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Using Public Resources for Economic Growth and Poverty Reduction

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REPUBLIC OF CHAD

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WEIGHTS AND MEASURES

Metric System

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AIDS	Acquired immune deficiency syndrome
BEAC	Banque des États de l'Afrique centrale
CFAF	Central African franc
CID	Computerized expenditure chain / budget information system (<i>Circuit Informatisé de la Dépense</i>);
CPA	Pharmaceutical purchasing center (<i>centrale pharmaceutique d'achats</i>)
DAFMs	Administrative and Financial and Contracts Directorates (<i>Directions Administratives et Financières et des Marchés</i>)
DAOs	Spending without prior authorization (<i>dépenses avant ordonnancement</i>)
DSA	Debt sustainability analysis
EIB	European Investment Bank
GDP	Gross domestic product
HIPC	Heavily Indebted Poor Countries Initiative
HIV	Human immunodeficiency virus
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LFI	Initial Budget Law (<i>Loi des finances initiale</i>)
LFR	Revised Budget Law (<i>Loi de Finance Rectificative</i>)
MDG	Millennium Development Goal
MoH	Ministry of Health
NEPAD	New Partnership for Africa's Development
NOPD	Non-oil primary deficit
NPRS	National Poverty Reduction Strategy
PIH	Permanent Income Hypothesis
PRSP	Poverty Reduction Strategy Paper
SHT	Société des Hydrocarbures du Tchad
SNRP I	First Poverty Reduction Strategy (<i>Première Stratégie Nationale de Réduction de la Pauvreté</i>)
SNRP II	Second Poverty Reduction Strategy (<i>Deuxième Stratégie Nationale de Réduction de la Pauvreté</i>)
STEE	Société Tchadienne d'Eau et d'Electricité
MTEF	Medium-Term Expenditure Framework
PAMFIP	Public Financial Management Modernization Support Program (<i>Appui à la Modernisation de la gestion des Finances Publiques</i>)
UNDP	United Nations Development Programme
WDI	World Development Indicators

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EXECUTIVE SUMMARY

Country Overview

Oil production in Chad provides an opportunity for growth and poverty reduction, in one of the poorest countries in the world. Chad is ranked 175th out of 182 countries in the 2009 UNDP Human Development Index ranking. Thirty years of recurrent conflict, instability, and civil war have led to the destruction of much of the physical and social infrastructure and drained this already poor country. Following rebel attacks in 2008 and 2009, and since the peace agreement between Chad and Sudan, the security situation has remained relatively calm, offering a window of opportunity for development. Oil production, starting in 2003, has led to a substantial increase in fiscal revenue and public spending. To channel these resources most efficiently, the government adopted a first poverty reduction strategy in 2003 and a second in 2008.

The opportunity to reduce widespread poverty has been, however, mostly missed to date, partly because of Chad's chronically unstable security situation. Chad's oil reserves are relatively modest and expected to be depleted within the next 25 years. It is therefore important to use this temporary resource windfall to set the country on a trajectory towards sustainable economic growth and poverty reduction. Some notable improvements have been achieved, particularly in physical infrastructure such as roads, and water and drainage. Chad continues nevertheless to face major challenges in social and economic development and is unlikely to achieve most MDGs on the current trend.

Fiscal Sustainability

Chad is spending its oil wealth quickly, raising concerns about sustainability and absorptive capacity. Since 2003-04, public spending has substantially expanded across all categories, driven by high oil revenue. Meanwhile, Chad mobilized relatively little non-oil resources. As a result, even compared to other oil-producing countries, Chad is spending a large proportion of its current oil revenues. The country's fiscal position has continued to deteriorate to reach an unsustainable level.

If current policies were to continue, the resulting debt path would lead to an unmanageable debt and debt-service burden. Chad's external debt burden diminished considerably over the past decade thanks to strong oil sector-driven growth and limited borrowing. The government even accumulated some savings in its account at the regional central bank when oil prices were high. However, these deposits proved insufficient, when oil prices dropped in late 2008 and 2009. Despite cuts in domestically-financed expenditure, the government had to drain its deposits, request central bank financing, and turn to non-concessional borrowing.

Effective Use of Public Resources

From a functional perspective, budget execution does not reflect strategic priorities. Budgetary appropriations more or less reflect the objectives spelled out in Chad's Poverty Reduction Strategies. Actual spending in priority sectors such as health and education has fallen short of expectations, however, because of greater problems in budget execution. Priority spending seems also to have been crowded out by unbudgeted expenditure, especially in the military.

From an economic perspective, a mismatch in the composition of spending prevents new infrastructure investment from becoming fully operational. Public investment has been expanding, especially in physical infrastructure, although cost effectiveness is questionable with a classroom costing more than four times as much as in the second most expensive country, Niger. Furthermore, expenditure on goods and services and on transfers has not followed, nor has appropriate staffing. This mismatch leads to concerns about the ability of government to meet the recurrent spending needs from the newly created structures. Field visits in late 2009 have revealed that many of the newly constructed health and education structures stood empty.

Acceleration of Public Finance Management Reforms

Despite progress in budget preparation, a limited multi-year framework and the absence of a formal project management system create problems. Major efforts have been made in recent years in the area of budget preparation. Macroeconomic projections and budget guidelines have improved. However, budgeting continues to be done on the basis of resources at hand instead of medium-term projections. Preparation of an annual budget based on a reliable multi-year budget would therefore be key to medium-term financial stability and a necessary condition for successful implementation of the government's policies and programs. Furthermore, there is no formal project preparation, adoption, programming, and budgeting framework and the development of such a framework would also be called for.

The expenditure chain remains too complex and institutional capacities limited. The expenditure chain is not yet sufficiently streamlined and steps need to be taken to better organize and more fully use information technology. Delegated appropriations are being delayed, hampering especially priority sectors such as health and education. Emergency budget procedures have become practically the rule for most spending in non-priority sectors and investment, crowding out priority spending. Further simplification would be called for. Furthermore, directorates in charge of budget execution have limited capacities and inter-ministerial coordination is weak, requiring efforts in capacity building.

INTRODUCTION

1. **Chad is among the poorest countries in the world.** Around 55 percent of the population lives below the poverty line and about 36 percent of the population lives in extreme poverty. Poverty is primarily concentrated in rural areas, where 87 percent of the country's poor live. Chad is ranked 175th out of 182 countries on the 2009 UNDP Human Development Index. Following rebel attacks in 2008 and 2009, and since the peace agreement between Chad and Sudan, the security situation in the country has remained relatively calm and could offer a window of opportunity for development and poverty reduction.

2. **In 2004 the Chadian economy underwent a fundamental transformation, as the country began to exploit its oil resources.** Oil was first discovered in the 1950s, the first exploration well was drilled in the early 1970s, but it was only in 2003 that oil production began with the sale of the first shipment in October 2003. The 2004 budget was the first budget to make use of oil revenues and government revenue increased more than six fold between 2003 and 2008.

3. **The opportunity to reduce widespread poverty provided by the dramatic increase in revenues has been, however, mostly missed to date.** Chad's first National Poverty Reduction Strategy (NPRS - I) was adopted in June 2003, aiming towards a 50 percent cut in poverty by 2015. In April 2008, the Government adopted a second generation NPRS. Despite both strategies, little progress is being made towards the Millennium Development Goals (MDGs): following the current trend, Chad is unlikely to achieve all but possibly one of the MDGs by 2015.

4. **The objective of this report is to examine to what extent oil revenues have been used to achieve stated government priorities.** It will examine the particular challenges that Chad faces in the management and use of its oil revenues, and provide suggestions on how oil resources might be better leveraged to achieve the country's development goals. After a brief description of the country context and recent trends in government revenue and expenditure, the note will attempt to respond to the following questions:

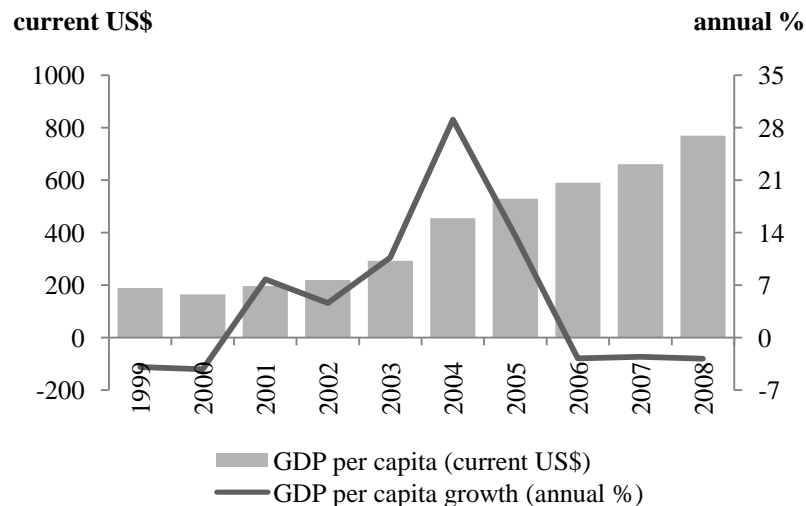
- In the context of this temporary resource windfall, is Chad striking the correct balance between savings and spending?
- Is Chad using public resources effectively to achieve stated government priorities?
- What are the major institutional/capacity shortfalls which explain weaknesses in public financial management?
- What measures might be put into place to improve public financial management?

CHAPTER 1. COUNTRY OVERVIEW

1. **Chad is one of the poorest countries in the world.** Chad is a landlocked country situated at the meeting point between the Sahel and the Sahara desert. Thirty years of frequent conflict, instability, and civil war have led to the destruction of much of the physical and social infrastructure and drained this already poor country¹. In addition, recurring droughts have exacerbated the already fragile situation of the rural population.

2. **Oil production has led to a remarkable increase in GDP per capita** (Figure 1). In 2002, before the start of the oil era, the economy was predominately agrarian, and GDP per capita estimated at around US\$ 220, less than half of the average in Sub-Saharan Africa.² By 2008, with average annual GDP growth rates of about 19 percent, GDP per capita had risen to about US\$ 770.³ Methodological differences between the available household surveys make it, however, impossible to determine to what extent poverty indicators have changed. Poverty still affects 55 percent of the population and is primarily concentrated in rural areas; where about 90 percent of the country's poor live. Furthermore, there are substantial regional disparities with a poverty rate of 50 percent in the rural parts of the North, but 70 percent in the rural South.

Figure 1 : Recent Growth in Per capita Income



Source: WDI

3. **Chad's first National Poverty Reduction Strategy (NPRS – I) was adopted in June 2003.** When it adopted its National Poverty Reduction Strategy in June 2003, the Government of the Republic of Chad undertook to meet four major challenges: (i) extreme poverty, which kept the

¹ Despite the relative return to peace in 1993, after 30 years of civil war, the country continues to experience periods of instability, including with rebel attacks against N'Djamena in April 2006 and February 2008. The regional security situation contributes to the pressure, with about 290,000 Sudanese refugees settled in the east of the country and 48,000 refugees from the Central African Republic in the south. Moreover, tens of thousands of Chadians have left their villages situated on the border with Sudan and are considered as internally displaced persons (IDP).

² World Development Indicators, 2009.

³ Ibid.

country near the bottom of the human development index; (ii) its limited capacity to respond to poverty; (iii) structural constraints to sustainable human development; and (iv) attainment of the completion point under the Heavily Indebted Poor Countries Initiative (HIPC Initiative). The NPRS - I also sets out Chad's commitment to achieving the eight Millennium Development Goals (MDGs) by 2015.

