

INSIDER VIEW

MADAGASCAR

THURSDAY, APRIL 10, 2003

Focus on exports and investment

WAY AHEAD THE UNITED STATES IS MADAGASCAR'S PARTNER OF CHOICE FOR ITS NEXT STAGE OF DEVELOPMENT. OPPORTUNITIES FOR EXPORTS TO THE U.S. MARKET AND A CHEAP LABOR FORCE MAKE THE COUNTRY AN ATTRACTIVE PROPOSITION FOR INVESTORS

MADAGASCAR, the fourth largest island in the world, is a paradox. Though geographically and politically part of Africa, lying off the Indian Ocean coast of Mozambique, it has a population whose origins are mainly South East Asian and Polynesian. Statistics suggest it is one of the poorest nations on earth, yet its potential for development is widely recognized.

Madagascar's eco-system delights naturalists, as a large percentage of its flora and fauna are unique to the island. Startlingly majestic baobab trees and a dazzling variety of lemurs vie for the visitor's camera lens. It is little wonder that the island is becoming an up-market adventure tourist destination, though the traveler has to be prepared for some rough roads, especially during the rainy season.

Not surprisingly, infrastructure projects in energy and telecommunications are an area of the economy to which American and other foreign investors are being wooed, in addition to initiatives in the mining industry. Once a bastion of revolutionary socialism, Madagascar embraced the principles of the free market in the mid-1990s, and has been reaping rewards ever since.

The island's eligibility for benefits under the Africa Growth and Opportunity Act (AGOA) offers bright prospects for bilat-



LOOMING LARGE Madagascar's textile and apparel exports have benefitted significantly from the U.S. African Growth and Opportunity Act (AGOA)

eral trade and investment, ushering in a new era in U.S.-Madagascar relations, to the delight of Madagascar's President, Marc Ravalomanana.

"I am very proud of our working together," he says. "I met President George Bush in New York, during the U.N. General Assembly. Relations with the United States are good because

we have the same take on things: fighting terrorism and building a society that is strong, united, and self-confident."

There are a number of practical reasons why Madagascar is of interest to potential investors. They include the ready availability of low-cost, hard-working employees, and a determination to maintain an annual economic growth rate of

five percent or more, which has been the norm in recent years.

Prime Minister Jacques Sylla shares the President's view that the United States is the partner of choice in the next stage of the island's development, despite Madagascar's French colonial heritage. "Previously, there was one point of reference for students here: the Sorbonne Uni-

versity in Paris," he says. "Now, when our youngsters go abroad, what they want is an MBA."

Andriamparany Radavidson, the Minister of Economy, Finance, and Budget, picks up the theme. "We've already been on the offensive," he says. "Delegations have gone to the United States to explain

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FACTS & FIGURES

POPULATION
15 million

AREA
228,880 sq miles

CURRENCY
Malagasy franc (MGF)

EXCHANGE
5,750 MGF per 1 US\$

CAPITAL
Antananarivo

GDP
\$14 billion (2001 est.)
purchasing power parity

GDP GROWTH
5% (2001 est.)

NATURAL RESOURCES
graphite, coal, bauxite, salt, quartz, semi-precious stones, mica, fish, hydropower

INDUSTRIES
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Madagascar

Power for the people and incentives for partners

SWITCHED ON LIBERALIZATION COULD TRANSFORM MADAGASCAR'S ENERGY SECTOR BY ATTRACTING FOREIGN INVESTMENT. RURAL ELECTRIFICATION IS A PRIORITY OF THE GOVERNMENT'S DEVELOPMENT PROGRAM

MADAGASCAR'S huge potential can be seen most clearly in its under-exploited energy and mineral resources, and the island's high plateaus offer wide scope for further hydro-electric development.

The French brought electricity to the capital, Antananarivo, in 1920. Yet today, great swathes of rural Madagascar, where most of the population lives, are still without it. Rural electrification is therefore a high priority in the government's development program, with the active encouragement of the World Bank.

"The problem is that the rural people's purchasing power is low, and the investments needed are high," says Elisé Razaka, Minister of Energy and Mines. "So we'll need to subsidize private companies that would like to take on the villages."

In contrast to the mid-1970s, when the then government nationalized many businesses operating in the energy sector, privatization and public-private partnerships are now the order of the day.

With the World Bank's help, Madagascar's Electricity Law was changed to liberalize the sector, starting with production. Distribution and other downstream activities are slated to be privatized at a later stage.

"We have inspected lots of

sites up in the high plateaus, and are now looking to the private sector to build the infrastructure and exploit them," Mr. Razaka says. "The state-owned energy company, Jirama, will make a contract with these companies to buy the energy produced."

Jirama's General Manager, Désiré Rasidy, admits that moving from a state-controlled environment to a liberalized system has not always been easy, but accepts the necessity.

