

**FOR
AGENDA**

EBD/10/29

May 3, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **Chad—Poverty Reduction Strategy Paper—Joint Staff Advisory Note**

Attached for consideration by the Executive Directors is the advisory note, prepared jointly by the staffs of the Fund and the International Development Association, on the poverty reduction strategy paper for Chad (EBD/10/28, 5/3/10). This paper, together with the staff report for the 2010 Article IV consultation with Chad (to be issued), will be brought to the agenda for discussion on **a date to be announced**. At the time of circulation of this paper to the Board, the authorities of Chad have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Any requests for modifications for publication must be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Josz (ext. 34021), Mr. Ladd (ext. 37554), and Mr. Kinda (ext. 39538) in AFR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Tuesday, May 11, 2010; and to the African Development Bank, the European Commission, the Food and Agriculture Organization, the Islamic Development Bank, the Organisation for Economic Cooperation and Development, the United Nations Development Programme, and the World Food Programme, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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THE INTERNATIONAL DEVELOPMENT ASSOCIATION AND
THE INTERNATIONAL MONETARY FUND

CHAD

**Poverty Reduction Strategy Paper
Joint Staff Advisory Note**

Prepared by the Staffs of the International Development Association and
the International Monetary Fund

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May 3, 2010

I. INTRODUCTION

1. Chad's first National Poverty Reduction Strategy was adopted in June 2003. Its implementation was undermined by persistent internal conflict, weak governance, and lack of commitment to and ownership of economic and social reforms. As a result, the opportunity to reduce wide-spread poverty provided by tapping Chad's oil wealth during the first poverty reduction strategy has mostly been missed to date. On the current trajectory, the country would not meet most Millennium Development Goals (MDGs).

2. The authorities initiated preparations of a new strategy in October 2006—"Stratégie Nationale de Réduction de la Pauvreté," SNRP II¹—covering the 2008-11 period. This new strategy, adopted in April 2008, focuses on a sensible set of priorities, notably on creating a business climate that is conducive to private sector growth, on rural development programs, on investments in human capital, and on strengthening governance. However, despite higher-than-expected oil revenue, continued insecurity, weak leadership and management have slowed execution of the SNRP II agenda to date. The government deposits accumulated at the central bank at the time of high oil prices in 2008 were run down significantly in 2009. The government has also resumed borrowing from the central bank and has taken a large loan with a grant element of 15 percent to sustain budgetary spending in 2010 and has guaranteed a commercial loan to build a new oil refinery. The limited engagement of the Bank following the disagreements with the government over the use of oil revenue under the pipeline financing agreement and the closure of the Bank's office in February 2008 after a

¹ Chad – Poverty Reduction Strategy Paper, 2008-11.

rebel attack on the capital also resulted in a delay in presenting this JSAN and PRSP to the Boards. The Bank is now in a process of re-engaging with the authorities, including under a forthcoming Interim Strategy Note.

3. The SNRP II identifies many individually helpful measures, but progress toward the Millennium Development Goals (MDGs) and Enhanced Heavily Indebted Poor Countries (HIPC) Initiative Completion Point would require the authorities to demonstrate much more determined leadership and commitment to the SNRP II objectives, and to focus on a manageable number of critical objectives. These are to improve macroeconomic and public financial management, security, transportation, rural development and human development. Few of the specific measures identified in the SNRP II's Priority Action Programs (Annex 1) have so far been pursued. The staffs have highlighted a smaller number of manageable measures, consistent with the SNRP II's objectives, in Sections IV and V.

4. This Joint Staff Advisory Note reviews the SNRP II, provides the staffs' advice on priorities for implementation and makes suggestions for possible improvements to the plan going forward. Section II highlights the results of SNRP II's poverty diagnosis and lessons learned from SNRP I.² Section III covers key macroeconomic and public financial management topics. Section IV provides the staffs' analysis of the policy agenda for specific sectors. Section V comments on monitoring and evaluation. Section VI concludes and offers issues for discussion.

II. CHARACTERISTICS OF SNRP II

A. Poverty Diagnostics

5. The SNRP II presents a candid description of the determinants of poverty in Chad. Poverty 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. The poorest segments of the population consist of large families in which the head of household has not gone beyond primary school and works in the primary or secondary sector. In rural areas, families headed by women are also among the poorest.

6. The document was unable to identify any trends in poverty. The main sources of data on poverty in Chad are two surveys: ECOSIT1 took place in 1995-1996, and ECOSIT2 was conducted in 2003-2004. Methodological differences make it impossible to compare the results of these two surveys and determine to what extent and at what rate poverty indicators have changed. The staffs would nevertheless encourage the authorities to use these results as a baseline from which to evaluate the impact of oil-financed spending going forward.

