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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Malagasy Republic: Growing Economic Independence from France

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
December 1971

INTELLIGENCE MEMORANDUM

MALAGASY REPUBLIC: GROWING ECONOMIC INDEPENDENCE FROM FRANCE

Introduction

1. In recent years, the Malagasy Republic has been attempting to reduce its almost complete dependence on France for economic assistance. A variety of non-French undertakings are already underway, and despite continued preferential trade agreements with France, other trading partners are becoming increasingly more important. Priority also has been assigned to obtaining foreign investment that would diversify the island's primarily agricultural economy, generate new exports, and promote import substitution. This memorandum presents the background and progress of the Malagasy program to date and considers the prospects for further foreign investment in light of the prevailing economic situation.

Discussion

Background

2. Following independence in 1960, the Malagasy government retained its strong economic ties with France. Like most former French colonies, the Malagasy Republic[1] is a member of the franc zone, and France guarantees full convertibility of local currency into French francs at the existing exchange rate. Fiscal and monetary policy is closely monitored by Paris, some 1,400 French advisers occupy key government positions, and French companies control most of the banking, trade, services, local industry, and plantation agriculture. France contributes about one-half of the foreign aid received annually, provides teachers and technical advisers, and covers the government's budget deficits.

1. The country's name is "Malagasy Republic", but it also may be referred to properly as "Madagascar." "Malagasy" is used correctly alone to refer to the people or language or as an adjective. For general location, see the map.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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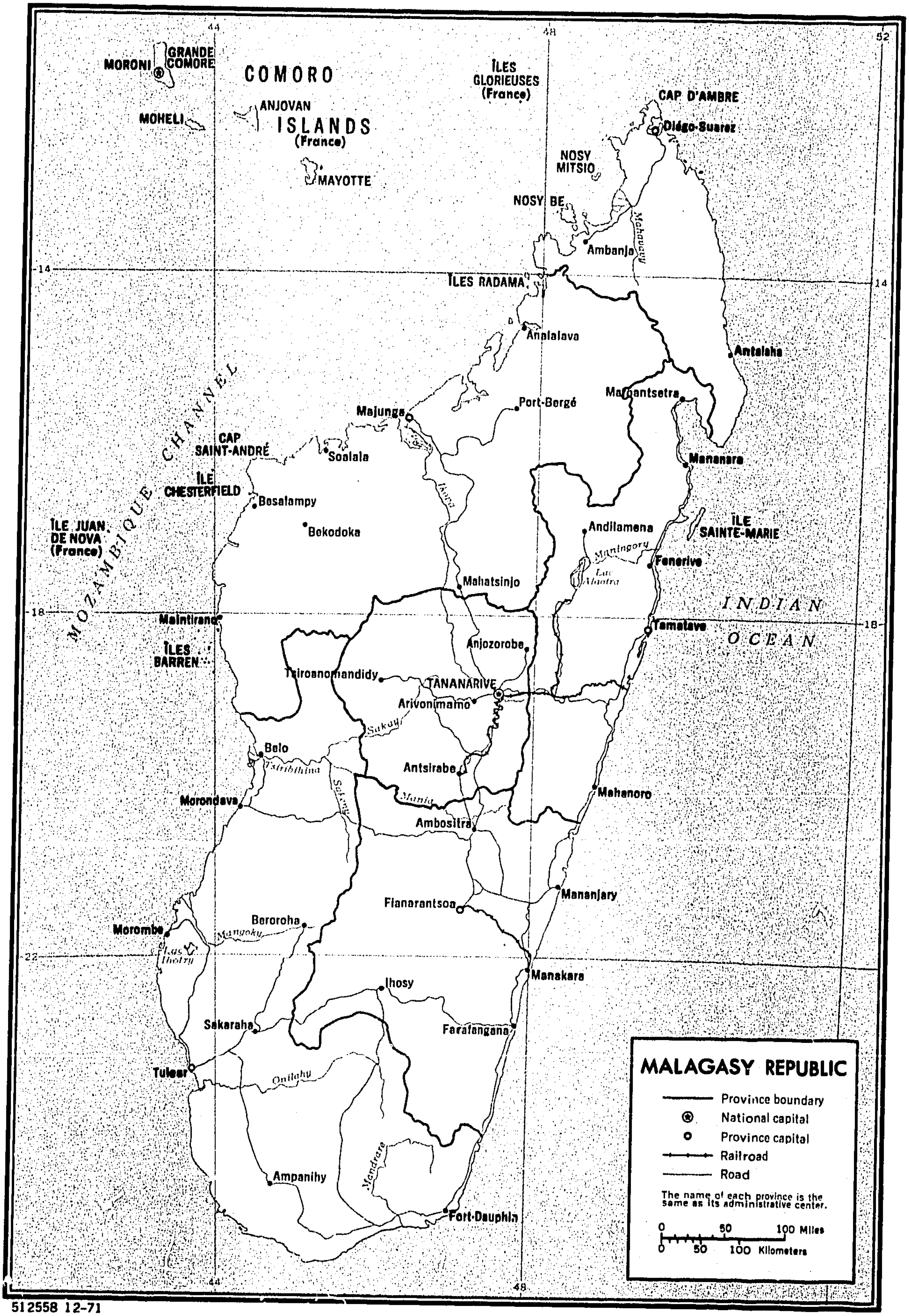