"Jirama is ready, because we know our limitations," he says. "This country needs \$400 million worth of investment for the rapid development of electricity: \$200 million for production, \$150 million for transport and distribution, and \$50 million for rural electrification."

The World Bank would like to see a competitive element in the privatization program, with several operators involved, but Mr. Rasidy is skeptical. "How would we split everything up? By municipalities and regions, like in Chile? The regions here are unequal; some are semi-desert."

In the petroleum sector, privatization has been under way since the monopoly enjoyed by the state oil company, Solima, ended in 2000. For example, a private company called Galana acquired Solima's fleet of oil-transporting trucks, a number of gas service stations, and the



GOING PRIVATE A number of state-owned assets have been sold-off

refinery at Toamasina.

Delegate Administrator Jacques Aimé Raharinirina says, "What remains in Solima's hands are the non-petroleum assets, including office buildings and some villas. We still have about 200 employees, of whom 106 are sailors. So we are thinking about moving into new activities, as we have experience, personnel, and some infrastructure."

That infrastructure includes 60 gas service stations that were not sold off. "We've got to get them working again, and refur-

bish them with the help of partners," Mr. Raharinirina says.

Parallel to the big changes taking place in Madagascar's energy sector, the mining sector has also been going through a period of significant reform.

It, too, falls under the authority of Minister Elisé Razaka, who is proud of the country's new Mining Laws, which were elaborated in 1999, in collaboration with the World Bank. Under these changes, the state has withdrawn from the sector, and mining regulations have been simplified.



ELISÉ RAZAKA
Minister of Energy and Mines



DÉSIRÉ RASIDY
General Manager of Jirama



JACQUES AIMÉ RAHARINIRINA
Delegate Administrator of Solima

One of the laws, on which American experts provided advice, relates to investment in the sector and has considerably enhanced the country's attractiveness to foreign direct investment (FDI). "It really guarantees investment, because if there is any final litigation, it goes to international arbitration," says Mr. Razaka.

"The Malagasy state is there to facilitate, to help the private sector install itself, and to make investments," he explains. "Everything is done to help the investor: freedom to repatriate hard currency, no taxes on imported

equipment, and so on."

The island is blessed with mineral reserves, many of which have lain untouched—partly because of a traditional reverence on the part of the local people for the land of their ancestors. Madagascar is already the world's leading producer of mica.

"As far as mineral resources are concerned, we really have the gamut," Mr. Razaka says. "Ilmenite, radium, iron ore, copper, cobalt, chromium, etc. In fact, everything people need for the aerospace and electronics industries."

In the mid-1990s, deposits of precious stones were discovered, including sapphires, rubies, and emeralds. This led to a sort of Wild West atmosphere in some remote areas, as Asian and African gem traders turned up, eager to capitalize on the new discovery.

One of the challenges the government faces is how to regularize such situations. "The state of mind here is different these days," says Mr. Razaka. "We want transparency, so investors are reassured."

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what is going on in Madagascar, and to see what the possibilities are for American investors."

Mr. Radavidson sees the rapid implementation of a program of public investment—mostly foreign-financed—as the first priority. This will create a climate favorable to private investment and form the basis for steady growth, which is forecast to rise by eight percent this year.

"Secondly, as we only have a population of about 15 million, growth has to be led by production for export," says the President. "In that sense, at the level of trade, the United States can come up trumps by integrating us into the U.S. market."

Until now, most of Madagascar's exports have been raw materials and cash crops, though the textile sector is taking off, selling sweaters and jeans to U.S. retail chains. Industry

accounts for 12 percent of Madagascar's gross domestic product (GDP), with textile manufacturing and the processing of agricultural products the main sub-sectors.

One of the reasons the government is so keen to see the road network improved is to facilitate the development of value added activities.

"We no longer wish to export our mineral and agricultural products in their unprocessed state, but would like to create more value added here," Mr. Radavidson says.

President Ravalomanana is in no doubt where the impetus for such changes will come from. "In Madagascar, the motor for economic development is the private sector," he declares.

He recognizes that many of his compatriots have yet to come to terms with this new reality. "We want to create a society led by a competitive



MARC RAVALOMANANA
President of Madagascar

economy," he says. "What's missing in Madagascar is competitiveness and competition."

The first task on President Ravalomanana's agenda was to heal the wounds of several months of tense stand-off between him and his predecessor, Didier Ratsiraka, who refused to accept defeat in elections held in December 2001.

The situation could all too easily have deteriorated. However,

reason prevailed in the end and the crisis was resolved, with President Ravalomanana's party winning a landslide victory in parliamentary elections in December 2002.