² [Chad – Poverty Reduction Strategy Paper, 2003-05](#) and corresponding [Joint Staff Advisory Note](#).

B. Lessons Learned from SNRP I

7. The document recognizes that progress under the SNRP I was mixed at best. Growth has been mainly led by activities in the oil sector. The unstable security situation hampered government activity and, combined with weak governance and lack of commitment, resulted in major deviations of budgetary spending from SNRP I objectives, a situation continuing since the adoption of SNRP II. Significant resources were spent on military equipment; and on education and health infrastructure, at high unit costs, and without the human capital to put them to use for providing basic social services. Little progress has been made to date toward the MDGs (with the exceptions of access to an improved water supply and HIV prevalence) and Chad remains well below the critical path toward achievement of the MDGs by 2015.³

8. The staffs agree that the government's priorities identified in SNRP I remain valid. Despite the disappointing performance under SNRP I and continued security concerns, the focus should now be on implementation of the strategy and putting to use the infrastructure that has been built. In this regard, the SNRP II's emphasis on strengthening the implementation and tracking mechanism is welcome.

9. Based on the lessons learned, the SNRP II pays particular attention to the restoration of security, the diversification of the economy, the improvement of governance and the promotion of human development. Rural development rightly gets more attention. The government also intends to pursue its policy of investing in human capital in order to enable the population to participate in and fully benefit from the country's economic development.

10. However, the SNRP II reproduces the shortcomings of the previous strategy, namely a lack of focus on a manageable number of actions and a weak monitoring and evaluation (M&E) system. The staffs encourage the government to streamline the scope and number of priority programs and actions. In addition, the SNRP II has had little influence on the design and implementation of economic policies, programs and projects. Going forward, the staffs encourage the government to better align the annual budget with the SNRP II.

III. MACROECONOMIC POLICIES AND FINANCIAL MANAGEMENT

A. Sustainability of the Macroeconomic Framework and Fiscal Policy

11. In 2008-09, revenue was sufficient to fully fund the SNRP II's higher-spending scenario. This scenario set out a comprehensive medium-term expenditure plan to attain the MDGs. The authorities projected that this plan would require additional external financial resources over the period 2009-11. So far, the spike in international oil prices in 2008 and higher-than-expected oil production have yielded sufficient resources to fully fund the SNRP II, but annual budgets were not well-aligned with the SNRP II. There were significant overruns in military and investment expenditure. Going forward, current estimates for

³ SNRP II Figure 2-2, pg. 37 and World Bank, World Development Indicators database.

2010-11 suggest that resources will continue to be sufficient to fund the SNRP II. However, annual oil output peaked in 2004 and will decline steadily until reserves are depleted over 20 years, driving a steady decline of government revenue over the same period.

12. The staffs agree that the non-oil primary deficit as a percentage of non-oil GDP (NOPD) is the appropriate fiscal policy anchor for Chad. Large oil revenues, while offering a windfall of additional resources with which to pursue the MDGs, are highly volatile and on a downward trend. The challenge is to insulate annual spending from this volatility, while taking full account of the long-term financing constraint. While the SNRP II states that the sustainable level of the NOPD is 10 percent, the staffs consider that it is in the low single digits.⁴ A prudent fiscal policy that gradually reduces the NOPD to a sustainable level over the medium term would allow both the transformation of oil revenue into a higher level of physical and human capital than before the oil era and a buildup of financial savings, the income from which could sustain a higher level of spending beyond the oil era. Fiscal consolidation need not come at the expense of development priorities; it can be achieved while focusing spending on priority areas (IV B. below).

13. The adoption of a sustainable fiscal policy could pave the way for resumption of a Fund-supported program and debt relief. Chad reached the Decision Point under the Enhanced HIPC Initiative in May 2001 but has not yet reached the Completion Point. Successful execution of a Fund-supported program, accompanied by the achievement of other Completion Point triggers, would lead to debt relief under the Enhanced HIPC and Multilateral Debt Relief Initiatives in an amount of about US\$ 1 billion in nominal terms, freeing up about US\$40 million per year for poverty-reducing expenditures for about 20 years. In this regard, the authorities' decision to access lending with a grant element of only 15 percent for financing the 2010 budget and to guarantee a commercial loan for an oil refinery has been a setback (paragraph 2).

