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May 30, 1986

To: Members of the Executive Board  
From: The Secretary  
Subject: Chad - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Chad which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on page 25.

Mr. Allen (ext. 8381) or Mr. Dicks-Mireaux (ext. 8393) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

CHAD

Staff Report for the 1986 Article IV Consultation

Prepared by the Staff Representatives for the  
1986 Article IV Consultation with Chad

Approved by A.D. Ouattara and S. Kanesa-Thanan

May 28, 1986

I. Introduction

The 1986 Article IV consultation discussions with Chad were held in N'Djaména during the period February 3-17, 1986. The Chadian representatives included Mr. Romba, then Minister of Finance and Supplies, Mr. Mawata, Director of the Budget, Mr. Madji, National Director of the Bank of Central African States (BEAC), and other senior officials concerned with economic and financial matters. Discussions were also held at the BEAC headquarters in Yaoundé. The staff representatives were Messrs. Allen (head), Dicks-Mireaux, Ndoeye, van der Mensbrugge (all-AFR), and Mrs. Sylla (secretary-BLS).

Chad is on the standard 12-month consultation cycle, and the previous Article IV consultation was concluded on April 26, 1985. Chad continues to avail itself of the transitional arrangements of Article XIV. After a period of considerable difficulty in remaining current on its financial obligations to the Fund, Chad settled all arrears with the Fund on November 8, 1984 and has since been current in its obligations. On September 18, 1985 Chad purchased SDR 7.0 million (22.9 percent of quota) under the compensatory financing (CF) decision. Summaries of Chad's relations with the Fund and with the World Bank Group are provided in Appendices I and II, respectively. Statistical issues are discussed in Appendix III, and basic economic and financial data are presented in Appendix IV.

II. Background and Recent Economic Developments

After the civil unrest in 1979-80 and briefly in 1982, Chad has made much progress in recovering from the war and in re-establishing an effective administration. While the northern one third of the country remains in hostile hands, the Government's authority has been strengthened in the south, where most rebel groups have now rallied to the Government's cause. At the same time, Chad has been suffering from the effects of a prolonged drought, which only ended in 1985. With the most pressing reconstruction needs already attended to, the authorities have turned their attention increasingly to the problems of longer-run development. A UNDP Round Table was held in Geneva on December 4-6, 1985 to present Chad's development program and to solicit support.

Continuation of the progress recorded in the last three years is now threatened by two important developments. With the sharp drop in the world price of cotton in 1985, Chad's balance of payments and fiscal positions have come under great strain. Furthermore, given the relatively high level of production costs for cotton in Chad, the parastatal company, COTONTCHAD, is now in serious financial difficulties. Since cotton dominates the modern sector of the Chadian economy, accounting directly for about 9 percent of GDP and 80 percent of total exports, the future prospects of the country hinge on a satisfactory solution to the problems of the cotton sector. The second threat to the progress of recent years is the renewal in February 1986 of hostilities in the north of the country.

Real GDP is estimated to have fallen by 3 percent in 1984 and to have risen by 18 percent in 1985 (Table 1). As a result of abundant rains in 1985, food production in the southern part of the country was good, and production recovered in the center from the minimal levels of previous years. This has reduced Chad's dependence on food aid, and although there was still a net food deficit in 1985/86, Chad resumed the export of cereals, primarily to Cameroon and Nigeria. Cotton production, discussed in more detail below, rose by 7 percent in 1985/86. Livestock production fell by about 9 percent in 1985 as steps were taken to reconstitute the herd.

With the exception of the cotton processing subsector, which suffered from a shortage of raw materials following the poor 1984/85 harvest, industrial production in 1985 continued to pick up. While manufacturing in Chad remains highly protected, industries have suffered from competition from illegal imports, usually originating in Nigeria. Commercial activity also continued to recover, particularly in the informal sector, which has moved into the gaps left by the modern enterprises that left the country during the disturbances. While the authorities have offered incentives for such enterprises to return, including duty-free import privileges and a moratorium on bank debt, very few have yet returned. This has impeded recovery of the tax base.

In 1983/84 raw cotton production reached its second highest level on record, 158,000 tons (Table 2). This reflected higher producer prices, good weather, and the recovery from the war. With world prices at the high level of CFAF 750 per kg of ginned cotton, Chad recorded a large balance of payments surplus, and COTONTCHAD made an operating profit of CFAF 11 billion on cotton. The next year, despite increased producer prices, the severe drought caused raw cotton production to fall to 98,000 tons. The consequent decline in export volume, together with a reduced export price of CFAF 590 per kg, allowed Chad to qualify for a CF drawing in September 1985. At the same time, COTONTCHAD recorded a net loss of over CFAF 4 billion on cotton production. The complete cotton sector accounts for the 1984/85 year, however, taking into consideration expenditures not directly related to cotton production, revealed an overall loss of about CFAF 18 billion. In 1985/86, while

Table 1. Chad: Selected Economic and Financial Indicators, 1982-86

	1982	1983	1984	1985	1986
		Estimates			Proj.
(Annual percentage changes, unless otherwise specified)					
Gross domestic product and prices					
GDP at current prices	11.8	14.3	8.1	27.0	9.5
GDP at constant prices	5.4	5.6	-2.7	17.6	3.3
GDP deflator	6.2	8.2	11.0	8.0	6.0
Central government finance <u>1/</u>					
Revenue	...	...	118.9	4.0	-3.6
Total expenditure	...	...	80.3	5.2	3.4
Money and credit					
Domestic credit	-4.5	3.7	30.0	21.5	...
Government	-5.7	-7.6	-4.0	-65.7	...
Private sector	-4.1	8.2	41.5	41.4	...
Money and quasi-money	4.5	22.3	59.9	6.1	...
Interest rate <u>2/</u>	5.8	5.8	5.8	5.8	...
External sector					
Exports, f.o.b. (in SDRs)	...	47.1	57.2	-47.2	-13.4
Cotton, f.o.b. (in SDRs)	...	99.3	71.4	-51.6	-21.4
Imports, f.o.b. (in SDRs)	...	45.2	15.0	-1.6	3.3
Export volume <u>3/</u>	...	51.4	50.0	-37.9	9.4
Import volume <u>4/</u>	...	46.3	13.3	-3.6	-6.0
Terms of trade <u>5/</u>	...	32.4	12.6	-23.7	-34.6
Nominal trade-weighted effective exchange rate (depreciation -)	-2.7	--	0.2	2.8	...
(In percent of GDP, unless otherwise stated)					
Overall government deficit (-) <u>6/</u>	...	-2.0	-1.9	-1.6	-2.0
Domestic financing	...	-0.1	-0.2	-0.5	...
External financing	...	1.4	1.5	1.5	...
Arrears	...	0.7	0.6	0.6	...
External current account balance					
Excluding official transfers	-9.8	-18.2	-15.4	-26.5	-23.6
Including official transfers	--	-1.5	1.1	-13.4	-12.3
External debt outstanding <u>7/</u>	...	...	22.6	16.7	...
Debt service ratio <u>8/</u>					
Excluding IMF	11.0	6.6	4.1	7.1	7.8
Including IMF	14.5	8.5	7.7	13.4	11.4
(In millions of SDRs)					
Overall balance of payments	4.6	8.7	16.3	-24.5	-24.4
Gross official reserves					
(weeks of imports)	10.9	14.7	20.1	12.4	0.8
Net foreign assets (end of period)	14.4	28.1	59.0	43.7	...
External payments arrears					
(outstanding at end of year)	...	...	51.4	54.6	...

