WORLD TRADE ORGANIZATION

WT/TPR/S/197/Rev.1
28 May 2008

(08-2492)

Trade Policy Review Body

TRADE POLICY REVIEW

Report by the Secretariat

MADAGASCAR

Revision

This report, prepared for the second Trade Policy Review of Madagascar, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from Madagascar on its trade policies and practices.

Any technical questions arising from this report may be addressed to Mr Jacques Degbelo (Tel.: 022 739 5583).

Document WT/TPR/G/197 contains the policy statement submitted by Madagascar.

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SUMMARY OBSERVATIONS

(1) ECONOMIC ENVIRONMENT

1. The socio-political crisis experienced by Madagascar from 2001 onwards ended in July 2002 and since then its economy has recorded sustained real growth, at an annual average of 6.2 per cent between 2003 and 2006, much higher than the 2.6 per cent demographic growth. This economic growth was boosted primarily by the expansion of industrial activities in the free zone, construction, financial services, mobile telecommunications and transport. These sectoral performances can be attributed in particular to the liberalization reforms, particularly in trade, implemented by Madagascar through its macroeconomic stabilization and structural adjustment programme, launched in 2002, and backed up by a Poverty Reduction and Growth Facility (PRGF) from the IMF. Focusing on the "Madagascar Action Plan" (MAP), the economic and social development strategy for the period 2007-2011 followed on from the Poverty Reduction Strategy Paper (PRSP) adopted in 2003. These various efforts have enabled Madagascar to benefit from a sizeable reduction in its external debt as a result of several initiatives, bringing its official external debt servicing down to 3.9 per cent of earnings from exports of non-factor goods and services in 2006.

2. Despite the reform efforts, recent economic performance and international support, Madagascar remains a poor country (a less developed country with per capita GDP estimated to be US$ 313 in 2006). Its economy is mainly based on services (around 57 per cent of nominal GDP in 2006), followed by agriculture, including fisheries, livestock and forestry (27 per cent); and manufacturing (16 per cent). Around three quarters of the population earns most of its income from agriculture, mainly subsistence farming, which means that this sector is a priority for achieving the MAP objectives. Performance in the agricultural sector is, however, generally poor. Manufacturing's share of the GDP is growing because of the enterprises established under the industrial free zone (IFZ) regime, which are given tax benefits. The majority of companies share the same concerns regarding access to finance, water and electricity supplies, and transport and telecommunications services, not forgetting macroeconomic instability and shortcomings in governance.

3. Government finance is facing considerable structural problems, particularly because of the common practice of giving tax and customs exemptions and the narrow tax base as a result of the size of the informal sector (estimated to be around 30 per cent of total GDP). Improvements are expected as regards governance, including transparency in fiscal management. The primary budget deficit of some 4.4 per cent of GDP in 2006 is financed by development aid, whose net total (grants less debt servicing) was estimated to be 10.4 per cent of GDP in 2006. The European Union (EU) and its member countries are large donors to Madagascar.

4. In addition, the restrictive monetary policy followed by the Central Bank of Madagascar (BCM) since 2005 has allowed the inflationary trends that emerged in 2004 to be brought under control. In 2005, the ariary replaced the Malagasy franc. Its real exchange rate has remained fairly stable since 2005, which has probably helped Madagascar's goods and services to maintain a degree of competitiveness on foreign markets.

5. The ratio of trade in goods and services to Madagascar's nominal GDP was some 71 per cent in 2006, approximately the same level as at the time of the first review of its trade policy (TPR) in 2001. Because of the socio-political crisis, exports only returned to their 2001 level in 2006. Their composition has remained more or less the same: around one half of exports is composed of primary products (shrimps, vanilla, cloves, chromite and graphite), which mostly go to the European Union. About a quarter of Madagascar's exports consists of clothing, which mainly goes to the United States where

it is given preferential access under the AGOA. There has been a marked increase in imports of goods (at an average annual rate of 16 per cent) since 2001, particularly as a result of soaring oil prices in United States dollars. Madagascar is a net importer of services, but net earnings from tourism have risen sharply (at an average annual rate of around 24 per cent since 2001). Overall, the trade balance has once again shown a deficit since 2002.