IV. PUBLIC FINANCIAL MANAGEMENT REFORMS IN THE SNRP II

A. Oil Revenue

14. The SNRP II calls for a permanent, transparent mechanism for managing direct and indirect oil revenues to smooth the expenditure path and build savings. To implement such a mechanism, the staffs recommend:

- maintaining the current level of oil-revenue transparency and enhancing it by adherence to the Extractive Industries Transparency Initiative (EITI);
- consolidating the “oil” and “non-oil” budgets into a single, properly-managed budget and;
- closely aligning expenditure, in planning and execution, with the SNRP II.

⁴ For estimations of the sustainable NOPD in Chad, see [IMF Country Report No. 09/68; Chad: 2008 Article IV Consultation - Staff Report; Box 1, p.13](#) and [IMF Country Report No. 09/67; Chad--Selected Issues; Chapter II.](#)

B. Non-oil Revenue

15. The authorities have made progress toward the SNRP II's goal with respect to non-oil revenue, increasing it to 11.7 percent of non-oil GDP in 2009, slightly higher than the 11.5 percent planned in SNRP II. However, this level is only half the non-oil revenue effort observed in Sub-Saharan Africa, which itself is only half the effort of advanced countries.⁵ Simplification of the tax code and continued improvement to tax and customs administration would be helpful, not only for revenue performance, but also for improving the business environment.

C. Expenditure Management

16. The SNRP II notes intense and widespread concern about poor management of public resources, the lack of accountability of officials managing budget resources, and pressures for fiscal reform, enhanced financial control and efforts to reduce corruption. The weaknesses and their remedies are well-known, but willingness to undertake necessary reforms has proven elusive so far. The main weaknesses are: poor alignment of planned and executed spending vis-à-vis the SNRP II; insufficient attention to the multi-year implications of investment decisions, including inadequate allocation for recurrent spending in health and education; neglect of the need for competitive bidding in public procurement; and the absence of *ex post* control of budget execution. The staffs recommend that the authorities (i) align budget planning and execution with the SNRP II; (ii) carefully plan and monitor investment projects; (iii) strengthen procurement, relying more on competitive bidding; (iv) track expenditure through to payment in the public financial information system; (v) reduce the amount of spending that bypasses the normal budget process; and (vi) strengthen *ex post* review of budget execution by Parliament and the Audit Court. These actions would require a significant renewal of government commitment and leadership to be successful.

V. THE SNRP II'S AGENDAS FOR KEY POLICY SECTORS

A. Security

17. The staffs agree that the consolidation of peace and security, and the stabilization of the political situation are key to promote growth and reduce poverty. The strategy recognizes the conflict in the East and the pressure it puts on military spending - at the expense of pro-poor social services. Therefore, implementation of the peace agreements with opposition groups is critical.

⁵ [IMF, Regional Economic Outlook: Sub-Saharan Africa, October 2009 "Weathering The Storm," pg. 38.](#)

B. Transportation

18. The SNRP II recognizes that improvement of the transportation sector is critical for Chad's economic development and poverty reduction. It identifies key areas of concern, but does not outline the priorities nor present a comprehensive development strategy covering the various transportation modes. It does not include any urban transport component to accommodate the expected rapid urbanization nor propose appropriate measures to improve road safety. In this regard, the staffs would recommend greater attention to the long-term needs of this sector, as identified in Chad's National Transportation Program, in annual budgets. They would also call for greater coordination among the different public institutions involved in transportation. In particular, greater attention should be paid to building institutional capacity.

19. An improved road network would have a significant impact on the movement of agricultural products to local and export markets. In the staffs' view, this emphasis on road network development is appropriate, since transportation costs in Chad are among the highest in Sub-Saharan Africa and its network density below regional average. The staffs would recommend that additional attention be paid to the financial challenges and feasibility of such an extension. However, achieving the envisaged network rehabilitation and extension is questionable in the absence of a maintenance plan. In this context, staffs would stress the need for transportation agencies, like the government as a whole, to (i) improve expenditure and budget management; (ii) strengthen implementation capacity; and (iii) ensure better planning, procurement, and quality control. The current strategy seems vague in its budgetary allocation to road infrastructure and lacks an action plan showing how the government intends to maintain its existing road network. In this regard, a clear results matrix with intermediate input and output indicators would help to monitor overall progress.

20. The plan to enhance the country's airports represents a useful complement to road investment, especially for areas far from the capital with limited road links. In the staffs' view, linkages between the road network and airports should be enhanced to achieve a stronger overall transportation network and greater regional integration; a key issue for a landlocked country. The staffs would also recommend developing plans to rehabilitate selected airports and improve air services with a focus not only on infrastructure but also on the policy environment and the capacity of the various agencies involved. These airports will be successful only if the government shows more logical selectivity between uses and can demonstrate profitability based on traffic demand and supply.