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3. Economic progress has been slow despite sizable French assistance. The real gross domestic product (GDP) has barely kept ahead of the expanding population. Per capita GDP in 1970 was about $125, slightly lower than the all-Africa average, excluding the Union of South Africa. Agriculture, which accounts for about 85% of total exports, has been relatively stagnant, and most of the island's seven million people live a rural, traditional life, producing the bare essentials for subsistence by primitive means.

4. Since independence, the government has tried to further industrialization by setting up development institutions to either lend to or participate in government-owned industries and by promulgating an Investment Code designed to attract foreign investment. Manufacturing represents about 12% of GDP, but the sector still is conceived mostly on a small-scale basis and is heavily dependent on foreign imports of equipment, raw materials, and management. Most industry is of the import substitution type, and underutilization of capacity is frequent.

5. The substantial French presence has not been without its drawbacks in the minds of Malagasy leaders. The extent of French investment and partial control of the economy and the high proportion of French aid combine to inhibit other foreign investors and restrict the options of Madagascar's economic planners. In addition, the preferential treatment accorded to French products creates problems for local industry. Commodities originating in France are duty-free in Madagascar and are not subject to import licenses as are goods from other countries.

6. In the past, Madagascar's insularity has prevented participation in regional economic projects with other African states. Its membership in the French-oriented Afro-Malagasy Common Organization (OCAM) has proven more useful as a vehicle for political rather than economic cooperation with other French speaking African nations. Madagascar also has remained aloof from the Organization for African Unity (OAU). Madagascar has no links with the nearby East African common market, which, as part of the sterling bloc, is oriented toward London and Asia. Actually, sisal from Tanzania, coffee from Kenya, and cloves and vanilla from Zanzibar all compete heavily with Malagasy exports.

Moves to Reduce French Dependency

7. The most significant development in reducing the French role has been the growth of Madagascar's ties with South Africa, a country that is both a potentially important market and less expensive supplier than France. South Africa, in turn, is very much interested in establishing relations with Madagascar as part of its "outward looking policy" in Africa. These ties, initiated in 1968 through exploratory missions and informal

contacts via private businessmen, have since been reinforced by visits from South African planning missions and industrial experts.

8. Increased trade and South African participation in Malagasy enterprises already is reflecting the newly found friendly relations between the two countries. Although still small, imports from South Africa in 1969 reached $1.5 million, compared with only $70,000 in 1966. Under a November 1970 protocol, the South African government and private businessmen will provide about $6.3 million to develop tourist facilities -- including an airstrip, roads, and a major tourist hotel -- on the offshore island of Nosy Be. South Africa also has expressed interest in mining minerals, including graphite, mica, chromite, and bauxite, heretofore under-exploited by unchallenged French concessionary firms.