Sources: Data provided by the Chadian authorities; and staff estimates and projections.

1/ Includes consolidated operations of the Treasury and the Amortization Fund (CAA) and the National Reconstruction Fund, but excludes the stabilization funds for cotton, petroleum, and sugar. Since 1975, no investment expenditure has been included in the budget. Data for 1977 do not include public debt service.

2/ Six-month to one-year time deposits of CFAF 5-10 million.

3/ Exports of cotton only; volume data for other exports are not available.

4/ Import value deflated by an import price index calculated as a weighted average of partner countries' export prices adjusted for exchange rate variations.

5/ Export price index for cotton divided by import price index.

6/ On a commitment basis.

7/ End of period.

8/ Scheduled debt service in percent of exports of goods and nonfactor services.

Table 2. Chad: Cotton Production and Related Data,  
1981/82-1985/86 1/

	1981/82	1982/83	1983/84	1984/85	1985/86
Raw cotton					
Area under cultivation (thousand hectares)	133.9	137.7	176.7	141.9	147.4
Production (thousand metric tons)	71.4	102.1	158.4	98.4	105.0
Producer price (CFAF/kg, white cotton)	60	70	80	100	100
Ginned cotton					
Production (thousand tons)	26.2	38.1	59.8	35.4	39.9
Export (thousand tons)	24.8	37.6	56.3	35.0	38.3
			<u>(CFAF/kg ginned cotton)</u>		
Export price <u>2/</u>	520	598	752	590	390
Assessed value ( <u>valeur</u> <u>mercitoriale</u> )	150	150	350	500	350
Export cost <u>2/</u>	503	559	559	714	549
Of which:					
Producer price	(160)	(186)	211)	(277)	(254)
Ginning cost	(217)	(240)	(155)	(193)	(126)
Transport, etc.	(104)	(113)	(137)	(157)	(178)
Export taxes	(22)	(20)	(56)	(87)	(--)
Net profit	17	39	193	-124	-159

Sources: Data provided by the Chadian authorities; and staff estimates.

1/ Crop years starting November 1.

2/ F.o.b. Douala.

production is estimated to have recovered to the more normal level of 105,000 tons, world prices have fallen further to some CFAF 390 per kg. COTONTCHAD is expected to incur a deficit, of about CFAF 20 billion, and Chad will have a further large balance of payments deficit.

The fiscal tables in this report consolidate only the Amortization and National Reconstruction Funds with the finances of the Central Government proper. It is hoped that a more complete consolidation can be attempted in the future. While Chadian public finances remain dependent on external support, significant progress has been made over the last three years in recovering from the war. The administrative capacity of the Government has been greatly enhanced: expenditure control mechanisms have been strengthened and agencies made more accountable, and revenues have responded well to improved valuation procedures for both exports and imports. Nevertheless, public finances remain highly constrained, and Chad has continued to accumulate internal and external arrears.

Total central government revenue doubled between 1983 and 1984, but increased only slightly in 1985 (Table 3). In 1984, revenue growth was attributable to an increase in the assessed value of cotton exports from CFAF 150 per kg to a more realistic level of CFAF 350 per kg, the sharp rise in the volume of cotton exports, better valuation of imports for customs purposes, improved collection of taxes on domestic transactions, transfers under the exchange rate guarantee scheme, 1/ a special one-time levy on salaries and companies (the contribution to the national reconstruction effort, CERN), and the collection of arrears of earmarked taxes by the Amortization Fund (CAA). In 1985, however, the exchange rate guarantee scheme yielded less revenue, there were no substantial arrears for the Amortization Fund to collect, and the contribution to the national reconstruction effort was eliminated. Other regular revenue items grew strongly, reflecting the continued recovery of the economy and improved collection efforts. Despite a fall in the volume of cotton exports, a higher assessed value of CFAF 500 per kg was used as the basis for cotton export taxes throughout the year. Total revenue exceeded the target communicated to the Fund in connection with the September 1985 CF drawing by some CFAF 2.8 billion.

After a growth in expenditure of 80 percent in 1984, the increase in 1985 was kept to just over 5 percent. 2/ The increase in 1984

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1/ Under the exchange rate guarantee scheme between France and the member states of the BEAC, the value of the member's holdings in the operations account with the French Treasury is guaranteed in terms of SDRs. Beginning in 1982, the BEAC has distributed to the member states part of the annual transfers from the French Treasury under this scheme.

2/ Excludes imports of foodstuffs, and military and development outlays, financed directly from foreign sources, almost entirely in the form of grants; these outlays are estimated to have been in the order of CFAF 32 billion a year in 1983-85.

Table 3. Chad: Central Government Operations, 1977 and 1983-86 <sup>1/</sup>

(In millions of CFA francs)

	1977 <sup>2/</sup>	1983	1984	1985	1986 Proj.
Total revenue	14,880	9,155	20,042	20,848	20,099
Tax revenue	14,620	6,106	13,038	15,127	16,597
Of which: exports <sup>3/</sup>	(1,460)	(281)	(2,742)	(2,938)	(579)
Nontax revenue	260	1,005	939	1,604	1,123
BEAC profit distribution	...	445	581	542	542
Exchange rate guarantee scheme	...	1,223	2,107	1,658	--
Extrabudgetary revenue	--	376	3,377	1,617	1,837
Amortization Fund (CAA) <sup>4/</sup>	(--)	(376)	(1,737)	(1,307)	(1,837)
Contribution to the national reconstruction effort	(--)	(--)	(1,640)	(610)	(--)
Total expenditure	18,220	13,513	24,367	25,662	26,525
Budgetary	18,220	11,855	20,953	23,495	25,709
Extrabudgetary <sup>5/</sup>	...	1,658	3,414	2,395	816
Amortization Fund (CAA)	(--)	(908)	(855)	(1,415)	(816)
National Reconstruction Fund (NRF)	(--)	(--)	(1,290)	(120)	(--)
Other	(--)	(750)	(1,269)	(592)	(--)
Deficit (-) on a commitment basis	-3,340	-4,358	-4,325	-4,774	-6,426
Change in payment arrears (increase +)	10	1,591	1,362	1,908	-2,758
External	...	202	107	511	-969
Domestic	...	1,389	1,255	1,397	-1,789
Deficit (-) on a cash basis	-3,330	-2,767	-2,963	-2,866	-9,184
Financing	3,330	2,767	2,963	2,866	...
External (net)	1,970	2,934	3,402	4,391	3,873
Grants	(...)	(3,723)	(4,381)	(5,614)	(5,000)
Amortization <sup>6/</sup>	(...)	(-789)	(-979)	(-1,223)	(-1,127)
Domestic (net)	1,360	-167	-439	-1,525	1,664
Banking system <sup>7/</sup>	1,050	-920	513	-2,930	1,664
Central bank	1,050	-887	1,022	-2,466	1,664
Of which: use of Fund counterparts	(--)	(724)	(-1,352)	(517)	(-815)
Commercial banks	--	-33	-509	-464	--
Nonbank sector	310	753	-952	1,405	--
Financing gap	--	--	--	--	3,647

Sources: Data provided by the Chadian authorities; Fund records; and staff estimates and projections.