(2) TRADE AND INVESTMENT REGIMES

6. The Ministry of Trade is responsible for defining and implementing Madagascar's trade policy. The private sector is associated on an *ad hoc* basis in following up trade policy-related issues. The Ministry of Industry, in cooperation with the Economic Development Board of Madagascar (EDBM), is responsible for investment policy, including the free-zone regime.

7. Madagascar is a founding Member of the WTO and grants at least most-favoured-nation (MFN) treatment to all its trading partners. It has not signed any plurilateral agreement concluded under the auspices of the WTO. Since 1995, Madagascar has participated as a third party in four dispute settlement procedures under the WTO mechanism, the three most recent being related to the European Communities' sugar regime. Madagascar's participation in the multilateral trading system remains limited, however; it has made few notifications to the WTO and does not have any interministerial committee to follow up multilateral trade issues. The areas in which technical assistance has been requested include formulating trade policy, taking part in the WTO's regular activities and in trade negotiations, government procurement legislation and practices, dismantling supply-side constraints, integration of trade policy into development strategies, notifications and implementation of WTO Agreements, including those on customs valuation, technical regulations, intellectual property protection, and remedial measures. Madagascar participates in the Integrated Framework.

8. Madagascar is a member of the Common Market for Eastern and Southern Africa (COMESA), whose free-trade zone has been in place since 2000 but whose project for a customs union has been deferred until December 2008. In 2005, Madagascar became a member of the Southern African Development Community (SADC), whose intention to establish a free-trade zone in 2008 was examined by WTO Members in 2007. Whilst awaiting the conclusion of an Economic Partnership Agreement (EPA) by the end of 2008, Madagascar signed an interim agreement with the EU in December 2007, covering free trade and other trade-related issues (including renewal of the sugar Protocol).

9. Since Madagascar's first TPR, its investment regime has been reorganized. Since 2003, the purchase of private land by foreign investors may be authorized by the Council of the Government subject to input in foreign currency. A special regime encourages large-scale investment in mining. New frameworks for the promotion and protection of investment and for the industrial free zone are planned for 2008. Several bilateral agreements are being negotiated in order to promote Madagascar as a destination. Since 2004, promoters have been able to complete the formalities for setting up companies in four days, at no charge, at the "Single Window for Investment and the Development of Enterprises" (GUIDE). The EDBM, which has been operating since 2005, conducts a technical examination of the requests for approval under the free-trade regime, whose benefits are granted by decree.

(3) TRADE POLICY INSTRUMENTS

10. All Madagascar's tariffs are *ad valorem* (zero, 5, 10 and 20 per cent), with the exception of those on petroleum products; in 2008, the simple arithmetic average rate was 13 per cent, three points lower than in 2000. Agricultural products (WTO definition) are subject to higher taxation (a simple average of 14.5 per cent) than non-agricultural products (12.7 per cent). During the Uruguay

Round, Madagascar bound all its agricultural tariff lines and several non-agricultural lines, representing a total of 29 per cent of tariff lines; in some cases, the rate applied exceeds the level bound on behalf of Madagascar prior to independence. Madagascar gives tariff preferences to products originating in the COMESA and the SADC.

11. VAT (20 per cent in 2008) and, where applicable, excise duty, is also levied, but the latter does not respect the principle of national treatment, a matter of consistency that was already a concern at the time of Madagascar's first TPR. Other import taxes imposed at the customs level were abolished in 2005. The waiver given to Madagascar by the WTO in order to maintain minimum values for customs valuation of used goods expired on 17 November 2003. Preshipment inspection has not been mandatory since April 2007. Nevertheless the use of GasyNet's customs data treatment system is compulsory, at a cost of 0.5 per cent of the c.i.f. value of the goods. A green channel is available to importers whom the system deems reliable. Computerization of trade-related customs operations has made considerable progress since the first TPR.