4. **In April 2008, the Government adopted a second generation National Strategy for Growth and Poverty Reduction (NPRS – II).** The strategy document recognizes the limited progress that the country has made towards the achievement of the MDGs, and lays out a strategy to improve human and economic development outcomes in the country. The major axes of this strategy include: (i) good governance; (ii) promotion of robust and diversified growth; (iii) sustainable development of rural areas; (iv) infrastructure; and (v) investment in human capital. This new strategy emphasizes the importance of growth for poverty reduction, and places particular emphasis on the need to improve the business climate and the efficiency of public spending.

5. **Some notable improvements have been achieved.** Substantial investments have been made in physical infrastructure; the network of paved roads has more than tripled in ten years – from 350 km to 1100 km. In water and drainage, infrastructure throughout N'Djamena and in the east of the country, improving access to safe drinking water. In 2010, 45 percent of the population had access to safe water compared to barely 30 percent in 2004.⁴ Some progress has also been made in expanding access to primary education.⁵ Gross enrollment was reported to have reached 98.2 percent in 2009, compared to 80.5 percent in 2002.⁶ Notable achievements have also occurred in the health sector, although advances have been slower: the under 5 mortality rate stood at 180‰ in 2010, compared to 194‰ in 2000.⁷ Vaccines have been prepaid for the next two years; HIV testing expanded; and a new fund granting free access to urgent obstetrical services was established in 2008. In N'Djamena, a national maternal and pediatrics hospital was constructed, and the construction of 85 health centers and 14 hospitals throughout the country is on-going (mostly replacing existing facilities).

6. **Chad continues nevertheless to face major challenges in social and economic development, and is unlikely to achieve most of the MDG** (Table 1). Given its history of political instability and low levels of economic development, the country is only beginning to catch up with other countries in Sub-Saharan Africa on health and education outcomes. Despite a recent expansion in primary education, gross primary enrolment in Chad remains below a group of comparator countries, with the exception of Burkina Faso (Figure 2). Similarly, given the weak health infrastructure and the difficulty of distributing vaccinations to its sparsely populated regions, child immunization rates remain low (Figure 3).

⁴ Data from the Ministry of Water.

⁵ The extent of the progress is, however, difficult to assess as administrative data for the education sector has not been aggregated for the past several years

⁶ Data from the Statistics Yearbooks 2002 and 2009.

⁷ Data from the Multiple Indicators Clusters Survey, 2000 and 2010.

Table 1 : Update on the Achievement of MDGs

Goal 1: Eradicate extreme poverty and hunger	Off track	GDP per capita is too low and irregular to significantly reduce poverty and malnutrition
Goal 2: Achieve universal primary education	In part on track	Primary education is officially free, and the primary gross enrollment rate is about 80 %, however, primary completion and quality of teaching remains low
Goal 3: Promote gender equality and empower women	Off track	Problems of gender inequality persist; the new Family Code, which could improve women's rights, has not yet been approved.
Goal 4: Reduce child mortality	Off track	Poor management in the health sector has led to persistently high rates of child mortality.
Goal 5: Improve maternal health	Off track	Weak implementation of the government's strategy has led to an increase in maternal mortality between 1998 and 2004
Goal 6: Combat HIV/AIDS, malaria, and other diseases	In part on track	Education campaigns have led to an increased awareness of HIV/AIDS, and ARVs are available free of charge; However detection and treatment of TB and malaria is lower than the Sub-Saharan African average.
Goal 7: Ensure environmental sustainability	In part on track	Important progress has been made on provision of safe drinking water and efforts have been made to fight against desertification.

Figure 2 : Gross Primary Enrollment Rate

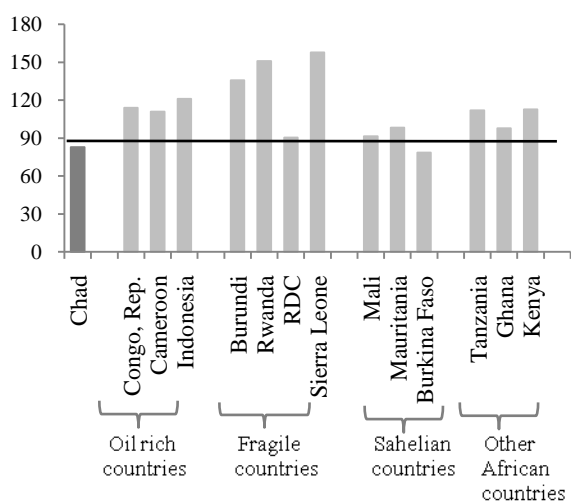
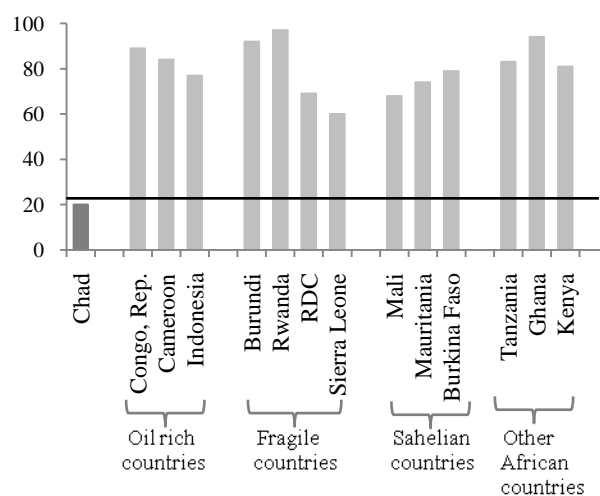


Figure 3 : Immunization, DPT (% Children ages 12-23 mths)



Source: WDI, 2009

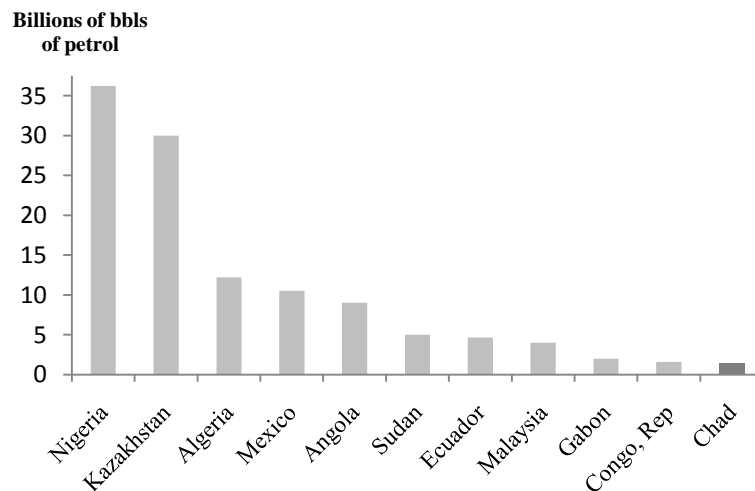
Note: All data from 2008-09

CHAPTER 2: FISCAL SUSTAINABILITY

2.1 The Medium-Term Fiscal Path Seems Unsustainable

7. **Chad's oil reserves are relatively modest and expected to be depleted within the next 25 years.**⁸ Chad has about 1.5 billion barrels of proven reserves, which represent about 145 barrels per capita. This amount is fairly modest when compared to 502 barrels per capita in Angola and 243 barrels per capita in Nigeria.⁹ With annual extraction rates of about 8 percent (proxied by production as a share of reserves), oil reserves are expected to be depleted by 2035. The successful exploitation of the second oil field would not significantly alter the downward path of revenue, since this oil field is only about one third of the size of the Doba oil field. The limited nature of oil revenues underscores the importance of using these temporary resources judiciously, and set the country on a trajectory towards sustainable economic growth and poverty reduction.

Figure 4 : Oil Reserves



Source: CIA Factbook, 2010

8. **A balance must be found between expanding public spending to meet pressing development needs, and managing the unpredictability of oil prices and limited nature of oil revenues.** The Government faces many challenges which justify the use of temporary windfall resources for investment in physical and social infrastructure. In the face of poor human development outcomes and widespread poverty, the country's oil wealth could go far to help to jumpstart growth and improve livelihoods. At the same time, investments create recurrent budget expenditure that will weigh on the government budget. Furthermore, given the unpredictable and highly variable changes in oil prices, it is important to maintain some level of savings which can be used to protect the level of

⁸ The analysis focuses on the Doba field. It is not excluded that further reserves be identified and exploited in the future. In addition, Chad is trying to develop other natural resources, such as gold, iron, and uranium.

⁹ Based on CIA Factbook estimates of oil reserves and population, 2010.

public spending in years when the oil price drops lower than expected. The Government must be mindful, therefore, to ensure that fixed expenditures are kept to a sustainable level, and that adequate funds are set aside in the medium-term to protect against major variations in the oil price.

9. **The permanent income hypothesis (PIH) provides a medium-term framework for the use of oil revenues.** The PIH framework addresses the key fiscal challenges facing oil producers. By linking public spending to oil wealth rather than current oil revenues, the approach prevents the current generation to deplete these resources for its benefits only and safeguards the interests of future generations. The framework also provides rules to guide fiscal policy that largely protect public spending from short-term fluctuations in oil prices, thereby smoothening the path of public expenditure. A more stable spending path helps address the risks associated with pro-cyclical fiscal policy such as exacerbating the volatility of economic activity generated by oil price fluctuations or exceeding the country's absorptive capacity that accompany rapid expansions in spending.

10. **Results suggest that Chad's fiscal policy is unsustainable.** The International Monetary Fund (IMF) examined the sustainability of Chad's non-oil primary deficit using the PIH approach, and found that in order to maintain fiscal sustainability over the medium term, Chad would need to contain its non-oil primary deficit (NOPD) as a ratio to non-oil GDP to low single digits.¹⁰ While Chad managed to contain the deterioration of its NOPB in the early years of oil production, the country's fiscal position has continued to deteriorate since then, with an NOPB reaching about 25 percent of non-oil GDP in 2009 (Table 2). If current policies were continued, the resulting debt path would lead to an unmanageable debt and debt-service burden.

Table 2 : Chad: Selected Government Finance Indicators, 2004-12
(percentage of non oil GDP unless otherwise noted)

	2004	2005	2006	2007	2008	2009
Government expenditure (domestic only)	14.4	15.5	24.6	33.7	39.4	40.9
Recurrent (net interest)	10.2	10.7	18.7	24.5	28.0	28.6
Capital	3.4	4.2	5.0	8.4	10.8	11.3
Interest and Principle	0.7	0.6	0.8	0.7	0.6	1.0
Government revenue	14.0	17.6	31.8	41.6	48.6	25.2
Non-oil revenue excl. grants	9.3	8.8	8.8	11.0	10.3	11.9
Primary fiscal balance (excl grants)	-0.4	2.1	7.2	7.9	9.2	-15.7
Non-oil primary balance (percentage of non-oil GDP)	-4.3	-5.2	-15.0	-22.1	-28.7	-28.0

Sources: Chadian authorities; and IMF staff estimates and projections.

2.2 Driven by High Levels of Spending and Limited Non-Oil Revenue

11. **The Government is highly reliant on oil revenues to finance public spending.** Government revenues increased more than six fold between 2003 and their height in 2008, going from CFAF 125 billion to CFAF 986 billion, reflecting increased oil production and high oil prices (Figure 5). Over 2006-09, oil represented on average about 43 percent of GDP and government oil revenues represented 71 percent of total government revenues. Compared with a group of other oil producing Sub-Saharan African countries, Chad mobilizes relatively little non-oil revenue. While

¹⁰ The NOPB is defined as total revenue excluding grants, oil revenue and interest on government assets, minus total expenditure excluding interest payments and foreign financed investment. Focusing on the NOPB rather than the overall balance eliminates fluctuations unrelated to the fiscal stance (such as volatile oil prices) and makes it clear that fiscal proceeds from oil should be viewed as financing.