9. Increasing economic relations with other countries also are underway. In May 1969, Canada signed a technical and cultural cooperation agreement, which specifically included services of Canadian industrial experts. Japanese financiers are interested in establishing automobile assembly plants and expanding their interests in Malagasy mineral resources and fisheries. Madagascar has discussed with both Portugal and South Africa the coordinated development of Madagascar's French-managed project for a completely new deep water port at Narinda, on the island's northwest coast. Madagascar's commercial contacts with other Indian Ocean countries are numerous, and these territories have undertaken common action to form the Indian Ocean Tourist Alliance, designed to promote the tourist trade of Madagascar, Mauritius, Reunion, and the Comoros Islands.

Diversification of Trade and Aid

10. Although Madagascar's relationship with France continues to be of primary economic importance, French influence, and consequently Malagasy dependence on France, gradually is lessening. In foreign aid, France's contribution dropped from 64% in 1964 to 43% in 1970 (see Table 1). In addition, the 1967 Suez closure and the June 1968 riots in France, which brought communications (air travel, mail, and business exchanges) to a standstill and virtually isolated Madagascar from the outside world, weakened considerably the Malagasy acceptance of French dependency. Moreover, de Gaulle's departure portended, to many leading Malagasy officials, a decline or even an ultimate end to France's paternalism and generosity toward its former territories.

11. The other five European Community countries have expanded their trade with Madagascar. Since 1968, the Malagasy government has extended to them the same trade preferences long accorded to France. In 1969 and 1970, when imports from France declined from the level of 1968, those from the other EC countries increased by about 50% and 75%, respectively (see Table 2).

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Table 1

Malagasy Republic:
Foreign Aid Receipts

Million US $

	1967	1968	1969	1970
Grants	46.1	42.0	40.0	41.5
France	30.8	24.8	20.8	21.1
FAC a/	8.0	4.3	2.3	2.4
Budget contribution	6.6	5.8	4.5	3.7
Technical assistance	11.7	9.6	8.7	10.7
Other	4.5	5.1	5.3	4.3
European Development Fund	10.9	10.7	12.6	11.9
United Nations and other	4.4	6.5	6.6	8.5
Loans	4.6	2.0	9.0	8.0
France	3.2	--	1.3	--
World Bank group	0.4	1.6	3.1	6.4
United States	--	0.4	1.7	0.9
West Germany	1.0	--	1.9	0.6
Israel	--	--	1.0	0.1
Total	*50.7*	*44.0*	*49.0*	*49.5*

a. Fund for Aid and Cooperation.

Table 2

Malagasy Republic:
Foreign Trade

Million US $

	1967	1968	1969	1970
Exports, f.o.b.	92.8	103.2	105.2	145.1
To United States	22.8	23.2	24.9	32.9
To France	34.0	34.6	38.1	50.0
To other EC countries	4.6	6.9	8.0	9.9
Other	31.4	38.5	34.2	52.3
Imports, c.i.f.	129.5	151.6	170.0	170.1
From United States	8.9	7.6	14.3	9.7
From France	83.8	95.3	86.4	93.4
From other EC countries	14.9	20.2	30.6	35.4
Other	21.9	28.5	38.7	31.6

12. To some extent, the non-French EC countries also have invested in Madagascar. The Italian firm AGIP has invested in oil exploration, gasoline stations, and a tourist motel; the West German firm SIDITEX has interests in the new Sotema textile factory; and the Italian National Bank of Lavoro has equity participation in the Malagasy Bank of Commerce and Credit. In addition, Italy signed a $5.4 million agreement for the development of a 37,000 acre farm in the Antanetibe area, and West Germany has granted a loan to build a spinning mill using locally grown cotton.

13. Madagascar also has obtained many advantages through its EC association. The French Fund for Aid and Cooperation (FAC) and the European Development Fund (EDF) of the EC, to which France makes a substantial contribution, are two of the largest sources of Malagasy external financing. Of the 18 African nations associated with the EC, Madagascar has benefited most heavily from EDF credits. During 1959-67, EDF credit commitments to Madagascar totaled about $100 million, an average of about $11 million annually. Some 70 EDF-assisted development projects have been completed or are in progress.

