplish his original role. Madagascar National Parks body (MNP) was created in 1990 to manage the country's network of 52 national parks, generating around 20 percent of its operating costs through park entry fees. The Economic Development Board of Madagascar (EDBM) has the role of investment facilitation across all industries and has also been active in the tourism sector. Sector governance, analysis, and planning is further hampered by the absence of reliable tourism statistics. Efforts to collect such data in Madagascar have apparently been fraught with error and those collected are only sent to the Ministry of Tourism after a delay of several months.

A number of issues hamper the development of the sector

288. **The *de facto* monopoly of Air Madagascar for domestic flights increases prices while bad roads limit alternative travel options.** Poor road conditions were by far the country's greatest weakness identified in the 2012 visitor survey. Limited road connectivity between tourism clusters is in fact one of the main reasons tourists take expensive and unreliable flights. Madagascar's rail networks are also in poor shape, yet have strong potential to provide tourists with a compelling experience while transporting them to emerging tourism destinations. Air Madagascar operates almost 100 percent of the domestic flights (only 0.5 percent are operated by Sky Service), but the service level frequently does not meet the expectations of users. Ticket costs are high while regularity and punctuality of flights is low. As a result, connectivity within Madagascar is poor, resulting in long travel times between destinations. Malagasy tour operators also report the loss of significant amounts of business from foreign tour operators due to security concerns since the airline was blacklisted by the EU.

289. **AM has faced financial difficulties for years**, with problems intensifying after the 2009 political crisis and the subsequent termination of their management contract with German air transport industry experts . AM was then dealt a major blow in April 2011 when its planes were blacklisted by the EU based upon inadequate plane maintenance procedures. The problem has yet to be resolved. Meanwhile, AM had to engage in expensive leasing contracts in order to maintain its flights to Europe. AM's problems have equally affected long-haul and domestic flights.

290. **Entry into the market is de-facto limited although in general the legal framework of the domestic airline industry in Madagascar tends to be liberalized.** To operate in the domestic market, an airline company needs to fulfil a number of requirements: **i)** the operating airlines must be Malagasy, **ii)** have their head office and principal place of business in Madagascar, and **iii)** be holding an operating license, and be under the regulatory control of the Civil Aviation Authority. Currently only two additional airlines perform regular domestic flights, the Passenger Air Madagascar and Sky Services. In addition, the domestic market currently does not generate enough traffic to be profitable, what keeps the market

¹¹¹ For example ONTM, the body charged with promoting tourism to Madagascar, has an annual budget of around 0.9 million Euros (US\$1.17 million). To put this sum in context, Seychelles (which attracted slightly fewer tourists than Madagascar in 2012) spends approximately US\$10 million per year on marketing

unreliable and expensive until there is an increase in tourism domestic travel by air.¹¹² Experience from other markets has shown that lower ticket prices following liberalization can generate such additional demand.

291. Even though, the internal network is liberalized and Madagascar has signed bilateral agreements with 38 countries, only 8 are active.¹¹³ Madagascar signed the Yamoussoukro Decision aiming to liberalize access to air transport markets in Africa, and has agreed with COMESA members to the regional airline policy towards a more liberal air access. Nevertheless, more needs to be done to complete the implementation of bilateral agreements (BASA). Only 2 out of the 8 active signed agreements are currently operating a total liberalization, and only few codeshare agreements between Air Madagascar and foreign companies exist yet. The vast majority (89 percent/ 6 agreements) of the existing international capacity in Madagascar is offered between countries with bilateral agreements of the type "progressive liberalization", that is to say, agreements have limitations. The current regulatory framework can be a restriction on the opening of some services for foreign companies. Even a bilateral agreement with a country type "open skies" does not guarantee the operation of service. Therefore efforts must be made to implement existing agreement, draft the annexes which establish airlines that will servicing the country and establish and implement new BASA and or service agreements with markets of high potential impact for the tourism sector.