Chad's non-oil revenue represents only about 9 percent of non-oil GDP, other Sub-Saharan African Countries have managed to mobilize between 20-25 percent (Figure 6).

Figure 5 : Evolution of Government Revenue, 2006-12

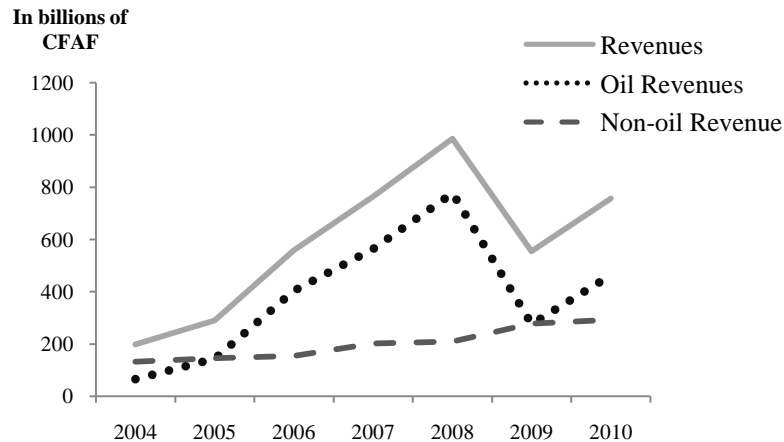
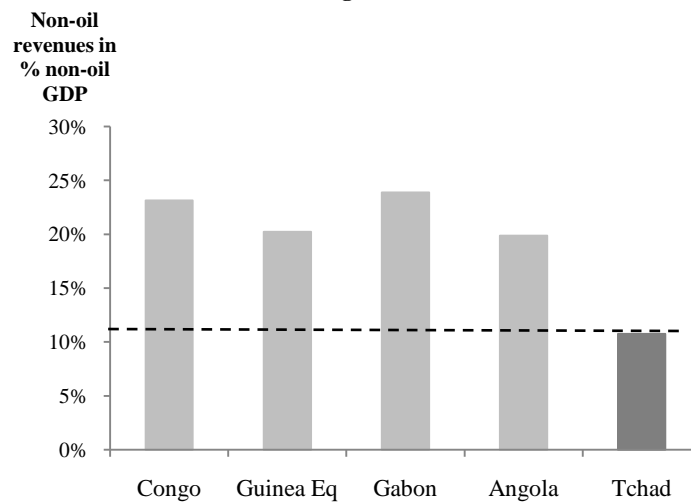


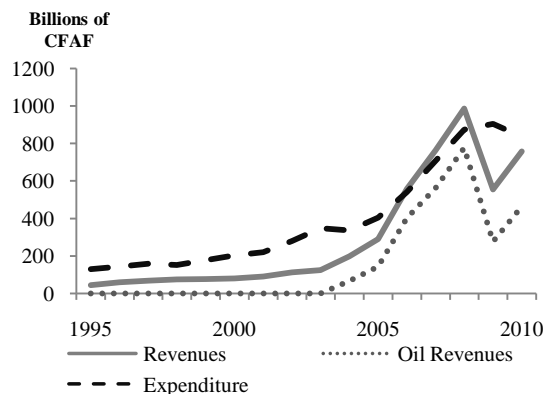
Figure 6 : Chad mobilizes less non-oil revenue than other oil producing countries (average 2006-09)



Source: IMF.

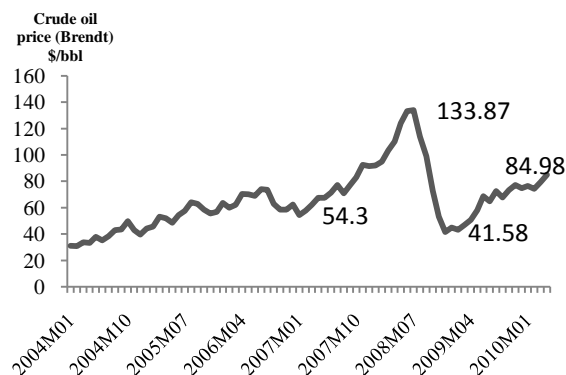
12. **Public expenditure has significantly increased, driven by high oil revenues.** Since 2003-04, public spending has substantially expanded across all categories. The domestically-financed budget increased from about CFAF 337 billion in 2004 to CFAF 905 billion in 2009 (from 14.4 percent of non-oil GDP to about 40 percent of non-oil GDP). The recurrent budget (net of debt service payments) increased from CFAF 145 billion in 2004 to CFAF 612 billion in 2009 (from 10.2 percent of non-oil GDP to almost 30 percent of non-oil GDP): a three-fold increase. The domestically-financed investment budget experienced a similar expansion, increasing from 3.4 percent of non-oil GDP in 2004 to 9.4 percent of non-oil GDP in 2009.

Figure 7 : Government Revenues and Expenditures 1995-2010, in millions of CFAF



Source: IMF, 2009.

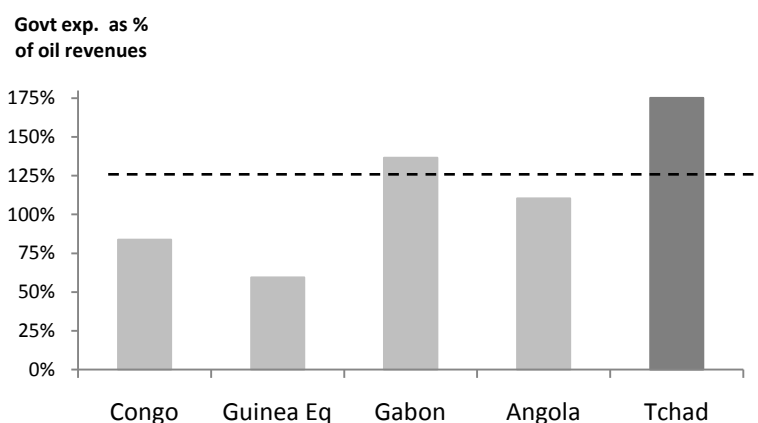
Figure 8 : Evolution of crude oil prices 2006-09 (Brent), monthly US\$/bbl



Source: IMF, 2009.

13. **Chad is spending its oil wealth quickly, raising concerns regarding sustainability and absorptive capacity.** Oil-producing countries in the region tend to rely heavily on oil revenues to finance their public spending. Even against this benchmark, Chad spends a large proportion of its current oil revenues (Figure 8). In 2006, for a group of comparator countries, government expenditures represented 77 percent of oil revenues, compared with 134 percent for the Chad. In 2008, when oil prices were high, Chad spent 210 percent of oil revenues compared with 85 percent for comparator countries. Although this high level of spending could be justified given Chad's development needs, current levels of spending must also be guided by concerns about: (i) appropriate savings to smooth public expenditure over time; (ii) future recurrent implications of investment spending; and (iii) absorptive capacity of the government to scale up spending.

Figure 9 : Expenditure as a percent of oil revenues for countries very dependent on oil revenues (average 2006-09)



Note: For all countries included in figure, oil revenues represent at least 60 percent of total government revenues.
Source: IMF, 2009.

2.3 Depleting Government Savings and Leading to New Borrowing

14. **Chad's external debt burden diminished considerably over the past decade thanks to strong oil sector-driven growth and limited borrowing.** Debt levels trended downward as Chad

reduced its use of external loans, amortized debt as scheduled, and prepaid IBRD and IDA loans associated with the financing of the Chad-Cameroon Pipeline Project in September 2008. The stock of external debt declined from 63 percent of GDP in 2001 to 24 percent in 2009 (Table 3).¹¹ All of Chad's external debt is public, and the bulk is owed to multilateral creditors, mainly the International Development Association (IDA) and the African Development Bank (AfDB). This includes debts incurred or guaranteed by the central government.

Table 3 : Chad: External Debt Stocks at Year-End, 2001-09 (billions of CFAF)

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total	794.7	786.6	736.9	797.2	898.9	896.2	794.0	782.3	764.6
(percent of GDP)	63.4	56.8	46.3	34.2	29.0	27.2	23.6	20.9	23.7
Multilateral	678.1	687.7	652.5	715.3	810.2	805.5	718.6	706.6	688.6
IMF	65.3	67.3	57.0	47.7	47.5	37.4	25.4	19.0	12.9
World Bank/IDA	380.6	398.3	394.0	444.5	507.8	486.1	453.4	422.0	408.0
African Development Fund/Bank	182.8	169.8	159.9	168.5	179.8	205.8	173.7	182.4	187.2
EIB	3.9	7.9	7.3	13.0	13.0	12.4	9.9	9.8	8.1
Others	45.5	44.4	34.2	41.6	62.0	63.8	56.2	73.4	72.4
Bilateral	116.2	98.6	84.1	81.9	88.8	90.7	75.4	75.7	76.0
Paris Club official debt	30.2	25.8	24.0	25.2	24.3	23.2	23.6	19.2	17.9
Non-Paris Club official debt	86.1	72.7	60.1	56.7	64.4	67.5	51.8	56.5	58.0
<i>Of which:</i> China, People's Republic	28.6	25.4	22.0	13.6	15.4	13.9	-	3.5	10.3
Taiwan, Province of China	29.2	25.0	20.8	19.2	20.8	16.2	15.0	15.1	13.8
Saudi Arabia	10.4	9.3	6.2	15.2	16.9	14.4	11.4	7.8	6.6
Kuwait	15.3	12.9	11.0	8.6	11.2	11.7	10.8	10.2	8.4
Other creditors	0.4	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0

15. **Oil production has not only increased the amount of resources available to the Government, but has left it vulnerable to oil price shocks.** Oil prices had previously varied between about 55 US\$/bbl and 75 US\$/bbl over the first half of the period, but began to mount steadily starting in 2007. From a low of 54 US\$/bbl in January 2007, oil prices rose to a high of 134 US\$/bbl in July 2008, and then dropped dramatically to 42 US\$/bbl over the following five months (Figure 8). When oil prices crashed between 2008 and 2009, government revenues shrank by 46 percent in a single year.

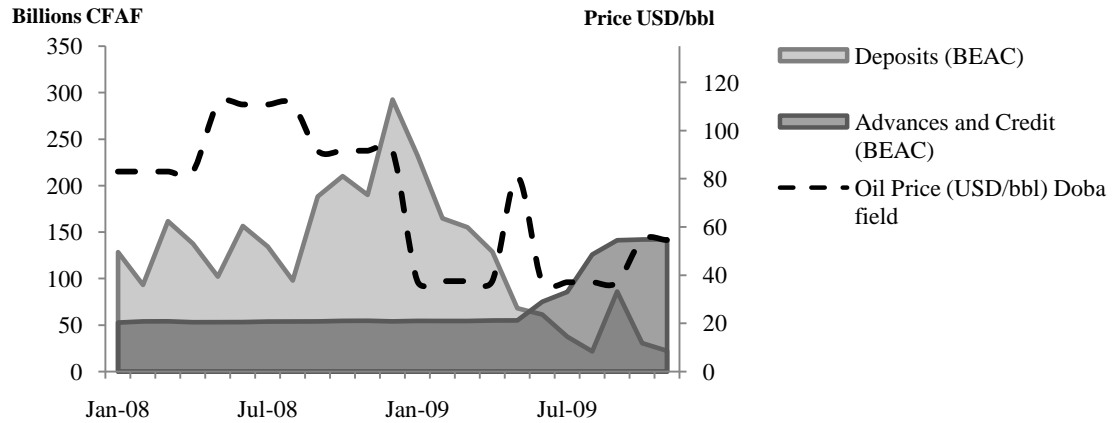
16. **Without appropriate savings the country had to borrow.** The government accumulated some deposits in its account at the BEAC when oil prices were high. However, these deposits showed insufficient, when oil prices dropped in late 2008 and early 2009. Not only domestically-financed expenditures did not adjust in accordance with lower revenues but, in fact, they increased from 2008 to 2009 by 9.6 percent. As a result, the government had to drain its deposits at BEAC, request advances to meet its financing needs, and turn to non-concessional borrowing. An official creditor has agreed to lend the Government of Chad \$300 million (3.6 percent of 2009 GDP) for budget support.¹² A commercial creditor associated with the construction of the N'Djamena refinery has agreed to lend the Chadian partner, the state-owned *Société des Hydrocarbures du Tchad* (SHT), €232 million (4.1

¹¹ The analysis is conducted on a gross basis.