<sup>1/</sup> On a calendar year basis. Excludes the stabilization funds for cotton, petroleum, and sugar.

<sup>2/</sup> Data for 1977 do not include public debt service.

<sup>3/</sup> Comprises largely receipts of export taxes on cotton. The export tax on cotton is assessed on a standard value per kg of ginned cotton exported, and not on the realized export price.

<sup>4/</sup> Includes working costs, contributions to international organizations, scheduled interest payments on external public debt, and IMF charges.

<sup>5/</sup> Excludes imports of foodstuffs, and military and development outlays, financed directly from foreign sources, almost entirely in the form of grants; these outlays are estimated to have been in the order of CFAF 32 billion a year in 1983-85.

<sup>6/</sup> Scheduled amortization on external public debt.

<sup>7/</sup> This includes variations in the level of the deposits of the CAA and NRF, but excludes changes in the deposits of other government funds and agencies.

reflected the difficulty of establishing an effective expenditure control system in the face of the pressing need for expenditures, particularly of a military nature. The latter tripled between 1983 and 1984, as more groups in the country rallied to the Government, and rose by a further 4 percent in 1985. Payments of wages and salaries have remained constrained, rising by 6 percent in 1984 and 8 percent in 1985. Most civil servants were paid only one half their scheduled salaries throughout the period. There has been some growth in civil service employment, but the main factors accounting for the increased expenditures on this item have been the movement of civil servants through the salary scale and the reintegration of former civil servants returning to the administration. Expenditures on goods and services have also been compressed, and the administration remains underequipped.

Total expenditures for 1985 exceeded the estimates made in connection with the September 1985 CF drawing by 25 percent or CFAF 5.2 billion. This reflected the difficulty of reducing military outlays in line with the authorities' objectives and the delay in imposing the system of expenditure limits. About one fourth of the year's military outlays were recorded in December, when bounty was paid to several previously hostile groups which rallied to the Government.

On a commitment basis, the annual government deficit has remained at about CFAF 4.5 billion over the period 1983-85. As a percentage of fiscal revenues, the deficit was reduced from 48 percent in 1983 to 22-23 percent in 1984 and 1985. The estimates for 1985 presented in connection with the September 1985 CF drawing implied a reduction in this deficit by about CFAF 2.2 billion, but in the event it increased by CFAF 0.4 billion. <sup>1/</sup> During 1983-85 arrears accumulated at an annual rate of between CFAF 1.6 and 1.9 billion, as a result the annual deficit on a cash basis has been in the range of CFAF 2.8-3.0 billion. For most of the period 1983-85, the Government has been at the limit of its statutorily permitted borrowing from the banking system, so deficit financing has had to come largely from budgetary foreign grants, averaging about CFAF 5 billion a year, primarily from France and to a lesser extent from the United States. At the end of 1985, however, Chad accumulated a margin of unused credit with the central bank amounting to about CFAF 2 billion, stemming from the unblocked portion of the September 1985 CF drawing and from the BEAC's profit transfer to Chad.

Chad continued to accumulate both internal and external arrears over the period 1983-85. As far as the external arrears are concerned, the Amortization Fund was not provided with sufficient resources to meet all debt service falling due. While arrears to some multilateral organizations have been settled, the total stock of external arrears at the end of 1985 is estimated at CFAF 22.7 billion (SDR 55 million), a part of which dates from the 1960s and 1970s. The total of domestic

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<sup>1/</sup> Revised presentation and the consolidation of the National Reconstruction Fund account for certain differences between the data in Table 3 and those presented in EBS/85/200.

arrears is not known. At least CFAF 5.3 billion of domestic arrears is held by the Amortization Fund, most of which dates from the late 1970s and are poorly documented. Arrears of at least CFAF 6.8 billion are known to have accumulated by end-1985, on commitments for which payments orders have not been issued, at the level of the budget office. These have arisen from the practice of not fully budgeting certain expenditures, and are largely bills of public enterprises and airlines. There are also arrears at the Treasury, on payments orders issued but not yet paid, which reached CFAF 1.8 billion at the end of 1985.

The Chadian monetary system is heavily burdened by a large amount of nonperforming credit, much of which has been frozen by the Government. Total domestic credit rose by 30 percent in 1984 to CFAF 56.4 billion (Table 4). Some CFAF 10.5 billion was accounted for by net credit to Government, which remained at its statutory ceiling. Of the CFAF 45.9 billion credit to the private sector, some CFAF 27.2 billion was frozen under a government moratorium until 1988. This moratorium covered certain claims and liabilities as of March 20, 1980, i.e., from the period of civil unrest, and was intended to facilitate the recovery of the economy. Performing credit in 1984 rose by CFAF 13.5 billion to CFAF 18.7 billion. A large part of this went to COTONTCHAD as crop financing, while the remainder financed the revival of manufacturing and commercial activity.

As a result of the high level of cotton exports in 1984, net foreign assets rose by CFAF 15.5 billion to CFAF 24.9 billion. Corresponding to the large increase in banking system assets, money and quasi-money rose by 60 percent to CFAF 67.8 billion: that part of monetary liabilities not frozen under the moratorium increased by 88 percent. A substantial part of Chadian banknotes is in circulation outside the country; the largest repatriations of such notes come from Niger, where they have apparently been used to finance transactions with Nigeria.

In 1985, and particularly in the last quarter, the level of net foreign assets fell sharply to CFAF 15.3 billion, reflecting the lower value of cotton exports and purchases of inputs for the next season's cotton production. The decline in foreign assets was concentrated in the central bank's holdings, while the holdings of commercial banks actually rose. This reflected the increasing recourse of the traditional sector to the banking system, requiring commercial banks to hold more assets abroad to finance their foreign transactions. Domestic credit continued to grow during 1985, largely reflecting the continued credit needs of COTONTCHAD, which by mid-year found itself unable to service its domestic debt according to schedule. In June it obtained a six-month deferral of repayment of the 1984/85 crop credit and, in view of its continued financial difficulties, has since asked for a further suspension. The staff estimates that at the end of 1985 credit to COTONTCHAD amounted to about CFAF 36 billion (56 percent of total private sector credit), of which about CFAF 12 billion was covered by the 1983 moratorium. Net claims on the Government declined by

Table 4. Chad: Monetary Survey, 1981-85

(In millions of CFA francs; end of period)