The business environment and skill shortages negatively affect the sector

292. Improving the business climate is essential to regain the confidence of investors—whether small or large, domestic or foreign, in the tourism or any other sector. As outlined earlier in this report, Madagascar ranks low in major indicators for the World Bank's Ease of Doing Business indicator (163 of 189 in 2015) or the WEF's Global Competitiveness Index (130 of 144 in 2014). As outlined earlier, some reforms have been undertaken but challenges remain. Investors particularly consider i) political instability, ii) lack of reliable infrastructure (air and road access), iii) difficult access to land, iv) electricity, and v) labor force as key constraints.

293. Access to land is a particular challenge for investors in the tourism sector. There is a general lack of coherence between land management/development (infrastructure, land planning and use, etc.) and tourism development objectives, land transaction procedures are slow, and land access is particularly challenging for foreign investors. The government initiated a land acquisition scheme in 2000 and established 22 land reserves (RFTs)¹¹⁴ with donor support to resolve the problem of making land available to tourism investors while bringing benefits to local communities from which the land was acquired. While in principle a useful approach to overcome constraints to land acquisition, issues related to corruption, illegal occupancy, weak land control, and management resulted in failure with the most attractive sites are already occupied and other sites not accessible.

294. Availability of electricity is indeed a major impediment for investors in general. The low access rate (only 14 percent of the population had access in Madagascar in 2010, lower than many comparator

¹¹² Greater air connectivity between tourism centers would positively impact the sector but would also require that infrastructure set up in such locations. Currently all small charter airlines work out of IVATO exclusively.

¹¹³ Comoros, South Africa, China, France, Mauritius, Italy, Kenya and Thailand

¹¹⁴ Réserves foncières touristiques

countries) is in part a consequence of poor performance by JIRAMA, the state-owned electricity and water company. 14 power outages in a typical months resulted in an estimated loss of 8 percent of sales for all companies, likely also affecting tourism establishments (Madagascar Enterprise Survey 2009). Expensive, volatile and rare access to electricity significantly hampers overall economic development. Allowing independent power producers and developing renewable energy sources are essential steps to expand rural electrification and promote job creation.

295. **The industry complains about the sheer number of taxes in the absence of specific incentives to the tourism sector.** Long border delays, high taxes, and the unpredictability in the trading environment affect the tourism sector particularly due to its high dependence on imported goods such as food items, vehicles, furniture, or other inputs. Additionally, heavy taxes on land transactions are strong constraints for investors. In the past, the private sector has also seen incentives being revoked suddenly and VAT imposed without sufficient lead-time to be able to pass on the increased costs to clients, negatively affecting sector performance. As in other sectors, concerns regarding perceived harassment of firms by tax collectors are frequently expressed, affecting profitability of firms and dynamics in the tourism sector as smaller companies are hesitant to enter formality.

296. **Workers and managers with the right skills are difficult to find.** Many tourism establishments show a very low level of quality in service, and the majority of the workers in the sector, especially outside of the capital, have not attended a Tourism Training Institute (TTI). Because staff turnover in the industry is very high, few tourism businesses offer formal in-house training programs for fear of staff being competed away following completion of the training. Typically on-the-job training is informal, often provided by managers with limited hospitality experience. Managerial skills in the sector are also lacking as most hotel operators have no formal training in the sector. Predictably, this has resulted in unprofessional service provision in many tourism establishments.

297. **Public vocational training is limited and of limited relevance to the private sector.** The National Tourism and Hospitality Institute (INTH) in Antananarivo provides vocational training to hotel workers as well as middle-managers (maitre d'hôtel, gouvernantes, etc.). Training curricula are weak and are not well aligned to the needs of private sector operators, trainers lack technical knowledge and lack up-to-date experience of the current sector practices and training schools often lack the facilities and equipment necessary to simulate the modern working environment. Graduates from INTH find it difficult to find a job in Antananarivo because most hotels are located in the Provinces and graduates are perceived as having only limited skills following training. However, graduates willing to move outside the capital often find a job within the year after graduation despite concerns about the quality of training at the INTH. Because they need staff, employers in the region frequently recruit from INTH, but at the same time train other staff (and graduates) on the job to address shortages in qualification.