12. Overall, the tariff shows mixed escalation, which is unlikely to encourage the establishment of certain industries (where escalation is negative) or boost the competitiveness of certain domestically-manufactured products (which are given strong effective protection because of the positive escalation) on international markets. In addition, companies in the free-trade zone are given exemption from duties and taxes on all types of imports together with refund of VAT on inputs of Malagasy origin once it has been proved that the finished products have been exported. The temporary admission regime is often utilized for the equipment needed for mining or petroleum prospecting.

13. Madagascar has not changed its import licensing regime since the first TPR and it applies to leaf tobacco and vanillin. In addition, other products require various import permits for sanitary, phytosanitary or safety reasons. For example, a veterinary or phytosanitary certificate is required for the import or export of any animal or plant product. Madagascar has not notified the WTO of any sanitary or phytosanitary measure taken to combat avian influenza or foot-and-mouth disease. There has been noticeable progress in standardization and the Madagascar Standards Bureau (BNM) started to operate in 2002. Based on the results of analyses carried out by independent foreign laboratories, it certifies imported goods that are subject to Madagascar's mandatory standards. Because of international market requirements, mandatory quality standards apply to exports of coffee and vanilla and optional standards to litchis and honey.

14. In 2004, Madagascar opened up activities downstream of the petroleum subsector by abolishing ceiling prices for petroleum products, although these are still monitored. The price of some basic commodities is monitored and administrative controls apply to the price of generic medicines. The measures adopted in 2005 on good competition practice by companies have not yet come into effect and the regulatory authority is not operating. Three companies have a *de jure* monopoly: HASYMA, for the production of cotton lint; KRAOMA, for the extraction and marketing of chromium; and the Malagasy Tobacco Board (OFMATA) for the production and import of tobacco. In addition, the State-owned company JIRAMA has a *de facto* monopoly of the transport and distribution of electricity and of the production, transport and distribution of water. TELMA, a private-law company, has a monopoly of the supply of basic fixed telecommunications services until June 2008. Despite some impressive achievements in the programme for State withdrawal drawn up in 1997, some major privatizations still have to be completed (for example, JIRAMA, Air Madagascar, and the southern railway network). Furthermore, the State retains a minority holding in several companies with a seat on the board of directors in order to influence decision-making.

15. Royalties apply to commonly exported goods such as forestry, fisheries and mining products. There is also a ban on exports of logs of any species and their semi-finished products in order to boost processing. A new Government Procurement Code was adopted in 2004 and has gradually come into effect since 2005. It provides for invitations to tender, although according to the authorities 22 per cent of the contracts in 2007 were awarded as a result of a single tender. A national preference margin of 10 per cent is provided in the new legislation. Madagascar is neither a member nor an observer of the Plurilateral Agreement on Government Procurement but would like to receive technical assistance in order to gain a better understanding of the Agreement.

16. Madagascar's industrial property regime dates back to 1992 and has not been fully harmonized with the provisions of the WTO TRIPS Agreement. Software, plant varieties and breeds of animals or essentially biological processes for obtaining plants or animals, as well as pharmaceutical and veterinary products, cosmetics and foodstuffs, are not patentable. Processes for manufacturing pharmaceuticals may, however, be patented. Software is protected for 25 years under the copyright regime. Piracy mainly affects CDs and DVDs.

(4) SECTORAL POLICIES

17. Madagascar is an agricultural producing country, but its potential is little exploited. Productivity in the agricultural sector is low because of the small size of farms and the rudimentary cultivation techniques. The relatively high demographic growth leads to growing demand for food, whose price has a marked impact on purchasing power. In addition to its domestic production, Madagascar mostly imports rice, sugar and powdered milk. Following a supply crisis in 2005, the customs tariff on rice was lowered to zero, but the customs imposes VAT of 20 per cent. Average tariff protection in the agricultural sector (ISIC definition) is 13.9 per cent.