¹² With a grant element of about 15 percent, with 2 ½ years grace and 6 years maturity

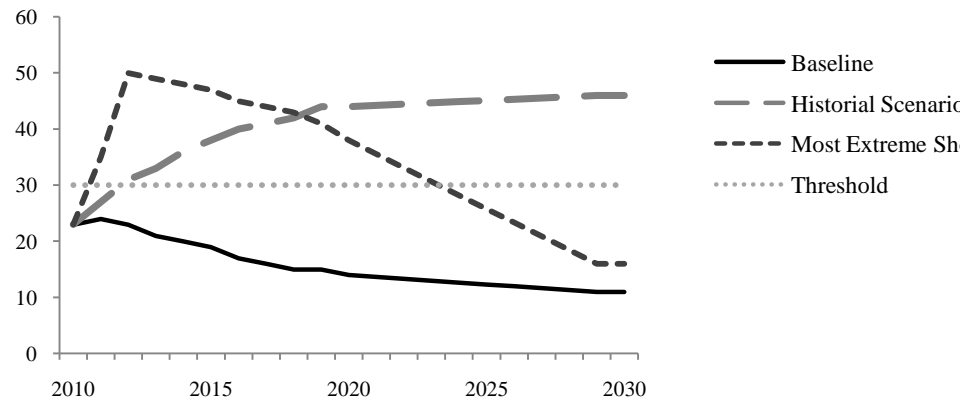
percent of 2009 GDP).¹³ These loans will increase external public debt from 24 percent of GDP in 2009 to 28 percent in 2011.

Figure 10: Evolution of BEAC Deposits and Advances, 2008-09



Source, IMF 2009.

Figure 11: Forecasted Present Value of Debt to GDP (Ratio)



Source : Joint Fund-Bank DSA, May 26, 2010.

¹³ At LIBOR plus 3 percent, with 5 years grace and 10 years maturity

CHAPTER 3: EFFECTIVE USE OF PUBLIC RESOURCES

3.1 A Functional Analysis

a. Chad's poverty reduction strategies have defined objectives

17. **The first National Poverty Reduction Strategy was the Government of Chad's first full strategy for poverty reduction and economic growth.** The Chadian Government presented their National Poverty Reduction Strategy Paper (NPRS) in June 2003. The document assesses the extent of poverty in Chad, defines the causes, outlines the strategy to eradicate poverty, and describes the plan for implementing the NPRS. The poverty reduction strategy aimed to set the country on a course to reduce poverty to below half the estimated 1995 level by 2015, in line with the Millennium Development Goals. The NPRS specifically aimed to: (i) improve political, judicial, economic and social governance; (ii) ensure strong and sustained growth; (iii) improve human capital, including HIV/AIDS prevention and mitigation; (iv) improve living conditions of vulnerable groups; and (v) restore and safeguard ecosystems. This NPRS was designed as the first of three strategies to be implemented between 2003 and 2015.

18. **The NPRS - II (2008-2011) is the Government of Chad's current instrument to promote growth, poverty reduction and the achievement of the MDGs.** In this capacity, it represents the basis for the planning of both government activities and externally funded donor activities. The major axes of this strategy include: (i) good governance; (ii) promotion of robust and diversified growth; (iii) sustainable development of rural areas; (iv) infrastructure; and (v) investment in human capital. The 2008-11 NPRS employs a medium-term expenditure framework to set required budget allocations to finance the government's ambitious development program.¹⁴ The budget estimates were elaborated on the basis of the costed sectoral priority action plans, which were then adapted to fit within the constraints of the macroframework. This process contributes to better planning of resources, but is limited by the absence of sectoral strategies in departments.

b. That are broadly reflected in budgetary appropriations

19. **Priority sectors over the first NPRS received slightly lower budgetary allocations than envisaged.** The first NPRS implied that about 55 percent of the budget be allocated to priority sectors to attain NPRS goals.¹⁵ Actually, budgetary allocations to non-security priority sectors accounted over this period (2004-07) on average for about 50 percent of the total budget (net of payments to debt).¹⁶

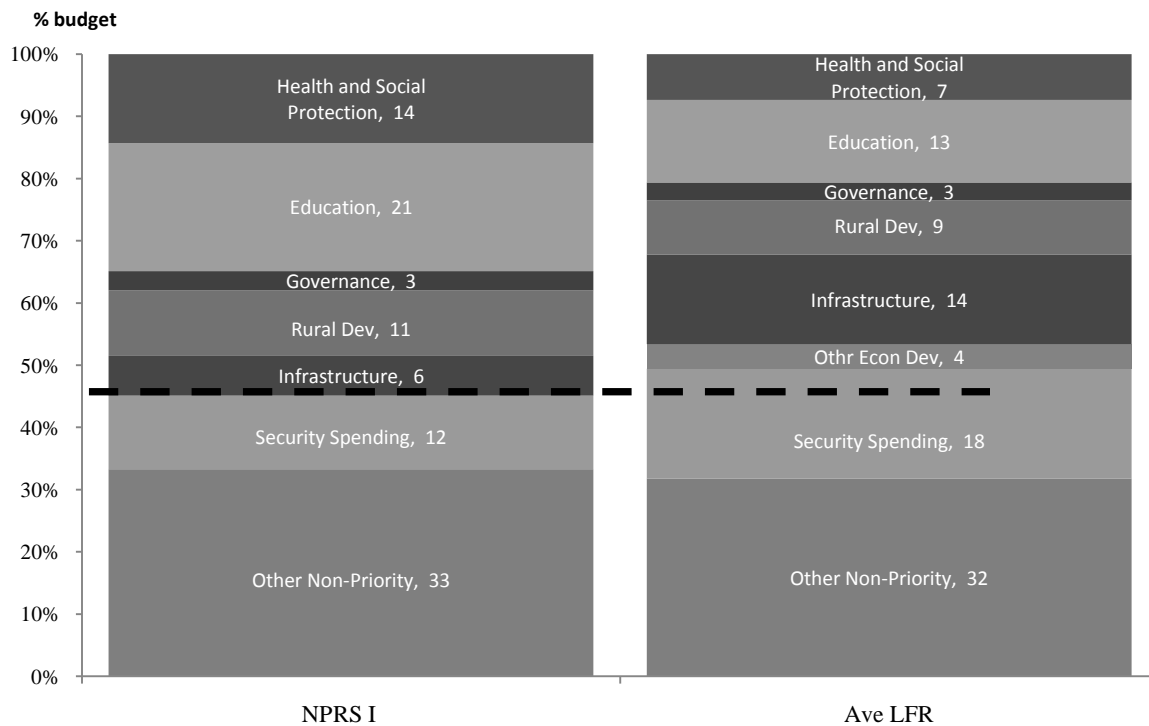
¹⁴ The first NPRS also included estimates of the cost of the implementation of the strategy, but was not based on as thorough of a costing exercise as the second NPRS.

¹⁵ Net of debt; For NPRS I, taken from Table 6: Public Spending by Sectors, 2003-06 ; for NPRS II taken from annex II of part I ; for the first two years of NPRS II, 2008-09, the documents estimates 52 percent of the budget will be allocated to priority sectors.

¹⁶ Priority sectors are as defined in the 2006 MOU: Min. Santé ; Min. Action sociale; Min. Enseignement de Base & Secondaire; Min. Enseignement Supérieur; Min. Agriculture; Min. Elevage; Min Environnement et Parcs Pêche et hydraulique; Ministère d'Etat aux Infrastructures; Ministère d'Etat à l'Aménagement du Territoire; Ministère d'Etat aux Mines; Postes et Nouvelles Technologies; Devpt Associatif & Micro-Crédits; Pétrole; Justice; Cour Suprême; Haute Cour de Justice; Droit de l'Homme; Décentralisation; Contrôle Général de l'Etat; Conseil Economique & Social

Lower-than-expected spending in priority sectors was the result of higher allocations to security spending which made up approximately 18 percent of the total budget on average, compared with the 12 percent in the NPRS.¹⁷ The remaining 32 percent of the budget was allocated to non-priority, non-security related Ministries, including sovereignty spending (such as the Presidency and the Office of the Prime Minister), as well as a number of other ministries (i.e. Ministry of Tourism, Ministry of Cultural Development).

**Figure 12: Comparison of NPRS I targets with LFR Allocations
average 2004-07**



Sources: Chadian authorities and staff's calculations

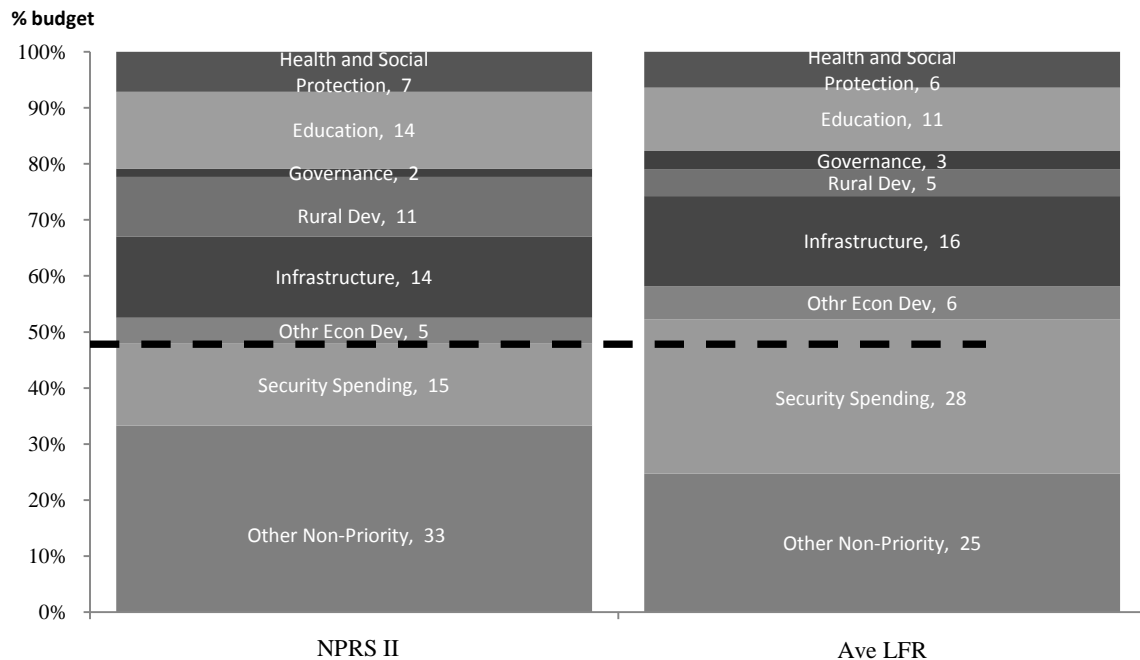
20. **Examining the allocation composition by sectors reveal, however, wider discrepancies.** Budgetary allocations to health and social protection were roughly half those proposed in the NPRS (at 7 percent compared with 14 percent in the NPRS). Similarly, allocations to education were about 60 percent of those estimated in the NPRS (at 13 percent as opposed to 21 percent), just over half of the allocation suggested to achieve quality universal primary education (20 percent of the budget). By contrast, allocations to infrastructure were more than twice the NPRS target (14 percent against 6 percent in the Strategy), while budgetary allocations to rural development were more or less in line with the SNRP (9 percent in the budget as opposed to 11 percent).