C. Rural Development

21. Chad has significant potential for agricultural development, particularly if water resources are better managed. Agricultural production is still highly dependent on meager and erratic rainfalls. Less than 2 percent of irrigable land in Chad is actually irrigated. As a result, cereal yields are among the lowest in Sub-Saharan Africa and an estimated 44 percent of Chad's population remains food-insecure.

22. Given the rural dimension of poverty and the low level of agricultural productivity in Chad, the staffs agree that the authorities should assess the implementation to date of the

recent Rural Development Intervention Plan (PIDR), identify its successes and weaknesses, and establish priorities for funding and implementation going forward. The evaluation of the PDIR should also include the institutional apparatus set up to implement it.

23. Half of Chad's economically active population is engaged in growing cotton, which until the discovery and development of oil was the most significant export. The SNRP II acknowledges that productivity in the cotton sector has fallen well behind that observed in other Sub-Saharan cotton exporters and it recognizes that action plans for improving farmers' access to inputs, transportation services and markets have not yet been implemented. Improving productivity in the sector and raising the incomes of cotton farmers depend critically on the long-delayed restructuring of the state-owned company, Cotontchad. Reforming Cotontchad has been on the government's agenda since 1999, yet little progress has been achieved: Cotontchad's output continues to decline and the company services its debts only thanks to fiscal transfers. Cotontchad is engaged in several business lines that may not necessarily yield economies of scope and unless it refocuses its activities, financial losses are likely to continue.

D. Water and Electricity

24. A comprehensive sector reform is urgently needed to improve access to drinking water and sanitation services in Chad. The SNRP II rightly identifies lack of maintenance as a major problem. In addition, it is particularly important to restructure the National Water and Electricity Company (STEE), as its operational performance has declined considerably over the past years. The staffs would recommend splitting STEE into two autonomous water and electricity companies, improving governance in these sectors and strengthening the financial situation of these companies.

E. Education

25. The strategy for education adopted in the SNRP II is appropriate, focusing on an increase of the level of schooling for the overall population. Particularly, it will enable poor students to get out of the cycle of poverty. For primary education, the objective is to meet the Universal Primary Education MDG by 2015 and for junior secondary education, the objective is to expand access and improve quality. Therefore, the enrollment of students from poor families in primary education is expected to increase and access to junior secondary education will discourage them from relapsing, like many of those who drop out after completing only the primary cycle. In light of the significant disparities across regions, priority is given to 25 lagging communities in the implementation of the SNRP II. Specific actions are also targeted to minority groups, poor families, and girls.

26. Access to primary education will be improved by reducing distance to schools, identified as a main cause of the low student retention rate. The staffs would recommend, however, that efforts also be made to reduce the current high repetition rates, which explain the student drop-out rate. In this regard, among other measures, time spent actually teaching and learning should be increased, the relevance of the curriculum enhanced, and school management strengthened. The language of instruction should correspond to the language used in the home and the local labor market.

27. A strategy for cost-effective school construction needs to be developed, including standard designs, planning and monitoring mechanisms. So far only 500 classrooms have been built per year on average within the existing financial constraints (compared to the SNRP II objective of building 1,200 new classrooms per year). The high unit construction cost does not allow financing a larger school construction program.⁶

28. The staffs recommend greater attention to the management of human resources in education. In particular, the low hiring of trained primary teachers (7,000 of whom were unemployed in 2009) should be addressed. While training programs for community teachers are needed, the strategy should also include appropriate incentives to encourage teachers to accept assignments in remote areas.

29. Budgetary funding for education needs to be enhanced. Despite the regulation requiring mandatory and free of charge basic education, operating costs of public schools are primarily financed by local communities and parents. The recurrent accumulation of salary arrears to community teachers represents a problem.

30. There is a need to strengthen procurement and expenditure control at the Ministry of Education to avoid leakages. The SNRP II requirement that only 50 percent of ordered school supplies and services reach their destination is inadequate, as it implies that the loss of half of procured school supplies and services is tolerated.

F. Health

31. The national health sector policy was updated in April 2007 with the objectives of improving the effectiveness of the health system, strengthening preventive measures, and better responding to the needs of the most vulnerable. In addition, the Ministry of Health prepared and adopted a road map for the reduction of maternal and infant mortality by 2015. However, management and implementation of the health policy remain weak, resulting in poor health outcomes. The percentage of total funding allocated to the health sector has increased; however, additional resources have not been spent on the highest priority needs, but rather on an ambitious construction program.