18. One of the MAP's objectives is to achieve a "sustainable green revolution" by expanding production and then improving the way in which it is managed, and also by removing constraints (particularly road transport) on its marketing. A policy to ensure more secure land tenure is making rapid headway in order to make it easier to finance agricultural activities. The State no longer intervenes in fixing the purchasing price from farmers, but subsidizes the supply of seed and inputs and small-scale equipment for growing rice; since 2002, these products have been subject to a zero tariff. Consultation forums for each branch (rice, litchis and vanilla) facilitate public-private dialogue on support measures in each branch. A monitoring centre keeps an eye on the price of rice on local markets and disseminates this information in order to streamline the market's functioning. Several projects financed through external funds support rural development.

19. Together with mining and tourism, fisheries and aquaculture are one of the three major activities on which the authorities are relying as a basis for Madagascar's medium-term economic development. Shrimps are one of Madagascar's principal exports. Its tuna resources are exploited under bilateral agreements with the EU and Japan, subject to a financial counterpart. Fishermen must have a fishing licence and pay royalties. Nevertheless, the authorities do not appear to have the resources needed to achieve sustainable exploitation of fisheries resources. They sometimes decide to close the fishing season and since 2004 have made it compulsory to install turtle exclusion devices on fishing gear. The fisheries subsector (ISIC definition) is subject to relatively high tariff protection of 18.8 per cent, well above the overall average of 13 per cent, as well as 20 per cent VAT, which does not encourage development of this subsector.

20. Environmental protection is also an element taken into account by the authorities when considering large-scale mining projects before authorizing them. Since 2005, an incentive framework has been available for

such investment and it is expected that there will be a sizeable increase in the production of mineralized sands, cobalt and nickel in the near future. These projects call for modernization of the railway and the building of new mineral ore ports. Madagascar still produces chromium ore (under a State monopoly), whose price is rising as a result of international demand. It also exports gemstones, but mainly through informal channels. Madagascar intends to observe the requirements of the Extractive Industries Transparency Initiative. Investment in prospecting by oil companies has risen sharply and it is expected that production of crude oil will begin in March 2008.

21. In addition to the companies set up under the free-zone regime, which must export 95 per cent of their output, the manufacturing sector is composed of companies producing for the domestic market, mostly foodstuffs, beverages and tobacco. They are given relatively high tariff protection of 16.7 per cent; excise duty applies at a higher rate to imported alcoholic beverages and cigarettes than to those domestically produced. Obstacles to the development of manufacturing include problems in Madagascar's electricity supply. Large companies generate their own electricity, but most of the others experience load shedding because domestic production is limited. Although in principle production, transport and distribution are open to competition, transport and distribution remain the sole prerogative of JIRAMA, whose privatization is a priority in order to attract the investment needed to modernize the infrastructure.

22. The number of leisure tourists has shown a marked increase since 2003 (over 20 per cent annually between 2003 and 2005), underpinned by a policy to open up Madagascar's skies. In addition, the authorities support the development of eco-tourism by creating tourism land reserves, access to which is open to foreigners, even though the supply of the necessary water, domestic transport and telecommunications services is inadequate. Financial services (banks, micro-finance institutions and insurance) are open to competition from foreign suppliers. A new regulatory framework governs micro-finance. Madagascar has not, however, bound measures on the supply of certain tourism services under the GATS.

(5) TRADE POLICY AND TRADING PARTNERS

23. Madagascar has made progress in liberalizing its trading regime. The positive results achieved by these reforms, as well as the performance of companies in the free-trade zone operating in a fairly liberal environment, underscore the need for Madagascar to continue with this liberalization, which should be backed up by continued structural reform and macroeconomic stabilization so as to enhance the business climate and lift supply constraints. Continued efforts towards good governance should help in this respect. It is important to ensure that the introduction of the COMESA's CET does not reverse the positive trend over the period since Madagascar's first TPR.

24. In general, stronger multilateral commitments by Madagascar through extension of its tariff bindings to more non-agricultural products, lower bound rates and a stronger GATS commitment would reinforce these reforms and make its trading regime more transparent, more credible and more predictable. Such a climate would help Madagascar to attract the capital needed to exploit its vast potential and derive greater benefit from its participation in the multilateral trading system. The international community could give Madagascar more help in its reform efforts by responding favourably to its requests for technical assistance.