Today, the government has the comforting knowledge that international financial institutions as well as bilateral donors like the U.S. are on its side. Funds that were temporarily blocked during last year's political crisis were released following the formal recognition of Mr. Ravalomanana's presidency last July.

Moreover, the country has been able to benefit from substantial debt relief following the granting of Heavily Indebted Poor Country (HIPC) status in 2000, releasing hundreds of millions of dollars to be spent in priority areas outlined in the government's poverty alleviation program—notably health, education and transport infrastructure.



RAW MATERIAL Cotton production totals about 150,000 bales annually

Madagascar

Private firms will be engine of a more diverse economy

MARKET FORCE MADAGASCAR NEEDS TO DIVERSIFY AND BOOST EXPORTS TO ENJOY SUSTAINABLE GROWTH. AS THE GOVERNMENT OPENS DOORS FOR THE PRIVATE SECTOR, COMPANIES ARE SEIZING NEW OPPORTUNITIES

STIMULATING the private sector is one of the government's main aims, to boost productivity, diversify exports, and attract investment. For that to happen, there needs to be economic as well as political stability.

The Minister for Development of the Private Sector, Industrialization, and Handicrafts, Davida Rajaon, identifies three main requirements: a balanced budget, a legislative framework favorable to investment, and access to finance.

"On the government side, we have committed ourselves to good governance and transparency," he says. "For their part, companies must respect laws that are in force nationwide."

Changes have been made to make Madagascar a much more investor-friendly country. Procedures have been simplified, the terms available are more generous, and the development of free trade zones has made manufacturing for export an attractive proposition.

"We've improved supply-chain management, by removing barriers and bottlenecks," says Mr. Rajaon. "We also help producers, financially and technically, so they can export."

Though Europe, other Indian Ocean states, and southern Africa have tended to be Madagascar's main markets up until now, the

government has high hopes for capturing a greater share of the U.S. market, thanks to the U.S. Africa Growth and Opportunity Act (AGOA).

"Of the 250 or so companies in free trade zones, most are working in textiles, with AGOA in mind," says the Minister of Trade, Alphonse Ralison. "But people are talking of up to 2,000 products that could benefit from AGOA."

Mr. Ralison, who himself has a private sector background, is an enthusiastic supporter of economic liberalization, which he believes will benefit both companies and consumers. "We have drawn up laws on competition, consumer rights, new chambers of commerce and so forth," he says.

Over the past five years, Madagascar's exports have received a huge boost from the expansion of the export processing zone (EPZ), and foreign direct investment has been substantial.

However agriculture, including fishing and forestry, is the mainstay of the economy, producing more than 70 percent of export earnings. There is a need for diversification, and prospects for tourism, construction, and mining are regarded as particularly promising.

A number of large Malagasy companies that started out as family businesses have seized new opportunities for growth. The Trimeta Group, for example, spans



FRESH APPROACH Aquaculture is big business in Madagascar

a wide range of activities, from petroleum products (under the name Galana) to construction, packaging, hardware goods, and hotels.

Trimeta's co-Chairman, Ykbal Hiridjee, says the company has capitalized on AGOA by building factories and warehouses for export-oriented firms. It is also penetrating the U.S. market.

"A lot of American companies are buying garments in Madagascar," says Mr. Hiridjee.

One of the big local players in the textile and garments industry is the Socota Group, but Socota has also moved successfully into the food industry. All of its foodstuffs, such as shellfish, are exported, as are around three-quarters of its textile products.



ALPHONSE RALISON
Minister of Trade



DAVIDA RAJAON
Minister for the Development of the Private Sector, Industrialization, and Handicrafts

Aquaculture has become big business in Madagascar over the past decade. One of the market leaders in the sector is Unima, which has developed a global reputation for gourmet shrimp.

Currently, most of Unima's export production goes to Europe. General Manager Aymn Ismail says the U.S. market is difficult to break into, as customers there like to buy their shrimp peeled.

"But we will lead our first assault on restaurants there, through chefs," he says. "We have chosen an importer who is the specialist in the field for the whole United States."

The challenge is to get things moving

One of the major challenges that Madagascar faces is the need to improve its transport infrastructure. This is a major focus of the government's efforts to combat poverty and promote economic growth, but given the huge costs involved external assistance is essential.

"We need infrastructure, because since independence, 50 percent of the roads have been destroyed, or fallen into disrepair," says President Ravalomanana. "We have to rebuild. We put our trust in donors, the World Bank, the African Development Bank, and others who are going to help us in the rehabilitation process and with building new highways, at an estimated cost of around \$1.2 billion."

Currently, less than 15 percent of Madagascar's approximately 25,000 miles of road are paved, though that does

include the vital link between the capital, Antananarivo, and the main port, Toamasina (often referred to as Tamatave). In the rainy season, many roads become impassable, and even at the best of times, progress can be slow. The economic cost in terms of time wasted is self-evident.