298. **Demand for vocational training is increasing and a number of private institutes have emerged.** The INTH selects only one out of every eight applicants and a number of private TTIs have opened in Antananarivo in recent years to respond to the high demand, but the overall number remains small. Few are outside of Antananarivo like the private TTIs in Nosy Be, Antsirabe, and Majunga. Also among private institutes, curricula are not well aligned to the existing business needs (they are not demand driven) and practical experience for the students is missing (there are no opportunities for apprenticeship

programs), facilities lack adequate equipment to simulate the modern working environment, and many instructors don't have up-to-date industry experience. As the result, private sector representatives feel that graduating students do not obtain the required skills to provide service of excellence to the industry. An important reason for the low number and quality of these institutes is the fact that local well qualified trainers are missing.

299. **High-end hotels do contract trainers for their own needs but foreign, or high quality, schools have not emerged.** It is unclear why investment into high-quality training institutes is lacking. In a low-income fragile country like Madagascar where citizens have limited access to finance or credits, potential job entrants might prefer to attend schools at lower costs, instead of borrowing to invest in their career. Subsidized public and private schools might also crowd out private investment as full cost of such an institute would be higher. INTH charges fees of around US\$90 per month and had been supported by donors until 2009 but is now struggling to maintain its standard. Tuition at the EU-supported Nosy Be school is around US\$30 per month. In a situation of high staff turnover, hotels might be hesitant to fund high-quality and high-cost training of their employees if they cannot be certain that staff will remain with them. Delays in obtaining work permits and formal authorization and licenses for a foreign school could also contribute to this outcome.

300. **Skills shortages are partially addressed through the hiring of foreigners which the existing labor laws permits, but delays are lengthy.** Many firms reported increasing difficulty in obtaining permissions from the Ministry of Labor for expatriates to work in a timely manner. A decision can now take almost a year, because of several administrative layers until issuance. EDBM is fighting to strengthen this process and so far expatriates have not been stopped from working, even without permits, but it makes investors nervous.

Priority recommendations

301. **To develop the tourism sector further, improving air connectivity to Madagascar, as well as within the country, needs to be urgently improved.** The government should focus on implementing existing agreements relating to air access by drafting and agreeing on the annexes which operationalize these agreements as they contain which airlines could service which routes with which frequency. At the same time, the government should agree and implement new BASAs with markets of high potential impact for the tourism sector such as major air traffic hubs.

302. **Improving access to Madagascar should be complemented with measures to improve access within Madagascar.** This could possibly be achieved by reviewing domestic regulations to facilitate entry and competition on key routes, while the government could provide subsidies for those routes that are socially important but economically currently not viable.

303. **While improving the overall business environment remains important, ensuring access to land is of particular importance for tourism investors.** The government should implement mechanisms that ensure that new and existing investors can obtain access to land in a transparent and fair manner, while ensuring that the assets of the poor are preserved. Improving the management of the land allocation process (and transparency), enforcement of regulations, and securing land titles for the existing tourism

land reserves (RFT) to be made available for investors, would allow increased investment while protecting the environment and vulnerable populations.

304. **Improving the availability of skills needs to complement these efforts.** Assisting existing training institutions to better align their curricula to business needs and improve capacity of trainers, and facilitate the entry of new tourism training institutes would go a long way in reducing the existing skills gaps over the medium-term. As graduates are equipped with more suitable skills, their chances of finding employment in the capital will increase while higher wages to remunerate their skills in provinces will likely draw more graduates to tourism locations. At the same time, faster and more transparent processing of work permits for foreigners with much needed skills will be necessary to bridge skills gaps in the short term.

Annex: List of background chapters available upon request

Chapter 1	Madagascar Private Sector Policy Note
Chapter 2	Trade Policy and Trade Outcomes in Madagascar
Chapter 3	Overview old Action Matrix
Chapter 4	Non-Tariff Measures in Madagascar
Chapter 5	Trade and Transport Facilitation
Chapter 6	Export Processing Zones
Chapter 7	Agriculture and Livestock