	1981	1982	1983	1984	1985
Foreign assets (net)	-1,615	2,522	9,476	24,939	15,329
Central bank	-435	3,037	10,067	20,312	8,760
Commercial banks	1,632	2,297	2,221	7,430	9,372
Postal debt	-2,812	-2,812	-2,812	-2,803	-2,803
Domestic credit	43,803	41,824	43,391	56,428	68,552
Claims on Government (net)	12,542	11,833	10,936	10,498	3,601
Of which: claims on Treasury, CAA, and NRF (net) <sup>1/</sup>	(10,317)	(9,608)	(8,688)	(9,201)	(6,001)
Post office <sup>2/</sup>	(3,098)	(3,098)	(3,089)	(3,089)	(3,089)
Claims on private sector	31,261	29,991	32,455	45,930	64,951
Performing credit	(...)	(...)	(5,282)	(18,743)	(40,747)
Non-performing credit	(...)	(...)	(27,173)	(27,187)	(24,204)
Money and quasi-money	33,162	34,649	42,389	67,759	71,907
Currency outside banks	22,143	23,609	29,196	44,925	47,363
Demand deposits	9,537	9,554	11,557	20,200	20,990
Active	(...)	(...)	(2)	(8,955)	(10,148)
Frozen <sup>3/</sup>	(...)	(...)	(11,555)	(11,245)	(10,842)
Quasi-money	1,482	1,486	1,636	2,634	3,554
Active	(...)	(...)	(5)	(1,003)	(1,923)
Frozen	(...)	(...)	(1,631)	(1,631)	(1,631)
Medium- and long-term foreign liabilities	2,181	2,377	2,633	2,296	1,628
Other items (net)	6,845	7,320	7,845	11,312	10,346

Sources: Data provided by the BEAC; IMF records; and staff estimates.

<sup>1/</sup> Variations in the level of these claims are equivalent to net domestic bank financing of overall central government operations as shown in Table 3.

<sup>2/</sup> Counterparts of postal debt and private sector and commercial banks' deposits with the postal checking system.

<sup>3/</sup> Includes private sector deposits with the postal checking system.

CFAF 6.9 billion in 1985. Some CFAF 2 billion of this was accounted for by the reduction of the central government overdraft following the receipt of the unblocked part of the September 1985 CF drawing and of Chad's part of the BEAC's profits. The remainder, almost CFAF 5 billion, is accounted for by an increase in deposits of unidentified extrabudgetary accounts. Monetary liabilities increased in 1985 by only 6 percent.

After recording a small surplus in 1984, Chad's external current account deteriorated by SDR 92 million in 1985 to reach a deficit of SDR 86 million (Table 5). This reflected the halving of the value of cotton exports from SDR 95 million in 1984 to SDR 46 million in 1985, and a sharp increase in net expenditure on services from SDR 61 million to SDR 101 million as oil exploration activity increased. There was also a slightly lower level of imports. Official transfers to Chad are estimated to have remained at about SDR 85 million over the last three years. Two thirds of the deterioration of the current account in 1985 was compensated by an increase in medium- and long-term capital inflows. Direct investment, primarily to finance oil exploration, is estimated to have increased by SDR 45 million, and disbursements of medium- and long-term loans to have risen by SDR 15 million. Chad's overall balance of payments nevertheless deteriorated, from a surplus of SDR 16 million in 1984 to a deficit of SDR 25 million in 1985, part of which was financed by an SDR 2.4 million accumulation of arrears on its external debt.

By the end of 1985, Chad's external public and publicly guaranteed debt is estimated to have reached SDR 119 million. Some SDR 91 million of this total is owed to multilateral organizations and SDR 22 million to bilateral lenders, primarily France. Debt service on this total amounted to SDR 8.4 million in 1985, with the average interest rate less than 3 percent. In addition, Chad had external arrears estimated at SDR 55 million at the end of 1985. Just over SDR 2 million was owed to multilateral agencies, SDR 26 million to bilateral lenders, SDR 22 million to foreign banks, and SDR 4 million to suppliers. Chad has recently approached its creditors to try to resolve this problem.

Chad's currency, the CFA franc, is pegged to the French franc at a rate of CFAF 50 = F 1. In terms of the U.S. dollar, the CFA franc depreciated steadily from late 1980 until early 1985. During 1985, however, it appreciated by 27 percent, and during the first four months of 1986 by a further 9 percent. Chad's nominal effective exchange rate for the CFA franc, after remaining approximately constant in the period 1982-84, rose by 5 percent between the last quarter of 1984 and the same period of 1985. In the absence of a reliable price index, it is not possible to calculate a real effective exchange rate for Chad.

### III. Policies and Outlook for 1986 and Beyond

In concluding the 1985 Article IV consultation with Chad, Executive Directors drew attention to the critical situation of Chad's public

Table 5. Chad: Balance of Payments, 1982-86

(In millions of SDRs)

	1982 <sup>1/</sup>	1983	1984	1985 Est.	1986 Proj.
A. Current account balance	0.2	-8.1	5.7	-86.4	-95.7
Excluding official transfers	-50.6	-95.9	-79.6	-171.4	-183.3
Trade balance	-28.3	-40.2	-17.1	-66.3	-78.1
Exports, f.o.b.	46.9	69.0	108.5	57.3	49.6
Of which: cotton	(27.7)	(55.2)	(94.6)	(45.8)	(36.0)
Imports, f.o.b.	-75.2	-109.2	-125.6	-123.6	-127.7
Services (net)	-27.0	-49.7	-60.5	-100.9	-100.7
Credit	3.9	31.2	37.1	33.8	40.2
Debit	-30.9	-80.9	-97.6	-134.7	-40.9
Of which: interest due <sup>2/</sup>	(-3.7)	(-4.4)	(-3.6)	(-3.0)	(-3.8)
Transfers (net)	55.5	81.8	83.3	80.8	83.1
Private	4.7	-6.0	-2.0	-4.2	-4.5
Official	50.8	87.8	85.3	85.0	87.6
B. Medium- and long-term capital (net)	-3.0	-2.8	6.1	64.6	71.3
External loans (net)	-3.0	-1.7	-1.0	13.1	27.9
Drawings	(0.4)	(2.3)	(3.8)	(18.5)	(33.4)
Amortization due	(-3.4)	(-4.0)	(-4.8)	(-5.4)	(-5.5)
Other (net)	--	-1.1	7.1	51.5	43.4
C. Short-term capital, including errors and omission	4.3	16.6	-0.2	-6.3	--
Monetary	-1.3	1.1	-10.7	-6.8	--
Nonmonetary, including errors and omissions	5.6	15.5	10.5	0.5	--
D. Exchange rate guarantee scheme	3.1	3.0	4.7	3.6	--
E. Overall balance (A+B+C+D)	4.6	8.7	16.3	-24.5	-24.4
F. Financing	-4.6	-8.7	-16.3	24.5	24.4
Central bank	-9.5	-14.8	-20.1	22.1	27.6
Arrears (net)	4.9	6.1	3.8	2.4	-3.2
Memorandum items:					
Exchange rate CFA francs per SDR, period average	362.79	407.35	447.89	456.15	415.00
Gross official reserves in weeks of imports	10.9	14.7	20.1	12.4	0.8

Sources: Data provided by the BEAC; and staff estimates and projections.