14. Madagascar has further diversified its trade and aid. In recent years there have been relatively substantial export gains with the United Kingdom, Senegal, Ivory Coast, Reunion Island, Malaysia, and Japan and small import gains with such African and Middle Eastern trading partners as Senegal, Kenya, and Saudi Arabia. Madagascar also has signed commercial agreements with Czechoslovakia, Hungary, the USSR, and Romania. A May 1970 accord with Romania includes provisions for technical assistance and educational and cultural exchange as well as trade. Trade with Eastern Europe and the USSR, however, accounts for only 2% of Madagascar's exports and 1% of imports. No trade takes place with mainland China.

US Involvement

15. Diversification has meant both increasing opportunities and increasing competition for US exports to Madagascar. Because of the preferential import privileges (quota-free entry and exemption from customs duty) accorded the EC and its overseas African associates, direct US exports are at a disadvantage, and most US companies with manufacturing subsidiaries located in the EC prefer to ship from Europe. Nevertheless, US technology is highly regarded in Madagascar, and Malagasy end-users increasingly are willing to pay a premium for American equipment and other goods where quality is an important factor. In some cases, the ability of US companies to provide advantageous export financing is a deciding element in the transaction.

16. Reversing a previous decline, US exports to Madagascar increased in 1969 and 1970 over the 1967-68 levels. Electrical and other machinery, earth moving and construction equipment, tractors, petroleum products, and aircraft account for most of Madagascar's imports from the United States. Coffee and vanilla constitute almost three-fourths of Madagascar's exports to the United States, with clove oil, cinnamon, sugar, and graphite accounting for the balance.

17. The US AID program, begun in 1961, is designed to supplement French aid. US aid amounted to almost $13 million during 1961-69. No new bilateral US aid has been programmed since Madagascar is not a "concentration country." The present program includes a planned multi-donor livestock project in the Majunga area on the northwest coast totaling more than $4 million and bringing together American, French, and Malagasy private and governmental interests. A railroad project and a project for telephone lines and equipment -- involving development loans totaling $5 million -- are now under construction. AID Self-Help funds have averaged about $100,000 annually over the past three years. In addition, AID contributes about $500,000 per year in PL-480 supplies to school feeding programs by Catholic Relief Services and participates in other programs operated by Church World Services and the United Nations' World Food Program.

18. An increasing amount of aid and investment is being provided by US private groups and individuals. Exploration for oil, led by American companies, is proceeding rapidly. Madagascar already has an oil refinery under multinational control. American investors also have shown growing interest in Madagascar's minerals, agriculture, and hotel industry. Recent Malagasy charges of US interference in the internal affairs of the country, and the consequent strain in US - Malagasy relations, might have an adverse effect on US private investment considerations, however.(2)

19. The US strategic interest in the island derives from the presence of a [redacted] 25X1
station. Established in 1964, the [redacted] tracking station is approximately 25 miles southwest of Tananarive on land provided by the Malagasy government. The authorized personnel complement is slightly more than a hundred Americans and about 135 Malagasy. Capital investment in buildings and equipment is more than $17 million. Annual operating costs are about $2.5 million, including $1.5 million for local expenditures and $380,000 for two international telephone circuits.

<u>Outlook</u>

20. Although its economic ties with France remain strong, the Malagasy government clearly is determined to strive for greater self-sufficiency and diversification of trade and aid. Its relations with France reflect not only the gradual diminution of French economic aid in recent years but also the Malagasy uncertainty that significant French support will continue indefinitely. South Africa eventually is likely to become a principal trade and aid source, and American, Canadian, and Japanese participation in the economy is expanding. Under present Malagasy political conditions, Communist states are a very last resort for aid and investment.

21. Continuing obstacles within the economy, however, are likely to deter large inflows of non-French foreign investment. The basic impediments to outside investments still prevail, namely the smallness of the internal market and extremely low per capita income, and development of domestic industry is inhibited by the preferential trade treatment and monopoly investment still accorded France and other Common Market countries. In addition, Madagascar's position as an island apart from Africa, with little historical or cultural ties to the continent, virtually precludes any meaningful Malagasy participation in regional economic alliances with other African countries.

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2. On 1 June 1971, following unsupported accusations of US complicity with former vice-president M. Andre Resampa in a plot to overthrow the government, the US Ambassador and five US embassy staff members were required to leave Madagascar. The Malagasy government has since appeared to retreat somewhat from its initially strong anti-US position in this matter, but its basic decision has not been altered.