21. **Similarly for the second NPRS, budgetary allocations for priory sectors as a whole have been slightly lower-than-envisaged with wider differences at the sector level.** During the first half

¹⁷ including Ministry of Defense, Ministry of Public Security and Exceptional Defense Spending

of the second NPRS period, allocations to non-security priority sectors accounted for about 48 percent of the total budget (net of payments to debt), compared with the 52 percent estimated for the first two years of the NPRS II.¹⁸ While budgetary allocations to infrastructure were slightly higher than anticipated, allocations to rural development were about half those suggested in the NPRS. With only 5 percent of the budget being allocated to rural development, Chad lags far behind the share of 10 percent of the budget that NEPAD suggests is necessary to reinvigorate the agricultural sector in Sub-Saharan Africa. Budgetary allocations to security spending once again turned out to be much higher (approximately 28 percent of the total budget on average compared with the 15 percent in the NPRS).

Figure 13: Comparison of NPRS II targets with LFR Allocations
average 2008-09



Sources: Chadian authorities and staff's calculations

c. But priority sectors face greater difficulties in budget execution

22. **Actual expenditures have fallen short of NPRS and LFR budget targets.** Because of greater problems in budget execution in priority sectors and high exceptional spending in other areas, actual priority expenditure fell short of expectations. For instance, total budget execution in 2005-09 was on average 94 percent of the amount foreseen in the revised budget.¹⁹ On average over this same period, priority sectors as a whole were only able to execute about 90 of the budget allocated in the LFR. As a result, priority sectors represented only about 45 percent of total spending in 2008-09

¹⁸ As defined in the 2006 MOU: Min. Santé ; Min. Action sociale; Min. Enseignement de Base & Secondaire; Min. Enseignement Supérieur; Min. Agriculture; Min. Elevage; Min Environnement et Parcs Pêche et hydraulique; Ministère d'Etat aux Infrastructures; Mère d'Etat à l'Aménagement du Territoire; Ministère d'Etat aux Mines; Postes et Nouvelles Technologies; Devpt Associatif & Micro-Crédits; Pétrole; Justice; Cour Suprême; Haute Cour de Justice; Droit de l'Homme; Décentralisation; Contrôle Général de l'Etat; Conseil Economique & Social

¹⁹ If two LFRs were passed in the same year, as was the case in 2006, the second LFR was taken.

(while the NPRS II envisaged about 52 percent of the budget to achieve the government’s planned objectives).

Figure 14: Priority v. Non Priority Execution NPRS I

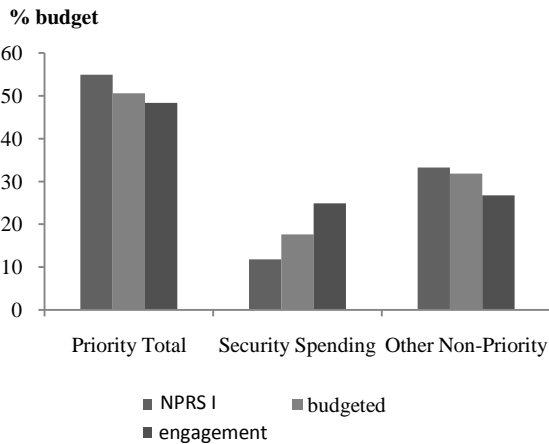


Figure 15: Priority v. Non Priority Execution NPRS II

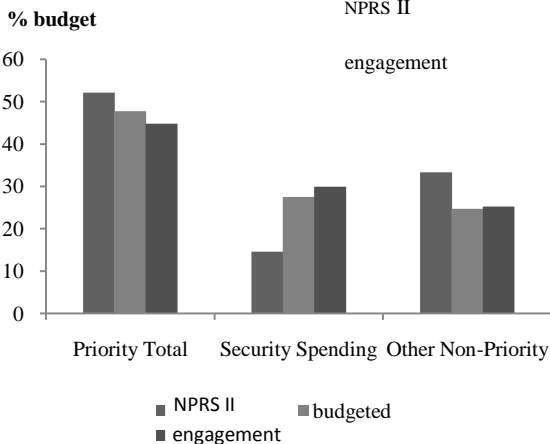
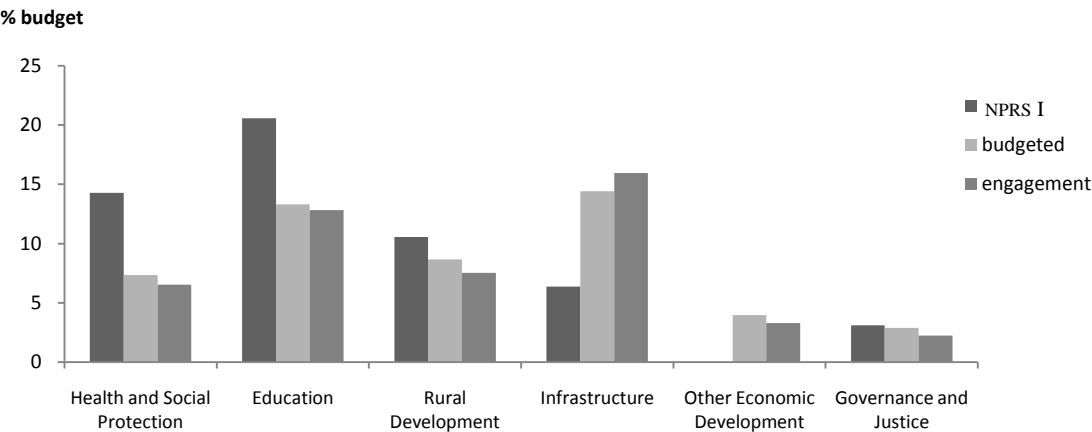
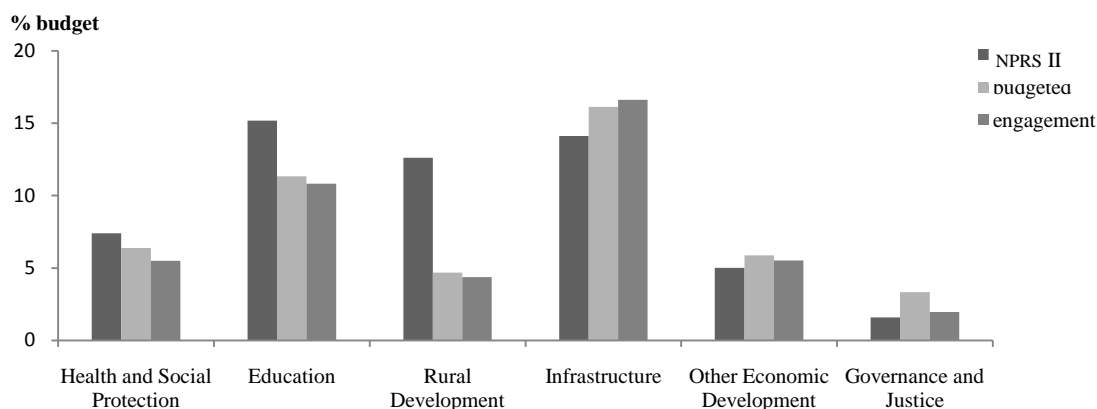


Figure 16: Sectoral Budget Execution During the NPRS I Period



Source: Ministry of Finance, NPRS I

Figure 17: Sectoral Budget Execution During the NPRS II Period

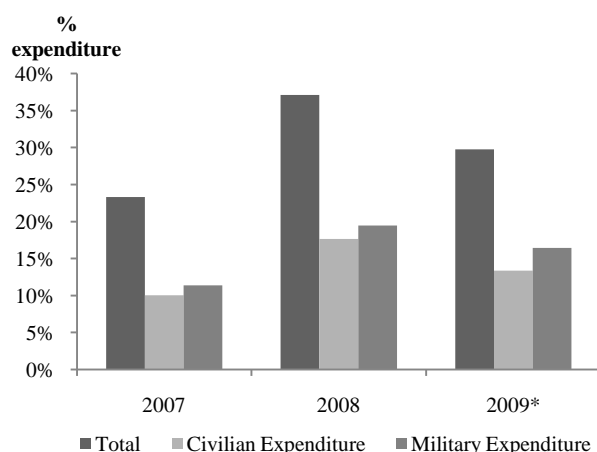


Source: Ministry of Finance, NPRS II

23. **Budget execution is stronger in some priority sectors than others.** Execution of the budget of the Ministry of Infrastructure is strong, with the ministry executing more than 90 percent of its budget nearly every year over the period. Social sectors perform, however, somewhat more poorly. While education had an average execution rate over the period 2005-09 of about 90 percent, health executed on average over 2006-08 about 88 percent of its budget, ranging from a high of 100 percent in 2005 to a low of 68 percent in 2006. In rural development, execution of the budget has improved markedly since 2006, increasing from 75 percent in 2006 to about 104 percent in 2008.

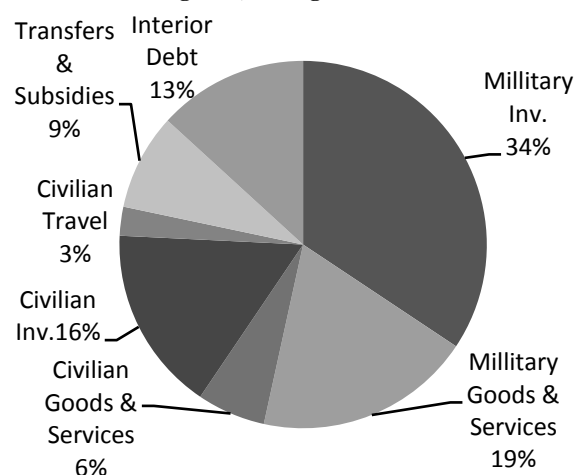
24. **Priority spending seems to have been crowded out by unbudgeted expenditure.** Weak budget execution appears to be, at least in part, due to relatively high use of DAO (*dépenses avant ordonnancement* - spending without prior authorization), which crowds out spending in priority sectors. On average DAO represent about 30 percent of all spending over the years 2007-09. While, on average about 70 percent of this spending was regularized before the end of the year in which it took place, this heavy use of DAO can disrupt the ability of ministries to engage their planned budgets due to treasury management issues. Military expenditure made up roughly 50 percent of the DAO during the period, and military DAO were roughly 16 percent of the total budget.

Figure 18: Civilian and Military DAO 2007-09



Source: IMF and Chadian Authorities, February 2010.

Figure 19: Distribution of DAO between Economic Categories, average 2007-09



Source: IMF and Chadian Authorities, February 2010.