<sup>1/</sup> Because of lack of records, the coverage of the balance of payments in 1982 is less comprehensive than in later years.

<sup>2/</sup> Excluding interest due on arrears.

finances and the sizable accumulation of domestic and external arrears. They commended the adjustment and reconstruction measures already adopted and urged the implementation of a more comprehensive and decisive adjustment program. Directors called for revenue-enhancing measures, including a shift to ad valorem taxation, and improved expenditure control, which would allow the full service of external debt and the elimination of all arrears. They underscored Chad's need for technical assistance, and emphasized the role of the World Bank in assessing Chad's investment plans. Finally, after welcoming the increase in procurement prices and measures to improve the financial position of state enterprises, Directors noted with satisfaction the decisive measures adopted to eliminate arrears with the Fund. During their discussion of Chad's request for a CF drawing in September 1985, Executive Directors again stressed the need for improved control over public finances and for Chad to eliminate its payments arrears.

1. Cotton

The recent sharp decline in world prices of cotton has hit Chad and its cotton producing company, COTONTCHAD, particularly hard. World prices are now CFAF 400 per kg or less, while in 1985, the cost price of Chadian ginned cotton f.o.b. Douala reached about CFAF 715 per kg (Table 2). The elements of cost per kg were payments to producers of about CFA 280, ginning and administrative costs of CFAF 190, transport and insurance costs of CFAF 105, export taxes of CFAF 90, and financial charges of about CFAF 50. These costs had all grown rapidly in recent years, reflecting the raising of producer prices, lax management, low levels of capacity utilization, higher export taxation, and the poor state of the transport system. In addition to large current losses, COTONTCHAD is burdened with large debts arising from its past operations. The Cotton Price Stabilization Fund, which was designed to help tide COTONTCHAD over just such a difficult period, is without disposable resources.

If the cotton company were to cease operations and cotton production were to be halted in Chad, the results would be catastrophic. Not only would the main source of export earnings disappear, but also farmers would be deprived of their principal source of cash, and the modern economy in much of the country would find itself without inputs or domestic markets. This would have an impact on the tax base well beyond the first round effects of the elimination of revenues from cotton exports. Finally, as the cotton company has been an important pillar in the administration of the south of the country in recent years, (a factor which has contributed to the rapidly rising costs of the company), its bankruptcy could greatly complicate the task of strengthening the civil administration.

In June 1985, as the first problems became apparent, COTONTCHAD approached the BEAC for a six-month rescheduling of the repayment of credit due in the remainder of 1985. This was granted. As the extent of the problem became clearer, a high level commission was established

in October to recommend emergency measures. The commission estimated that, by October 1986, COTONTCHAD's cumulative loss from the 1984/85 and 1985/86 seasons, together with the cost of procuring inputs for the 1986/87 season, would reach about CFAF 21 billion. <sup>1/</sup> It recommended that COTONTCHAD take immediate action to reduce costs by CFAF 1.5 billion a year by applying stricter procurement and expenditure criteria, an immediate reduction in staffing of some 350 people, and a salary freeze--measures that were adopted promptly. It also recommended a reduction in taxes on COTONTCHAD's activities, the net effect of which would have been tax relief of about CFAF 2 billion a year. The Government agreed to some of these proposals, although, as discussed below, the annual loss of tax revenue from COTONTCHAD in 1986 and beyond is likely to be much greater than CFAF 2 billion. The commission recommended that the BEAC be asked to provide sufficient new credit and grant further rescheduling to allow COTONTCHAD to meet its obligations until the end of October 1986. At its November 1985 council meeting, the BEAC agreed to make further credit available to COTONTCHAD.

The problem of cotton was raised with donors during the December 1985 UNDP Round Table. Interested donors, primarily France, the European Communities, and the World Bank, agreed that a study would be urgently undertaken to look at the short-term adjustment measures and financing needs of the cotton sector, with the aim of providing the basis for emergency assistance. The study has concluded that the production of cotton should be viable in Chad provided prices recover over the medium-term, to at least CFAF 550-600 per kg. Chad should be able to reduce its production costs to below this level and become competitive with other cotton producers in West Africa. The recommendations of the study were considered at a meeting in N'Djaména of donors and the Government in early March, and most recommendations were adopted.

In the area of raw cotton production, the study recommended maintaining the current level of producer prices at CFAF 100 per kg. Producers would, however, be required to pay the full cost of fertilizers and pesticides, as opposed to the 50 percent they pay at present. Furthermore, efforts would be made to hold the size of the crop to 100,000 tons, by diminishing the area under intensified cultivation and reducing the radius of collection. The Government has accepted these measures, with the modification that the raising of payments for inputs will now take place in two stages over the 1986/87 and 1987/88 seasons.

The study also recommended that COTONTCHAD make substantial additional savings: by reducing the number of purchasing centers, discouraging production in peripheral areas, closing all but five of the twelve existing ginneries, improving ginning yields through better selection and management, reducing the number of trucks, selling two of the company's four planes, further reducing staffing levels, closing

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<sup>1/</sup> Subsequent studies have shown the cumulative loss to have been much greater than this.

overseas representation, moving the headquarters from N'Djaména to the cotton-producing area, and raising the price of cotton sold to the domestic textile company, STT. These measures have all been adopted, with the exception of the relocation of COTONTCHAD's headquarters.

The study recommended that all cotton export duties and payments to the Amortization Fund be suspended. The Government is unwilling to accede to such a formal suspension, although it recognizes that COTONTCHAD will not in fact be able to pay such taxes during the period of crisis. The study recommended that the Cotton Price Stabilization Fund be abolished, but the Government has decided against this, provided the fund reduces its costs and becomes self-supporting.

With these measures, assuming export taxes are not paid, and excluding the servicing of COTONTCHAD's outstanding debt to the banking system, it is estimated that the cost of cotton production can be reduced to about CFAF 550 per kg. Until world prices recover to this level, however, COTONTCHAD will need additional financial support estimated at CFAF 7.7 billion, CFAF 6.5 billion, and CFAF 4.5 billion, respectively in the three years end October 1989; and other organizations active in the cotton sector, the National Rural Development Office (ONDR) and the Chadian Cotton Research Institute (ICRT), will need support totalling CFAF 3.8 billion. The World Bank and the French CCCE are preparing emergency assistance in the form of loans and grants to cover these needs, which will be discussed with the Chadian authorities and potential contributors in Washington in late May. The World Bank is also preparing a study on the longer term prospects for cotton in Chad and the possibilities for diversification, which should provide the basis for a rehabilitation program in the cotton sector during 1987.