"The Ministry of Public Works and the Ministry of Transport have a joint program to build 1,000 miles of highway," says the Minister of Transport and Meteorology, Olivier Rakotovazaha. "This will help villages."

The social element of transport is seen as crucial, if people are to broaden their horizons and develop their potential. The Malagasy people are deeply rooted in their own locality, and for a period of their history were actually forbidden to move. But improved communications are an essential factor in the country's modernization scheme.

That includes the rehabilitation of the railway system inherited from the French colonial period. "We have two rail networks, one in the north and one in the south," Mr. Rakotovazaha explains. "The United States, Britain, and Switzerland have contributed to the rehabilitation of the southern network. We put the northern contracts out to tender, and



OLIVIER RAKOTOVAZAHA
Minister of Transport and Meteorology

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FACING Africa to the west and the Indian Ocean to the east, a thousand miles long and 36 miles at its widest point, Madagascar is a land of fascinating variety and contrasts, and a dream come true for nature-lovers.

The island boasts a wealth of flora and fauna to explore, from giant chameleons and lemurs, to wild

WORLD APART MADAGASCAR'S UNPARALLELED NATURAL ENVIRONMENT GIVES IT HUGE POTENTIAL FOR TOURISM. INVESTORS ARE BEING ENCOURAGED TO TAKE A LOOK

orchids and towering baobab trees. Indeed, most of the plants and animals are to be found nowhere else in the world. The scenery, too, is spectacular, with rainforests, canyons, volcanic ranges, and bays lined with sandy beaches.

Tourism is the country's second-largest source of foreign currency reserves and is growing at an annual rate of 18 percent. Still at an early stage of development, the industry offers huge potential for investment.

To encourage investors, the government has designated special Tourism Land Reserves (Réserves Foncières Touristiques, or RFTs) for the development of beach and nature tourism. Investment rules have been relaxed and international companies can own 100 percent of the capital of a Madagascar tourism establishment.

Olivier Harnisch, General Manager of the 170-room Hilton Madagascar, has no doubt that the country has something unique to offer.

"Madagascar is one of the countries with the greatest wealth of resources in the world, in terms of tourism," he says.

"These resources have not been used in the past, but now there are many initiatives by the government

comes to mind. That would be a big step forward. When we reach it we will be able to consider ourselves a tourist destination."

Mr. Harnisch believes that the stability, safety, and infrastructure to welcome foreign tourists—exemplified by the Hilton Madagascar—need to be part of the island's offerings.

Hilton has been managing the hotel for more than 30 years. Situated in the capital, overlooking Lake Anosy, the hotel is close to government offices and major international organizations. It offers international standards of service, including air-conditioning throughout, and a range of leisure and meeting facilities, restaurants and bars.

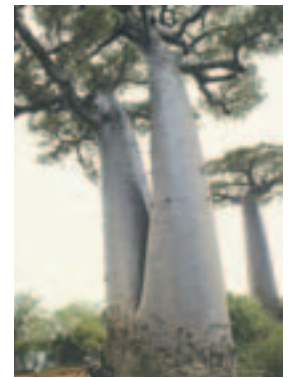
"We have the standards, the



OLIVIER HARNISCH
General Manager of the
Hilton Madagascar

to develop the industry. Everyone who comes here remarks on the potential. The Malagasy people are very willing. They have a great attitude and are very patient."

The major challenge, Mr. Harnisch says, is to create an image for the country. "The first step is to reach the traveler who wants to experience nature, beaches etc—so that Madagascar is one of the three or four choices that



STANDING TALL giant baobab trees

safety, the back up from the company—everything to cater for the needs of the international traveler," says Mr. Harnisch.

He considers the U.S. market very important. "We have a lot of American customers, and we are very happy to have them," he says.

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South Africans made the winning bid."

Ports are also part of the government's infrastructure master plan. "We have around 3,000 miles of coastline," the Minister points out. "But we only have one international port: Tamatave. We really need one on the other side of the island, maybe at Majunga."

Domestic air services are provided by a sole carrier, Air Madagascar, which is slated for privatization. "But given the situation following the 9/11 events,

that will take two or three years," Mr. Rakotovazaha says.

Airports are run by an autonomous body called Madagascar Civil Aviation (ACM). "ACM has been detached from the Ministry, because the government is following a policy of state disengagement, and encouraging the private sector," the Minister explains. "ACM's costs will be covered by airport fees, not by the Ministry."

Madagascar has a dozen airports, and 40 smaller airstrips. But even Antananarivo's airport is in urgent need of upgrading and runway extensions.

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Responsible for all aspects of the country's ports, airports, highways, and railroads, as well as meteorology, the Ministry of Transport and Meteorology is modernizing and developing Madagascar's transport sector.

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