25. As a result, in comparison to other Sub-Saharan African and oil producing countries, Chad performs relatively poorly in terms of its allocation of public resources to sectors that are important for poverty alleviation and economic growth (Table 4). While Chad does reasonably well in comparison to other peer countries in its allocations to rural development – even though the allocation to this sector falls short of the country’s own NPRS’s objective – and infrastructure, it lags behind in allocations to health and education. The relatively high allocation to rural development in Chad is warranted, since a large share of the population continues to live in rural areas and, after the oil sector, agricultural is the next most important sector in terms of contribution to GDP (in 2007 agriculture represent 11.7 percent of GDP, livestock 9 percent and fishing and mining 2.2 percent).

Table 4 : Comparison of Spending on Priority Sectors

	(Percent of GDP)					
	Chad	Republic of Congo	Indonesia	Tanzania	Cameroon	Rwanda
	Average 2006-09	Average 2004-08	Average 2006-07	Average 2003-04	Average 2005-06	2007
Select Priority Sectors	9.5	7.2	8.5	12	5.6	11.6
Education	2.4	2.0	4.1	5.1	3.0	5.2
Health	1.0	1.8	1.1	2.7	0.8	2.6
Rural Development	2.8	0.6	0.6	3.2	0.4	1.0
Infrastructure	3.4	2.8	2.6	1	1.4	2.8
	(US\$/Cap)					
	Average 2006-09	Average 2004-07	Average 2006-07	Average 2003-04	Average 2007-07	2007
Select Priority Sectors	62.7	127.2	78.9	88.7	82.3	31.6
Education	15.7	36.9	38.0	56.8	39.6	18.3
Health	6.4	35.2	10.5	5.8	11.5	9.0
Rural Development	18.2	11.2	6.0	8.5	5.8	3.5
Infrastructure	22.5	43.9	24.4	17.6	25.4	9.6

Note: Data includes external funding.

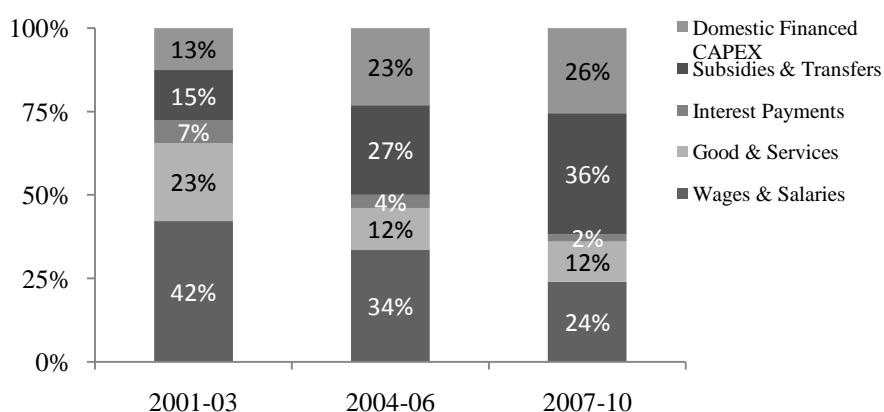
Source: IMF; World Bank; Bank of Tanzania; Bank of Indonesia; Ministry of Finance Republic of Congo

3.2 An Economic Analysis

a. Public investment has been expanding

26. **There is a strong argument for Chad to invest in its social and physical infrastructure.** Given the country's limited infrastructure, effective public investment could have a positive impact on productivity and create incentives for private capital accumulation. Countries with a low capital stock, like Chad, may benefit more from investments which increase the return to private investment and economic growth.²⁰ Not only might the return to these investments be higher than which the country might receive as returns in the financial market, but public investment spending may yield positive productivity externalities and jump-start growth.

Figure 20: Economic Composition of Govt Spending, 2001-09
(in percent of domestic exp.)



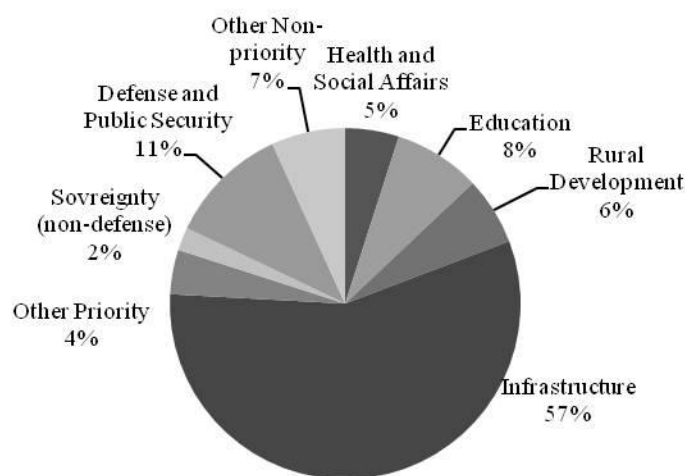
Source: IMF.

27. **Public investment in Chad is dominated by spending on physical infrastructure.** Investment spending in physical infrastructure took up approximately 57 percent of the investment budget on average over the period (Figure 20), with the importance of infrastructure in the investment budget growing steadily over the period (Figure 21). As a result, improvements in the country's infrastructure can be noted. For instance, in 2004 only about 700 km of Chad's roadways were paved (less than 2 percent of the total road network).²¹ By 2009, about 1100 km of the roadways had been paved, including most major roads in N'Djamena and roads connecting major cities.

²⁰ See Takizawa, Gardner, and Ueda (2004)

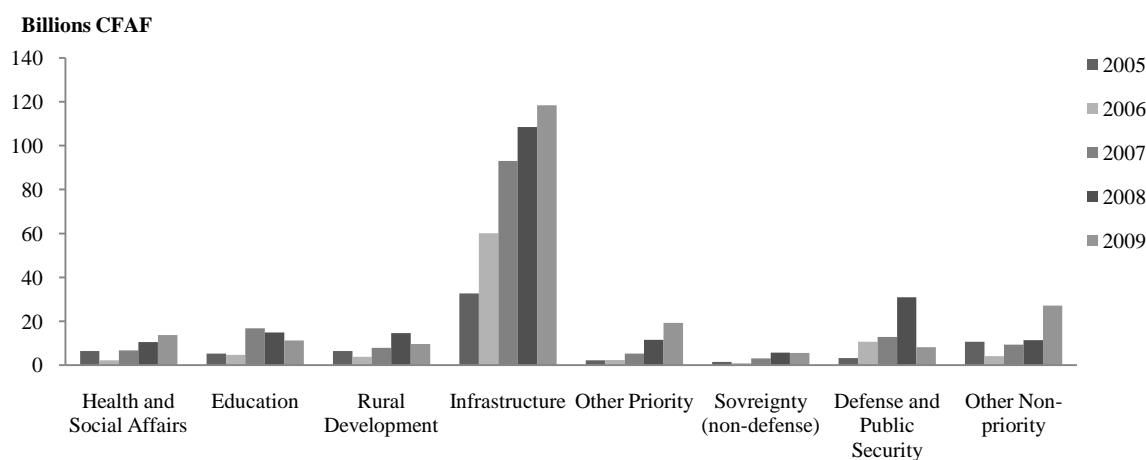
²¹ *Chad - Trade and transport facilitation audit* (English) World Bank Working Paper, 2004.

Figure 21: Distribution of Investment Spending 2005-09 (commitment basis)



Sources: Chadian authorities and staff's calculations

Figure 22: Trends in Investment Spending 2005-09 (commitment basis)



Sources: Chadian authorities and staff's calculations

28. **Defense and public security make up the next largest category of investment spending.** The relatively heavy weight of defense in the investment budget (11 percent) is stemming predominately from a spike in spending in 2008, related to the heightened instability in that year. While this investment might be justified in context of the consolidation of peace, it would be important to assure that investment in defense does not crowd out other investments that would result in increases in productivity, growth, and poverty reduction.

29. **Investment in the health and education sectors has also increased substantially during the oil era.** Investments in these key social sectors make up about 13 percent of the overall budget. Investment in health and social affairs more than doubled from CFAF 6.4 billion in 2005 to CFAF 13.7 billion in 2009. Similarly, investment in the education sector increased from about CFAF 5.2

billion to about CFAF 11.2 billion in 2009. While these increases are certainly needed given the weaknesses in basic service delivery, this rapid expansion has occurred without strong collaboration between the sector ministries (Health and Education) and the Ministry of Infrastructure, which implements the investment projects, making the operationalization of this new infrastructure problematic (see below).

b. But cost effectiveness is questionable

30. **While a cost-benefit analysis is not feasible in this case, a simple assessment of unit costs shows that Chad's investment spending has not been very efficient over the past several years.** As indicated in the table below, the unit costs of constructing both classrooms and health centers in Chad are far above the regional average. While it is reasonable to assume that unit costs in a remote landlocked country such as Chad will be higher than the average country, the differences are remarkable. For classrooms, Chad has by far the most expensive unit costs, which are more than 4 times higher than those of the next highest country, Niger. Within Chad, there are also important variations. Health centers range in cost between CFAF 120 million and CFAF 256 million (about US\$230,000-US\$480,000), with the upper range being about 60 percent higher than the average, and the lower range being about 25 percent lower.

Table 5 : Comparison of Unit Costs for the Construction of Health Centers and Classrooms

	Chad (2009)	Chad (2003)	Niger (2007)	Senegal (2005)	Nigeria (2004)	DR Congo (2005)	Africa Ave
Classroom ²² (US\$/unit)	\$57,229	\$16,737	\$13,962	\$9,701	\$4,875	\$,9500	\$6,740
Classroom (US\$/m2)	\$741	--	--	--	--	--	\$119

c. Expenditure on goods and services, and on transfers have not followed

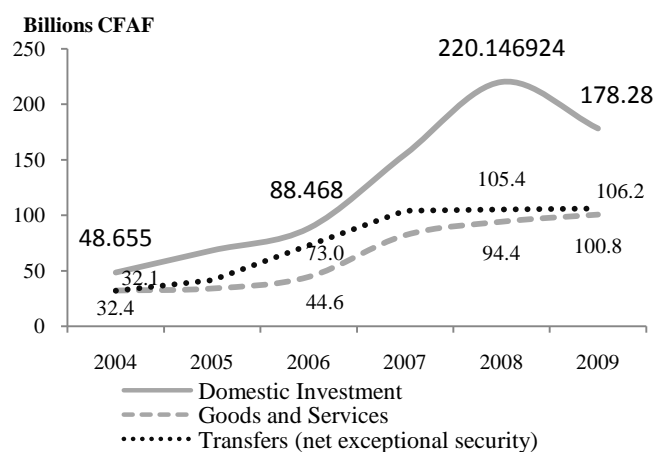
31. **Spending on transfers and goods and services, which are crucial to making investments function, has not kept up with investment spending.** During the period 2004 to 2009, expenditure on transfers and on goods and services rose by about 156 percent, while domestically financed investment spending rose by 270 percent.²³ This mismatch leads to concerns over the ability of the government to meet the recurrent spending needs of the newly created structures (especially schools and health facilities). Field visits in October 2009 have revealed that many of the newly constructed health and education structures stand empty, without having been granted adequate budget to assure their operationalization.²⁴

²² Primary level classroom constructed out of cement

²³ Foreign financed investment over this period dropped by about 30 percent, offsetting this dramatic increase somewhat.

²⁴ Intersectoral World Bank Mission of October 2009.