One major obstacle to this rescue plan remains the treatment of COTONTCHAD's outstanding indebtedness. Hitherto, COTONTCHAD's losses have been essentially covered by the banking system. By the end of October 1986, it is estimated that COTONTCHAD's liabilities to the banking system will reach at least CFAF 30 billion, in addition to over CFAF 12 billion of frozen credit from the 1983 moratorium. This nonperforming credit, together with some CFAF 12 billion of frozen credit to other enterprises, would probably account for over 75 percent of outstanding private sector credit in Chad by that time. If the liabilities of COTONTCHAD were rescheduled, say for ten years at commercial interest rates, the servicing cost could add about CFAF 150 per kg to COTONTCHAD's overhead, making the restoration of profitability impossible.

The mission took the position that COTONTCHAD needed a major financial restructuring, with a large part of its debt being converted into equity or cancelled. If external support could be found to allow the reimbursement of bank debt, Chad's foreign exchange reserves could be reconstituted. It is not clear at this time that the foreign shareholders are prepared to do this, and the Chadian Government certainly

lacks the resources to do so. This issue, which is crucial to both the viability of COTONTCHAD and the financial health of the banking system, remains to be resolved.

## 2. Public finance

The 1986 budget introduced a number of new measures to improve tax collection and increase revenues. The most important single measure was the reintroduction of a poll tax, expected to raise CFAF 1.2 billion. Increased revenues were also expected from the full year effect of taxes on beer, cigarettes, soap, sugar, and oil, introduced between February and May 1985, for the benefit of the Amortization Fund. The decision to lower the assessed value for the levying of cotton export duties from CFAF 500 per kg to CFAF 350 per kg was expected to reduce revenues from this source by about CFAF 900 million, and the decision to harmonize import duties over five years with those of UDEAC (the Customs Union of Central African States) was also expected to reduce revenues. In reviewing the budget estimates, the mission felt that in practice all revenues from cotton export taxes would be foregone, amounting to an additional loss of about CFAF 2.7 billion. On the other hand, there was scope for greater revenue collection from the single tax ("taxe unique"), on which considerable arrears accumulated in 1985, bringing total estimated revenue to CFAF 20.1 billion, or 4 percent less than in 1985 (Table 3).

Total central government expenditure in 1986 was estimated in the budget to fall by 0.6 percent to CFAF 25.5 billion. The decline was to be accounted for by a sharp reduction in extrabudgetary expenditures, including scheduled interest payments to be made by the Amortization Fund, while budgetary expenditure proper was estimated to rise. The main factor was an increase in civil service wages from 50 percent to 60 percent of the official salary scale; together with the payment of certain salary arrears this was estimated to cost the budget about CFAF 1.4 billion. Military expenditures in the budget, which reached CFAF 9.4 billion in 1985, compared with a budgeted amount of CFAF 7.5 billion, were budgeted at CFAF 8.0 billion for 1986. In preparing its projections, the mission felt that at least CFAF 8.5 billion should be budgeted for this item, although in the light of recent events this may also prove far too low. A new policy, which was to have been introduced in 1986, consisted of government loans to senior officials for the purchase of automobiles. In view of the scarcity of resources, the authorities have since decided not to implement this policy. Another move was henceforth to assume only a specified part of the telephone and other utility bills of senior officials, as against the totality of such consumption now being charged to the Government. In adjusting the authorities' estimates, the mission also included full payment of the Government's 1986 utility bills, rather than the 50 percent budgeted, which increased expenditure by about CFAF 500 million. In sum, the mission estimated that expenditure in 1986 would rise by 3.4 percent to CFAF 26.5 billion.

The deficit on a commitment basis was therefore estimated at CFAF 6.4 billion or 32 percent of total revenue, compared with the budgeted level of CFAF 4.3 billion, or 20 percent of total revenue. This is significantly larger than the CFAF 4.8 billion recorded in 1985, but reflects the decline in revenues from cotton, without which the deficit would have been reduced in 1986. The authorities will also need resources to eliminate domestic treasury arrears (CFAF 1.8 billion), to settle at least those external arrears to multilateral organizations (CFAF 1.0 billion), and to pay amortization on outstanding debt (CFAF 1.1 billion). The total financing need in 1986 is therefore CFAF 10.3 billion. Access to the banking system, to meet this need, in the form of utilizing the overdraft at the BEAC could provide CFAF 1.7 billion, after the settlement of obligations to the Fund and of the special advance from the BEAC. If external budgetary support is at the same underlying level as last year, this could provide at least CFAF 5.0 billion. This would leave a gap of about CFAF 3.6 billion to be filled by a combination of additional external finance and adjustment measures.

With the help of Fund technical assistance, expenditure control mechanisms were greatly strengthened in 1985. By June 1985 the approval of expenditures outside the normal budgetary process had been stopped in N'Djaména, and from September, quarterly expenditure limits were introduced. Expenditure control in the provinces has remained more difficult, but the central authorities have sent missions out to ensure the implementation of instruction. The mission proposed certain improvements designed to ensure that expenditure limits were communicated to all government units before the start of the relevant period, and that subsequent limits be adjusted downwards if quarterly revenue targets were not met or earlier expenditure limits exceeded. It is understood that these proposals have since been adopted. Military expenditures from the budget are also in principle subject to quarterly limits, but in practice are more difficult to control. As opposition groups have rallied to the Government, expenditures have had to be increased to pay for their incorporation into the armed forces. The recent renewed hostilities in the north of the country are also likely to require increased expenditures, notwithstanding any system of expenditure control.

A second expenditure item which poses difficulties is the wage bill. While the Government is in the process of conducting a census of the civil service and has completed it for N'Djaména, data on public sector employment are not reliable. The mission stressed the need to place a limit on the size of the civil service. The authorities were unwilling to commit themselves to a limit, since, with the aim of promoting national reconciliation, they wish to continue to guarantee a job to any civil servant who left the country during the period of unrest and who returns. While the number of potential returnees is probably under 2,000, the open-ended nature of this commitment and the burden it could add to public expenditures in the future are worrisome. The mission suggested that the problem might be resolved by

combining a limit on civil service staffing with an externally financed program to promote the reintegration of returning civil servants in the nongovernment sector of the country.

In the past, cotton export taxes have been assessed on the basis of a standard value (valeur mercuriale) set each year by the Government, rather than on the realized export prices. This standard value was only adjusted to changing world market prices with a considerable lag, depriving the Government of potential revenue and introducing a considerable element of administrative discretion into cotton taxation. In line with the recommendations of the Executive Board, a Fund technical assistance mission in November 1985 proposed the application of a system of cotton export taxation on an ad valorem basis. The Chadian authorities have accepted the findings of this report in principle. However, given the crisis in the cotton sector, the question of applying the recommendations would seem moot, since it is unlikely that any export tax can be collected for the time being.

The overhang of domestic arrears poses a serious obstacle to the process of normalizing financial conditions in Chad. In February 1986 the Government set up a commission to document the problem and to propose solutions. At the time of the September 1985 CF drawing, the authorities indicated their intention of avoiding any accumulation of internal or external arrears in 1985. Nonetheless, arrears at the level of the Treasury, reached CFAF 1.8 billion by the end of 1985, of which CFAF 1.4 billion was accumulated during 1985. The Chadian authorities explained to the mission that these arrears resulted from the shortage of cash at the Treasury, Chad having fully utilized its overdraft on the central bank. Nevertheless, Chad did have resources available at the end of 1985 stemming from the unblocked portion of the September 1985 CF drawing (CFAF 1.1 billion) from the Fund and from the transfer of BEAC profits (CFAF 0.5 billion). At the time of the discussions, a decision had not been taken on how these resources were to be spent--whether to settle arrears, to finance investment, or to use them for other purposes. The mission urged the authorities to clear arrears at the level of the Treasury as a matter of priority, and expenditure to this effect has been included in the mission's 1986 budget projections.

