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Toward greener priorities: Madagascar



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In the past, economic policy advice revolved mostly around finding ways to foster economic growth with low inflation and adequate efficiency. Scant attention was paid to the distribution of incomes and wealth. The use of social, institutional, and political indicators to supplement economic data was rare. Cross-country comparisons to identify opportunities for economic progress were the exception, not the rule. To this day, the production of internationally comparable green national accounts has remained elusive. Even so, we now have the Human Development Index, which combines GDP per person with life expectancy and education, a significant step forward.

By itself, GDP does not provide an unobstructed view of economic developments. It is not enough to know national income and wealth, because it also matters how equitably they are shared. Moreover, GDP still leaves many important things out, not only environmental degradation but also economic structure, education, public health, human rights, justice, gender equality, and democracy to convey a fuller picture of the goings on. Specific challenges such as climate change call for urgent additional attention.

Meanwhile, wealth—a stock measure—encompasses all forms of assets: physical assets (such as buildings and machinery), financial assets (like stocks and bonds), natural assets (including forests and minerals), and human capital (such as education and skills). Relatedly, the World Bank's Adjusted Net Savings (often called 'genuine savings') serves as a measure of economic resilience and long-term sustainability. It accounts for the depreciation of physical assets, natural resource depletion, and pollution damage, while also factoring in investments in human capital.

Double diversification

Economic diversification and development tend to go together across countries. While specialization promotes efficiency and growth, excessive specialization can heighten national risk. Thus, a balance

between specialization and diversification is necessary in two closely related areas: economic diversification, to reduce excessive reliance on the production of a few commodities or export destinations and institutional diversification, to lessen the excessive undue influence of narrowly based political elites. Both types of diversification aim to reduce risk and boost growth. If economic diversification is intrinsically valuable and good for growth, and if economic and institutional diversification are like two sides of the same coin, then institutional diversification, including democracy, must also be good for growth while being valuable in its own right.

Let us look at two charts.¹ Chart 1 shows the cross-country relationship between the purchasing power of per capita Gross National Income (GNI) in 2021 and economic diversification during 2000–2021 as measured by researchers at The Mohammed Bin Rashid School of Government (MBRSG) in Dubai. Covering 112 countries, the chart suggests a significantly positive cross-sectional correlation between diversification and growth, which delivered each country to the per capita GNI level achieved in 2021. Likewise, Chart 2 shows the cross-country relationship between the purchasing power of per capita GNI in 2021 and one important aspect of institutional diversification, democracy in 2021 as measured by the V-Dem Institute of Democracy at the University of Gothenburg, Sweden.

Diversification can also facilitate efficient mitigation of climate change and limit its adverse effects. Diversification resembles climate policies in that both reflect the need for efficient and equitable management of common property resources. Natural resources are susceptible to overexploitation, as is the air we breathe. Institutional diversification can help through the build-up of institutional capital, including social and cultural capital as well as infrastructure, aiming to make society more efficient and cohesive. This makes increased efficiency tantamount to technological progress. This is how investments in human, social, and cultural capital as well as physical capital can be good for growth.

Chart 1. GNI per capita and diversification

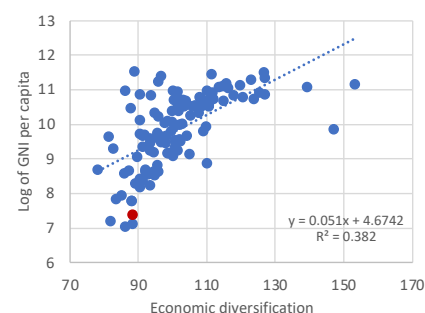
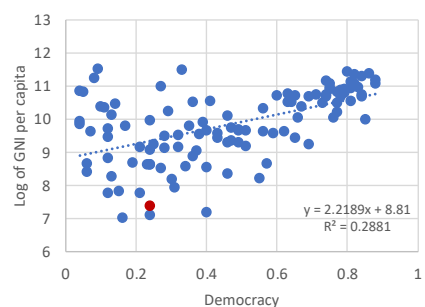


Chart 2. GNI per capita and democracy



Climate change

Madagascar is rich in natural capital. Efficient and equitable management of resource rents is essential to keeping socially counterproductive rent seeking under control. Madagascar's CO2 emissions are minuscule. Even so, the costs of climate change are large. The World Risk Report (2023) ranks Madagascar 17th. The sole other African country to be listed among the most vulnerable top twenty is Mozambique, in 7th place. Hence the importance of diversification, education, and trade for sustainable and inclusive growth to enable Madagascar to better cope with recurrent disasters.

A suitable strategic focus for Madagascar at this time would be on policies and institutions that foster economic development, protect the natural environment, and address both climate change and its local impacts. Economic and institutional diversification would effectively support the government's efforts to mitigate climate change and

manage its consequences.

Hausmann (2022) proposes several imaginative ways to accomplish this under the heading Green Growth Opportunities: (a) Generate more electricity from green sources (wind, solar, hydro) to reduce the need for burning fossil fuels. (b) Embrace the move of energy-intensive industries toward places rich in green energy to contain transport costs. (c) Foster good institutions and policies to minimize country risk and contain the cost of capital. (d) Pursue new technologies that can help reduce costs. (e) Think of different ways to capture carbon, such as reforestation. (f) Keep evolving, keep learning.

These recommendations presuppose a reorientation of public and private expenditures and priorities toward greener pastures. Madagascar has the potential to become a “climate solution country” in the global fight against climate change, thanks to its unique combination of natural resources (agricultural land, forests, ample water resources), critical minerals, abundant biodiversity, over 5,000 km of coastline, and renewable energy potential. Madagascar has minerals. By responsibly managing these resources, Madagascar can supply the critical materials needed for the global transition to clean energy, helping to combat climate change. Moreover, Madagascar has significant potential in solar and wind energy. Madagascar should strengthen protected area regulations, and speed up reforestation including at the community level. It can leverage carbon market funds for REDD+ initiatives to benefit local communities and involve mining companies in reforestation to enhance corporate responsibility and access carbon finance. The country’s rich biodiversity presents opportunities for eco-tourism and conservation-based economic development.

Conclusion

Madagascar’s poverty and persistently slow growth with weak governance have been exacerbated by climate change and COVID-19. The country’s high exposure to cyclones, droughts, floods, and sea level rise makes climate resilience crucial. Economic diversification is essential for development in the face of increasing climate risks, as is institutional diversification.

Diversification and climate risk mitigation tend to go hand in hand. Economic diversification requires improved fiscal management, including contingency funds for immediate and long-term climate adaptation and reconstruction, as well as integrating comprehensive disaster risk strategies into fiscal planning and enhancing climate impact

assessments. There is also a need to strengthen social safety nets to protect vulnerable populations, using revenues from environmental tax reforms, such as a “feebate” system, and expanding insurance coverage for climatic risks.

Structural reforms need to focus on climate-resilient investments and green technology as well as strict environmental standards in mining, particularly for critical minerals essential for the energy transition. Enforcing strict environmental standards and ensuring that large mining projects comply with sustainability standards will contribute significantly to climate resilience.

By combining economic and institutional diversification with such comprehensive reforms, Madagascar can improve its resilience to climate risks and promote sustainable economic growth.

References

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Footnote

1. Source: Authors’ computations, based on the Global Economic Diversification Index, World Development Indicators, and Democracy Report 2023, Defiance in the Face of Autocratization. Madagascar is shown in red.