32. Implementation of the government's health program suffers from a number of weaknesses, including:

- *Shortage of human resources:* The sector faces a chronic shortage of qualified health personnel, especially in rural areas, and the ratio of health personnel to population is far below WHO standards. Moreover, existing staff is unequally distributed throughout the country, with the majority of personnel located in N'Djamena, which only represents 9 percent of the total population. An estimated 900 additional health workers will be needed to staff new and planned facilities, not including the staff

⁶ For the Government social infrastructure program, the classroom unit cost is about US\$60,000, compared to US\$15,000 for Bank-funded Education Project.

needed for two hospitals in N'Djamena and one regional hospital in Doba. Efforts to train and recruit health workers are inadequate.

- *Lack of equipment:* In 2009, equipment for only three district hospitals was ordered and delivered, leaving three completed hospital buildings without equipment. While 78 new health centers are expected to be constructed in 2010, equipment has been ordered for only about 40 of these centers.
- *Lack of funding for current expenditure:* Insufficient allocation and delayed transfers to front-line providers result in lower supply and quality of service.
- *Lack of medicines:* There are frequent shortages of essential medicines and arrears in government payment for drugs.

33. The staffs recommend that public health expenditure be made more effective. There are major concerns about the government's capacity to provide basic maternal and child health services and about the effectiveness of the major building program taking place, in light of the scarcity of available skilled personnel. To improve health expenditure effectiveness, the authorities need to improve budget planning and speed up transfer of budgeted resources from the central government to health care providers. Consideration could also be given to results-based financing to improve the performance of health service providers and service delivery.

G. Financial Sector Stability and Development

34. Notably absent from the SNRP II is a recognition of the importance of a strong, efficient financial sector to private investment and trade. Chad's banking system is subject to several vulnerabilities, stemming from its lack of depth, high credit concentration, undercapitalization of some institutions, insufficient on-site supervision and, generally, the underdevelopment of financial markets and services throughout the CEMAC region. The authorities need to closely cooperate with the regional bank supervisor to ensure financial stability. Also, together with relevant regional agencies, they could constructively build on the recommendations of the 2006 CEMAC Financial System Stability Assessment to strengthen and develop the financial sector.⁷

VI. MONITORING IMPLEMENTATION OF SNRP II

35. The institutional framework established to monitor the implementation of the SNRP II has been strengthened compared with what was in place under the SNRP I. A Technical Secretariat has been established to provide support to the Steering Committee, comprising representatives of public, private, and civil society, responsible for monitoring implementation of the SNRP II.

⁷ [2006 CEMAC Financial System Stability Assessment](#).

36. In light of the poor functioning of institutions and lack of reliable data in Chad, the staffs recommend, however, that the monitoring and evaluation system and implementation arrangements be further strengthened. First, the interactions between the different bodies involved need to be clarified. Too often, line ministries operate with little coordination. Second, rules must be spelled out to ensure full participation and transparency in monitoring. Third, the capacity of the statistical agency needs to be strengthened, in order to generate more timely data at lower cost. Fourth, given regional disparities, indicators should include a regional dimension. Finally, the monitoring and evaluation should draw in other stakeholders and open space for civil society and non-governmental organizations to provide independent feedback, outside government control and funding, to provide additional checks and balances for the use of oil and non-oil revenue.

37. The staffs recommend refining the strategy by identifying clear priorities. Given the country's implementation capacity, the number of priority action programs (approximately 80) and projects in the SNRP II is excessive. In addition, various planning and budgetary processes coexist, but are not integrated, thereby undermining their effectiveness. Aligning these various frameworks (annual budget, sector strategies and plans, regional plans) with the SNRP II would improve coherence and effectiveness.

VII. CONCLUSIONS AND ISSUES FOR DISCUSSION

38. Bank and Fund staffs agree with the SNRP II's broad objectives for growth and poverty reduction in Chad. The document builds on lessons from the implementation of SNRP I and focuses on the restoration of security, the improvement of governance, the diversification of the economy, and the promotion of human development.

39. The authorities need to be mindful of the risks to this strategy. Among these are (i) lack of commitment to implementation; (ii) constraints on institutional and technical capacity to take the necessary actions; (iii) the volatility and declining path of oil resources; and (iv) security concerns.

40. Going forward, the staffs believe the strategy can only be successful if the authorities make a clear shift away from past patterns and demonstrate commitment to poverty reduction and good governance, and there is strong leadership in the implementation of the strategy. Implementation would need to focus on a manageable number of actions from among those identified above to improve the sustainability of fiscal policy, bolster revenue and expenditure management, strengthen execution of key sector policies, and enhance monitoring and evaluation.

41. In considering the SNRP II and associated JSAN, Executive Directors' views are sought on whether they agree with:

- the areas identified by the staffs as priorities for strengthening the SNRP II and its implementation and;
- the areas identified as key implementation risks.