While the authorities had hoped to devote CFAF 1 billion of budgetary resources to investment in 1986, as in previous years, estimated available resources proved insufficient. The capital expenditures in Chad's investment program will therefore be entirely financed from abroad. At the UNDP Round Table Conference in December 1985, donors indicated their willingness in general terms to step up their project financing in Chad. They were presented with some 200 projects of varying priority and at different stages of preparation, and agreed to concentrate their assistance in the areas of food production, cotton, transport, health, and education. Aid coordination meetings on these subjects will be held throughout 1986. With Fund technical assistance, the Chadian authorities are now preparing an investment budget, which should assist in the coordination of this external

assistance. It is expected that in 1987 a full investment budget will be integrated in the regular budgetary framework. This should allow a better assessment of the recurrent cost and financing implications of the investment program. In the mission's view, and in the light of the fragility of Chad's public finances and balance of payments, priority should be given to projects that have minimal recurrent costs, that can generate resources for the Government, and that can improve the balance of payments. There is also a need for the Ministry of Finance and the Amortization Fund to participate fully in any borrowing decisions connected with the investment program, so as to ensure that financial resources will be available as needed to service the debt.

### 3. Money and credit

As already mentioned, the Chadian banking system is suffering from a large volume of nonperforming credit. To the credit frozen for five years in 1983 must be added a large part of COTONTCHAD's outstanding credit that needs to be refinanced. At the same time, Chad's external reserves have been falling rapidly in line with declining export earnings, and in 1986 commercial banks may be required by the central bank to repatriate some of their holdings in order to limit the fall in the BEAC's foreign reserves. Under the BEAC's rules, once the operations account for the zone as a whole is in deficit, corrective measures must be taken, particularly in those countries causing the problem. Hitherto, the operations account of the zone has always been in surplus, largely because of the strength of the external position of the zone's three oil exporters (Cameroon, the People's Republic of Congo, and Gabon). In 1986, though, with the decline in the world oil price, it is possible that the worsening external position of the BEAC countries as a whole will require the pursuit of a much more restrained credit policy.

Unless and until sufficient external assistance is provided to COTONTCHAD to allow it to reduce its outstanding liabilities to banks, thus permitting a recovery in reserves, the banking system will have to continue to direct a considerable part of its credit expansion toward COTONTCHAD. It is the mission's view that this could well require a squeeze on credit to other sectors of the economy, although credit demand may well be reduced if the retrenchment in COTONTCHAD has secondary effects. In the view of the authorities, credit to sectors other than cotton should grow by almost 10 percent in 1986. They expressed their unwillingness to deprive other sectors of credit in order to accommodate the needs of the cotton sector.

Full details are not available on the bank assets and liabilities covered by the 1983 moratorium, nor is there an articulated plan for coping with the consequences of the end of the moratorium in 1988. The financial position of the two banks that have reopened appears weak, and the future of the two remaining banks is uncertain. The mission urged that steps be taken to strengthen bank supervision to improve the

quality of banks' portfolios and related balance sheet provisions. It suggested that the Chadian Government request the BEAC to undertake a full-scale bank inspection.

#### 4. The balance of payments

The 1986 current account deficit, at SDR 96 million, is expected to be 11 percent larger than in 1985. Following a further decline in the value of cotton exports, the trade deficit is projected to widen by about SDR 12 million to SDR 78 million. Net services income is expected to be at the same level as in 1985, and net transfers slightly higher. In the capital account, a small decline in direct investment caused by an expected reduction in oil exploration activity should be more than compensated by larger drawings on external loans. The overall external deficit of SDR 24 million is expected to be at about the same level as in 1985, but if some external arrears are settled, the decline in gross official reserves could be larger than that of the previous year.

Most external assistance to Chad has been in the form of grants, and much bilateral debt was canceled in 1978-79. Nevertheless, as of the end of 1985, Chad's external debt excluding arrears amounted to SDR 119 million, on which annual service of about SDR 9 million was due. The payment of this debt service is largely the responsibility of the Amortization Fund, which in the past has not been provided with adequate sources of revenue to make all scheduled payments. Chad's external arrears as of the end of 1985 are estimated at SDR 55 million, many of which date back to the 1960s and 1970s. In early 1986 Chad approached those bilateral and private creditors to whom it believes it owes arrears, with a view to clarifying and regularizing the situation. The mission urged the authorities to ensure that the budget make up for any shortfall in the Amortization Fund's resources, in order that Chad might not incur new external arrears, and to make sufficient provision in the 1986 budget for the elimination of arrears to multilateral creditors.

Over the medium term, if imports stay at their current nominal level, there should be a gradual improvement in Chad's trade and current account balances as cotton export prices recover (Table 6). Medium-term projections of Chad's balance of payments also depend crucially on assumptions with regard to oil prospecting and production, development aid flows, and the amount and nature of external assistance to COTONTCHAD. As far as oil is concerned, the staff projections assume that prospecting activity is reduced to zero by 1989, and no allowance is made for the impact of any future oil production on exports or imports. As yet, commercial oil production is not assured, and recent price developments may reduce the attractiveness of exploration and production in Chad. It is possible, however, that the scenario is too pessimistic in this respect.

Table 6. Chad: Balance of Payments,  
Medium-Term Projections, 1986-91

(In millions of SDRs)

	1986	1987	1988	1989	1990	1991
A. Current account balance	<u>-95.7</u>	<u>-72.8</u>	<u>-60.1</u>	<u>-34.0</u>	<u>-26.4</u>	<u>-27.8</u>
Excluding official transfers	-183.3	-164.7	-153.7	-127.9	-118.4	-120.2
Trade balance	<u>-78.1</u>	<u>-75.5</u>	<u>-74.8</u>	<u>-63.5</u>	<u>-55.3</u>	<u>-54.4</u>
Exports, f.o.b.	49.6	51.2	52.3	59.8	66.5	73.3
Of which: cotton	(36.0)	(36.4)	(36.4)	(42.6)	(48.0)	(53.3)
Imports, f.o.b.	-127.7	-126.7	-127.1	-123.3	-121.9	-127.8
Services (net)	<u>-100.7</u>	<u>-86.8</u>	<u>-76.5</u>	<u>-62.0</u>	<u>-60.6</u>	<u>-63.4</u>
Credit	40.2	43.4	46.9	50.7	54.7	59.1
Debit	-140.9	-130.3	-123.5	-112.7	-115.4	-122.5
Of which: interest due	(3.8)	(4.5)	(4.9)	(5.3)	(5.4)	(5.9)
Transfers (net)	<u>83.1</u>	<u>89.5</u>	<u>91.3</u>	<u>91.5</u>	<u>89.5</u>	<u>90.0</u>
Private	-4.5	-2.4	-2.4	-2.4	-2.4	-2.4
Official	87.6	91.9	93.7	93.9	91.9	92.4
B. Medium- and long-term capital (net)	<u>71.3</u>	<u>81.4</u>	<u>63.7</u>	<u>29.7</u>	<u>24.6</u>	<u>25.4</u>
External loans (net)	27.9	52.5	49.2	29.7	24.6	25.4
Drawings	(33.4)	(57.8)	(54.4)	(34.7)	(31.3)	(32.5)
Amortization due	(5.5)	(-5.3)	(-5.1)	(-4.9)	(-6.7)	(-7.1)
Other	43.4	28.9	14.5	--	--	--
C. Short-term capital, including errors and omissions (net)	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
D. Exchange rate guarantee scheme	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
E. Overall balance (A+B+C+D)	<u>-24.4</u>	<u>8.6</u>	<u>3.7</u>	<u>-4.3</u>	<u>-1.8</u>	<u>-2.4</u>