Figure 23: Evolution of Selected Public Spending



Source: IMF

32. **Transfers, representing a third of the budget on average over the period, are dominated by a few large subsidies.** Over the period 2004 to 2009, the amount allocated to transfers increased from about 13 percent domestically-financed expenditure to about 33 percent. Exceptional security spending represents about a third of total transfers over the period (at about CFAF 76 billion on average). Transfers to STEE and COTONCHAD, two parastatal companies, also put considerable weight on the budget, representing CFAF 14.2 billion and CFAF 11.8 billion respectively on average over the period 2006 to 2009.²⁵

Table 6 : Evolution of Transfers, 2006-2010

	2006 Act	2007 Act	2008 LFR	2009 LFR	2010 LFI	%Δ 2005-10	% total
<i>In billions of CFAF</i>						<i>In percent</i>	
Community Teachers	2.30	3.50	3.50	4.50	4.30	87%	2%
Other primary education (including higher education)	1.00	1.23	1.23	1.00	1.00	0%	1%
Higher education	7.36	9.70	7.75	7.52	8.81	20%	4%
General National Hospital of Reference	1.00	2.80	2.68	3.00	2.85	185%	1%
Fonds d'aide aux soins primaires	-	3.00	5.07	7.48	7.33	-	2%
Other health	0.40	1.83	-	-	-	-100%	0%
Other rural development	9.03	11.36	6.06	7.25	7.63	-16%	4%
CotonChad	13.14	21.70	10.00	7.75	6.30	-52%	6%
STEE	10.67	18.00	18.50	12.30	11.56	8%	7%
Accords de paix	9.60	16.54	19.80	18.70	10.71	12%	7%
Dépenses exceptionnelles de Sécurité	67.65	82.91	70.20	86.43	71.52	6%	38%
Total	156.79	222.62	204.51	211.30	212.79	36%	100%

Source: IMF

33. **A number of transfers important for basic service delivery continue to be underfunded.** Transfers to the health sector have been relatively stagnant over the whole period, and between 2009 and 2010, allocations to transfers in the health sector decreased by 3 percent. This decrease came at

²⁵ STEE was separated into two companies in May 2010.

the expense of funding for General National Hospital of Reference and allocations for special assistance funds for primary care. In the education sector, the budget for transfers has increased relatively slowly over the period. While the transfer budget for the payment of community teachers, who make up 70 percent of total teachers, has increased by about 87 percent, this amount does not come close to covering the needs in the sector, as about 8,000 community teachers do not yet receive subsidies. Further, the budget for these transfers is often executed with large delays. Delays in the payment of community teachers over the first three quarters of 2009 led to payment arrears of 10 months.

Box 1 : Transfers to STEE and COTONCHAD

Cotton Sector

With the livelihoods of as many as three million people, or one quarter of the population, dependent on cotton, the sector is an important crop for the Chadian economy. It offers prospects for significant poverty alleviation and has been until recently a major source of foreign exchange earnings. A combination of adverse factors, however, have led to a declining contribution of cotton to the overall economy, reflected by production falling from its peak production of 270,000 tons in 1997 to about 100,000 tons two years ago and only to 30,000-50,000 tons, forecast for next crop season. Despite declining production of CotonChad, public transfers to the subsector have kept on increasing. The cumulated subsidies accruing to the subsector are estimated to have reached about CFA 60 billion over the past five years. At the same time, cotton producers are estimated to be receiving typically only a small portion of the world price which has resulted in a shift in production practices to subsistence farming. Under these circumstances, the ability of the cotton sector to fully realize its potentials for growth and poverty reduction has been compromised.

A road map for restructuring the whole industry, leading to the privatization of CotonChad, the vertically integrated production-marketing parastatal was elaborated in 2005. Admittedly, there are crucial roadblocks on the way to the envisaged eventual privatization, such that to date, the implementation of the road map is yet to be completed. CotonChad's debts continued to increase and now amount to CFA 102 billion. Cotonchad's breakeven production level is estimated at about 150,000 tons –considerably above the 40,000 tons projected for next crop season.

STEE

Chad has the lowest per capita electricity consumption in the world; consumer costs are one of the highest and the service quality one of the worst in Sub-Saharan Africa. More than 80 percent of the electricity produced is consumed in N'Djamena. However, only one-third of the city has electricity. About ten cities and secondary centers have independent networks. There is no electrical grid in the country. The rate of access to electricity is no more than 2-3 percent of the population, one of the lowest rates of electricity consumption in the world. At the same time, Chad has some of the highest rates for electricity mainly because of the high cost of imported diesel oil. For an actual capacity of 50 megawatts, the STEE rarely produce between 20-30 megawatts. The operational performance of STEE remains a concern: (i) the irregular supply of fuel led to recurrent power cuts, technical and commercial losses of energy are high (over 30%) and distribution costs of the STEE (40 cents \$ US / kWh) far exceeds the average fare (33 cents \$ US / kWh). In addition, a significant number (over 30%) of preferred customers do not pay their bills. As shown in the table, STEE depends heavily on government grants and funding from donors to continue its operations, but as of yet these subsidies have not led to the development of efficient and reliable electricity provision, even in the capital city.

STEE costs and margins (2008)

Loss per kWh produced (F CFA / Kwh)	-80
Loss per kWh sold (F CFA / Kwh)	-186
Revenue (Billion F cfa)	19.22
Government grants(Billion F cfa)	26.99
Total (Billion F cfa)	46.21
GAP (Billion F cfa)	-4.14

Source STEE

Source: For CotonChad: Rapport d'audit financier et organisationnel 2009 ; Rapport Cellule Economique 2009

d. Nor has appropriate staffing

34. **The strong growth in the size of the public service was largely driven by an expansion of the military.** Increased oil revenue has allowed an expansion of staffing. Total public employment has expanded by about 75 percent over the period 2004 to 2009, putting the wage bill at about 75 percent of non-oil revenue. This significant increase was mainly driven by the military. Between 2004 and 2009, the number of positions in the military increased 140 percent, as a result of instability in the East and the rebel attack on N'Djamena in early 2008.

Table 7 : Employment in selected priority sectors 2000-06

	2004	2005	2006	2007	2008	2009	% Δ 2004-09
	Act.	Act	Act	Act	Act	Est	
<i>in thousands of CFAF unless otherwise indicated</i>							
Average Annual Salary	1,188	1,388	1,388	1,467	1,536	1,494	26%
Civil	1,471	1,575	1,694	2,160	2,210	2,197	49%
Education	1,513	1,760	1,770	2,184	2,234	2,249	49%
Health and Social Affairs	1,756	1,453	1,540	1,963	2,048	2,069	18%
Rural Development	1,184	1,158	1,262	1,555	1,620	1,713	45%
Governance	942	1,196	1,272	1,553	1,677	1,588	69%
Military	738	1,071	949	798	844	877	19%
<i>in number of staff unless otherwise indicated</i>							
Total employment	67,462	70,392	85,168	104,394	107,644	117,391	74%
Civil	41,397	44,327	50,168	51,306	54,556	54,891	33%
Education	13,739	15,618	17,503	17,699	19,269	19,136	39%
Health and Social Affairs	4,357	4,909	5,164	5,433	5,773	5,715	31%
Rural Development	3,502	3,627	3,692	3,803	4,118	3,894	11%
Governance	1,948	2,008	2,610	2,652	2,702	2,853	46%
Military	26,065	26,065	35,000	53,088	53,088	62,500	140%

Sources: Chadian authorities; and IMF staff estimates and projections.

35. **The heavy weight of the military in the public administration may be crowding out the hiring of health and education personnel.** Cross-country comparisons indicate that the size of the military is large, even compared to post-conflict states. Sierra Leone, over the same period, had about 2 military personnel per 1,000 people. The Republic of the Congo had a somewhat more important military presence with a little over 3 military personnel per 1,000 people. Chad, however, was the highest with about 4 military personnel per 1,000 people (Table 8). By contrast, Chad had the lowest density of physicians and teachers (with the exception of physicians in Sierra Leone).

Table 8 : Comparative Public Sector Employment (average 2004-09)

	Chad	Burkina Faso	Congo, Rep.	Ghana	Mali	Sierra Leone	Uganda
Physicians (per 1,000 people)	0.04	0.06	0.15	0.13	0.08	0.02	0.10
Teachers (per 1,000 people)	2.80	3.00	4.77	7.88	4.68	7.66	6.69
Armed forces personnel (per 1,000 people)	4.28	0.77	3.45	0.47	0.97	2.24	1.65
Compensation of employees (% of expense)	20.00	42.33	17.88	39.89	32.33	25.98	12.62
Military expenditure (% of central government expenditure)	24.95	11.01	5.28	2.64	14.56	9.01	13.91
Proportion of seats held by women in national parliaments (%)	5.98	13.55	8.00	10.15	10.17	13.88	28.32
Total Population, millions	10.32	14.24	3.48	22.39	12.12	5.26	29.68

Source: IMF, WDI 2009

36. **The shortage of qualified health personnel and their unequal distribution is one of the main bottlenecks in the delivery of quality services in the health sector.** Though the number of staff in the health sector has increased gradually by 22 percent from 2004 to 2009 (from 4,097 to 5,021), health staff ratios are far below WHO norms: Chad has only one doctor per 26,645 inhabitants against a norm of one per 10,000; one midwife per 14,788 women of reproductive age against a norm of one per 5,000 and one nurse per 5,765 inhabitants against a norm of 5,000. Moreover, not only are health personnel scarce, but they are also unevenly distributed favoring N'Djamena where only 9 percent of the population resides.

CHAPTER 4: ACCELERATION OF PUBLIC FINANCE MANAGEMENT REFORMS

37. **The data presented in the first part of this report underscore the importance of accelerating the implementation of public financial management reforms.** With the advent of oil revenues in 2004, the challenge for Chad was – and remains – the need to set in place a public financial management system capable of ensuring optimal allocation of resources, effective operational management, and rigorous oversight for the delivery of public services that had hitherto been lacking in the country. Beginning in 2005, the Government embarked on a vast undertaking within the framework of the Public Financial Management Modernization Support Program (*Programme d'Appui à la Modernisation de la gestion des Finances Publiques*: PAMFIP). The PAMFIP action plan provides a frame of reference for actions aimed at modernizing public finance in Chad, and covers all the major functions and tools where rapid progress is needed to guarantee effective use of public resources (such as Treasury, Customs, Taxation, Budget, Government Contracts, Computerization, Internal and External Controls).

38. **There have been some improvements, yet there is still significant progress to be made.** The analysis in the first section of this report showed that public finance reforms have not yet had their intended impact on the delivery of public services neither in health and education nor in the areas of economic and social development. To a large extent, the difficulties in achieving these results can be traced to the shortcomings in the allocation and use of public resources, i.e. budget preparation and execution. The volatile security context may explain much of the authorities' decisions during the period 2005-09. With the prospects of a calmer security situation, there is a window of opportunity to improve budget management.

4.1 Toward Improved Budget Preparation

a. Despite progress in budget preparation

39. **Major efforts have been made in recent years in budget preparation.** Since 2007, the budget preparation schedule has been adhered to, and the budget law has been submitted, adopted, and implemented on time. Furthermore, credit allocation decrees have been signed and the budget set in place at the central level by the end of January of each year. However, as indicated in the first section, serious weaknesses remain, particularly in regard to budget composition, which scarcely reflects the priorities that the Government has set for itself in its national Poverty Reduction Strategy.

40. **Macroeconomic projections and budget guidelines have improved.** Despite limited human and material resources, efforts have been made by the Ministry of Finance since 2005 to improve macroeconomic projections and budget guidelines. A central Medium-Term Expenditure Framework (MTEF) is produced, and this provides the frame of reference for the annual budget. This process should contribute to improved resource planning. Budget law preparation procedures have been in effect since 2003, based on a Medium-Term Budget Framework and program budgets prepared by ministries in priority sectors, in line with the objectives and priorities set forth in the national Poverty Reduction Strategy. TOFE estimates, which cover a three-year period with indicative sectoral expenditure ceilings, are produced on time (between May and June of each year) and are incorporated in the budget circular.

b. A limited multiyear framework creates problems

41. **But progress remains constrained by the annual budget framework.** The shortcomings in budget preparation, as in most countries of Sub-Saharan Africa, stem mainly from budget planning that is limited to an annual timeframe. Thus, budgeting continues to be done on the basis of resources that are immediately available (cash on hand and annual revenues), in lieu of medium-term expenditure planning. Thanks to the availability of oil surpluses, budget laws adopted since 2007 show very high expenditure levels in various sectors, with no real consideration of the risks involved in the medium term, especially in view of substantial swings in oil prices and the recurrent costs in social sectors (such as construction of classrooms, health centers and hospitals, roads). Since 2004, this practice has created a situation in which the Government has raised civil servant wages and subsidies, as well as launched new programs to address the substantial needs of its citizens, but without any rigorous analysis of the consequences for the medium-term sustainability of public finances.

42. **The recommendation would be to prepare an annual budget based on a reliable multiyear budget.** Work is ongoing to improve forecasting and it is expected that the 2012 Budget be based on more reliable medium-term projections for revenue and expenditure. Preparation of an annual budget based on a reliable multiyear budget, which should itself reflect available financing, is the key to medium-term financial stability and a necessary condition for successful implementation of the Government's policies and programs. To that end, it is critical to: (i) step up efforts to prepare macroeconomic projections and budget guidelines; and, especially; (ii) introduce the preparation of continuous three-year program budgets as planned under PAMFIP.

c. Along with the absence of a formal project management framework

43. **The preparation, programming, and implementation of development projects also pose problems.** Although Chad has managed, over the last five years, to carry out a great number of development programs and projects in most sectors, there is no formal project preparation, adoption, programming, and budgeting framework. Thus, in practice, the various ministries simply submit project proposals to the Ministry of Finance to be included in the budget and, in most cases, there have been no preliminary studies of these proposals, nor any rigorous analysis to guarantee their technical quality and ensure efficient and effective utilization of project resources. In this context, very costly investment decisions are made without any clear idea of their consistency with macroeconomic and sectoral objectives set forth in the National Poverty Reduction Strategy, the technical options, the immediate and medium-term financial consequences, and the opportunity costs.

44. **This absence of a formal framework tends to encourage circumvention strategies.** The absence of a recognized project evaluation and programming system has also facilitated the current practice of starting projects without parliamentary authorization (i.e. without including them in the budget law); a supplementary budget law is then needed to rectify the situation. In extreme cases, projects have been launched during the fiscal year by circumventing normal spending procedures through expenditure authorizations with no prior scheduling. Thus, despite efforts made since 2007, the Ministry of Finance does not always have at its disposal a complete list of projects under way or under consideration, much less of contracts signed in connection with such projects. This uncertain

environment, where the Government's legal commitments are unknown, makes it very difficult to control budget risks.

45. **The recommendation would be to develop the national project planning and management system.** Measures to improve project management are underway, including the establishment of a database on contracts. To ensure greater consistency between the National Poverty Reduction Strategy and the annual budget, improve the medium-term budgetary balance, and ensure efficient and effective use of the limited financial resources at its disposal, the Government should: (i) expedite development of the national project planning and management system as called for by PAMFIP; and (ii) finalize development of a database on government contracts, allowing them to be monitored from the time they are signed until all commitments are extinguished.

4.2 Toward Simplified Budget Execution

a. The expenditure chain remains too complex

46. **The complex and cumbersome nature of the expenditure chain hampers priority sectors.** An effort was made to simplify the expenditure chain by eliminating the Commitments Directorate in January 2010. However, the expenditure chain is not yet sufficiently streamlined, and steps need to be taken to better organize and more fully utilize computer technology at a number of different levels – financial audit, expenditure scheduling Directorate, and Treasury Directorate – in order to guarantee a secure flow within the chain and facilitate effective processing of expenditures. In the meantime, the expenditure chain remains complex and, in particular, prevents priority sectors from executing their budget allocations at the central and deconcentrated levels.

47. **Execution continues to be slow in so-called priority sectors.** Despite considerable progress made with respect to adherence to schedules, the actual placement of appropriations earmarked for regional services still runs into very substantial delays, as in the past. In 2009, the first installments of delegated appropriations, specifically for health and education, did not begin to be sent out until the month of September. For 2010, education appropriations were not yet in place in June. As a result, the deconcentrated entities of priority ministries are faced each year with frozen budgets, debt, and over-charged operating costs in the various regions of the country. This situation is due to the persistence of an old and complex practice requiring double commitments on delegated appropriations.

48. **The frequency of supplementary budget laws disrupts implementation of budget appropriations in priority sectors.** At the central level, commitments are often suspended for several weeks, if not several months, on the grounds that a supplementary budget law is under preparation. Since, on average, two supplementary budget laws have been adopted each year since 2006, this means that priority sectors, apart from infrastructure, have faced difficulties in receiving their budget appropriations as approved by the National Assembly. While a supplementary budget law is being prepared, the frozen or canceled appropriations mainly affect the priority sectors, which are then often obliged to postpone or even abandon certain contracts, sometimes covering essential needs as in the case of Pharmaceutical Purchasing Center (CPA) for the drugs order in 2009.

Box 2 : *Credits Délégués* in the Health Sector

A portion of the non-salary recurrent budget (goods and services) of the Ministry of Health is allocated to the deconcentrated departments (the regional health units, regional health schools and the autonomous hospitals) based on the procedure of « credit delegation » which provides for such direct transfers to deconcentrated units. While these resources represent only a small share of the non-salary recurrent budget (around 8 percent in 2008 and 2009), the deconcentrated units also face difficulties in accessing these funds due to the delays posed by multiple budgetary controls.

Despite efforts of the Ministry of Health to treat the « credit delegation » as a priority, the long approval process for budget execution has led to serious delays and complications in accessing this budget. The commitments made under the « credit delegation » procedure are subject to numerous verifications and clearances at the central level of the Ministry of Finance (the Directorate in charge of controlling commitments (eliminated in 2009), the Financial Controller and the Directorate in charge of making payment orders “Ordonnancement”) before being transmitted to the regional Governor, the regional Department of Finance and then the deconcentrated health units. The expenditure process is not undertaken through the Integrated Financial System (“Cadre Intégré des Dépenses”) but is handled through the previous, outdated process: once the documents (in form of a “notification of credit”) are transmitted to the regional districts, the Governor (or the Prefect), the regional Finance Department and the Treasury manage the payment process.

Because of these cumbersome procedures, payments to the suppliers can be as much as 1-3 years late, resulting in a lack of credibility and loss of purchasing power of regional hospitals and health centers since suppliers ask for higher prices to make up for delays in the payments. In addition, delays in budget implementation increase the risk that suppliers refuse to provide services to health centers and to the hospitals (for example, the deconcentrated health units received the “credit notification” only in the last quarter of 2009 because of a freeze of commitments until August).

Source: Chad: Review of Public Expenditure Issues in the Health Sector (forthcoming)

49. **The proliferation of expenditures prior to payment orders (*Dépenses Avant Ordonnance*: DAOs) has an eviction effect on priority spending.** The security situation resulting from armed attacks by the rebellion has led the authorities to make intensive use of DAOs, an emergency procedure in the financial legislation, for military spending, and regularize such expenditures only later. This arrangement is understandable for meeting security requirements, but it has become practically the rule for most spending in non-priority sectors and for investments. Since most DAOs are not secured by budget appropriations, the result, when they take effect, is to freeze or postpone spending in priority sectors. The fitting out of classrooms and health centers built in recent years provides one example of this.

50. **The recommendation would be to simplify the expenditure chain by:**

- (i) Simplifying the ex-ante manual oversight of delegated appropriations intended for regions. During budget preparation, each ministry should be able to provide the list and amount of appropriations earmarked for each of its deconcentrated services. Using the computerized expenditure chain (*Circuit Informatisé de la Dépense*: CID), the Comptroller will be in a position, once checked, to issue automatically and sign expenditure authorizations for all regional services as soon as the budget is set in place by the end of January;
- (ii) Stopping the practice of freezing ministries’ operating expenditures during preparation of budget amendments. As in the case of wages and investments, it should be possible to

continue drawing on the other budget lines once the computerized expenditure chain makes it possible to manage the pace of budget execution and credit limits;

- (iii) Accelerating efforts now under way to reorganize the various services involved in the expenditure chain, including deconcentration of services charged with ex-ante oversight in key ministries (Financial Audit);
- (iv) Limiting the use of DAOs. Although the phenomenon of expenditures taking place prior to payment orders cannot be resolved without firm political will, there should be no particular reason to resort to DAOs, particularly in certain sectors such as investments, once the expenditure chain has been simplified;
- (v) Establishing specific procedures at the Ministry of Finance to guarantee that all DAOs are at least covered by budget appropriations prior to payment, as in most other African countries.

b. And institutional capacities remain limited

51. **The ministries' Administrative and Financial and Contracts Directorates (*Directions Administratives et Financières et des Marchés*: DAFMs) often possess very limited capacities.** The training and number of employees of these directorates, key to proper budget execution, are often inadequate. In addition, DAFM directors are not appointed by, and do not fall under the authority of, the ministries in which they operate. Indeed, under the current statutes, DAFM directors are employees of the Ministry of Finance, which creates some ambiguity in the chain of budget responsibility and difficulties in the performance of related tasks.²⁶

52. **Interministerial coordination is weak.** The absence of regular meetings to coordinate budget execution within sectoral ministries, on the one hand, and on a cross-cutting level (Ministry of Finance and Planning), on the other, makes it difficult to perform the necessary work of monitoring budget execution. The technical ministries are not in the habit of holding regular coordination meetings for the purpose of sharing available technical, financial, and administrative information on the status of different projects and activities, identifying problems, and anticipating difficulties. At the governmental level, such coordination in regard to the monitoring of budget execution should also be strengthened at the Ministry of Finance, because the current meetings of the Technical Committee have proved insufficient for resolving the difficulties encountered by the different sectors in executing their programs.

53. **The budget execution informational and monitoring tools are inadequate for the purpose of tracking the progress of expenditure programs in priority sectoral ministries.** The budget information system (CID) does produce a table of the four expenditure phases. However, this table is of limited reliability because it contains incomplete information, particularly with respect to wages and credit transfers, and it does not include all budget execution operations. In addition, the ministries' access to statements published by the CID system is limited and does not allow them to track the progress of their expenditures.

²⁶ See Decree 334/PR/PM/02 of July 26, 2002 establishing the DAFMs and Decree 352/PR/PM/02 of August 21, 2002 laying out their powers, duties, and functions.

54. **The recommendation would be to build capacity.** The responsibility for budget administration and the appointment of DAFMs should be turned over to sectoral ministries in order to increase their control over their respective expenditure programs. The DAFMs' mandate and the procedure by which they are appointed should be clearly specified. In this regard, the recent appointment of former budget staff as DFAM at the Ministries of Education and Health is encouraging. Prompt action should be taken to implement an employee training plan on budget execution as a way to address the weak capacities of the DAFMs. Regular monthly meetings should be held between the Ministry of Finance and sectoral ministries to track commitments and expenditures.

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