Source: Staff projections.

Following the Geneva Round Table, it is assumed that external aid disbursements for development projects increases by 5 percent a year from 1986. While the total cost of projects presented in Geneva for the 1986-88 period was much higher than the aid flows projected here, the staff has preferred a cautious approach in view of Chad's limited absorptive capacity and the time it will take to start and complete many of the projects. The staff has assumed the gradual elimination of food aid and the full external financing of any fiscal deficit.

As far as the financing of COTONTCHAD is concerned, the staff projections assume that external support at concessional interest rates amounting to about SDR 40 million is given in the period 1986-88, and that this is used to repay bank credit or reduce future credit demands. On the basis of these assumptions, and with exports other than cotton growing in SDR terms by 8 percent a year, Chad should be able to record a balance of payments surplus in 1987 and approximate equilibrium thereafter. The tentative nature of these projections and the uncertainty surrounding many of the assumptions and the underlying data must be stressed.

#### IV. Staff Appraisal

Chad has made considerable progress during the last three years, but still faces serious economic and financial difficulties. The country has gradually recovered from the effects of severe civil unrest and a prolonged drought, production has increased, and the administration of the country has been strengthened. Public finances are under somewhat better control, and the December 1985 UNDP Round Table has clearly shown donors' willingness to assist Chad in its development efforts.

In 1985 further economic progress was achieved, although at the same time financial disequilibria worsened. The good rains allowed agricultural production to regain its normal level and a start to be made on reconstituting the livestock sector. Commercial activity, particularly in the informal sector, has continued to expand. However, these positive developments have been overshadowed by the consequences of the fall in the world cotton price. In addition to sharply reducing export revenues and fiscal receipts, the fall in the price of cotton has generated large losses for the cotton company, COTONTCHAD, whose production costs have risen sharply in recent years. COTONTCHAD, which has incurred large debts, has now been obliged to reschedule its obligations to the banking system and stands in need of considerable additional support.

Over the last three years, fiscal revenues have increased substantially, as the economy has recovered and tax administration has improved. Expenditures have been increasingly brought within the framework of the budget and more effective control mechanisms have been implemented. Nevertheless, the level of expenditures in 1985 was considerably greater than budgeted, or envisaged at the time of the

September CF request. The budget deficit on a commitment basis thus widened slightly in 1985, and further arrears, both domestic and external, were accumulated contrary to expectations in September 1985. These developments indicate the need for a further strengthening of expenditure control. Control of military outlays is, of course, particularly difficult, given the security problems facing the country. As the Government had very little margin for domestic bank financing of the deficit under its statutory ceiling, the bulk of the finance came from external sources. These resources could have permitted Chad to avoid accumulating new arrears at the Treasury and the Amortization Fund in 1985.

Adjustment in Chad requires, first and foremost, a comprehensive solution to the problems of the cotton sector. COTONTCHAD and the Chadian Government have already adopted a program of measures which should reduce current production costs substantially over the next two years. Discussions are continuing on how to cope with COTONTCHAD's outstanding debt resulting from accumulated deficits, the servicing of which is beyond the capacity of either the company or the Government. If this matter can be satisfactorily resolved, there should be no obstacle to agreement on a program of emergency assistance to the cotton sector, financed largely by France, the European Communities, and the World Bank, which will sustain the sector until the world price recovers. This program should allow time for putting in place a medium-term adjustment program for the cotton sector, and for the diversification of the economy. The World Bank has already started the preparatory work for such a program.

Even without the crisis in the cotton sector, the problems facing Chad would be severe. The improvement in fiscal performance is the central task. Cotton exports can no longer be regarded as a reliable and steady source of revenue, and the scope for increasing other revenues is limited. If Chad is to avoid accumulating new domestic and external arrears and to begin settling existing arrears, the scope for an increase in expenditures in the foreseeable future is extremely limited. Chad's investment program will inevitably have to be financed almost exclusively from external sources on highly concessional terms. The tightness of the fiscal position over the next few years means that Chad should avoid any measures that will increase the burden of recurrent expenditures on the government budget. Expenditure controls need to be vigorously maintained so as to avoid the accumulation of new arrears. In this respect, no increase should be permitted in the civil service, and efforts should be made to reduce the burden of military outlays on the budget.

To cope with the problem of arrears, as a first step, all planned expenditures, including those on utilities and air travel, should be clearly set out in the budget. In March 1986 the Government started a census of domestic arrears to ascertain their precise stock with a view to formulating a program for their elimination. As far as external arrears are concerned, Chad has approached its creditors in order to

deal with the problem. To ensure that Chad remains current in the future with its debt servicing obligations, the Amortization Fund should be supplied with sufficient resources; to the extent that the Amortization Fund's own sources of revenue are insufficient, the Government should provide funding from its general resources. Chad also needs a rescheduling of its external obligations. All future borrowing should be on the most concessional terms possible, and the debt servicing implications of any new loans should be reviewed by the Ministry of Finance and the Amortization Fund.

If Chad is to avoid new arrears and to settle arrears at the levels of the Treasury and of the Amortization Fund to multilateral lenders, the financing gap in 1986 will be over CFAF 3 billion. The prospects are for increasing gaps rising to about CFAF 7 billion over the next few years. Even after taking account of possible additional external financing, further adjustment measures to reduce the deficit over the medium term would be necessary; this would not only increase Chad's room for maneuver but also provide donors added confidence in the authorities' commitment to reform. In addition to tight expenditure controls, Chad should consider higher taxation of petroleum imports or any equivalent measure to channel part of the advantage of lower world oil prices to the budget. Furthermore, it might consider the reintroduction of a surcharge on salaries to finance part of the salary increase given to civil servants in 1986; this surcharge could replace some levies on salaries now collected by unofficial or extrabudgetary bodies which are not included in the consolidation of government operations.

Despite the progress of the last three years, there remains an undetermined amount of public expenditure outside the budget. Efforts should be made for a full accounting of extrabudgetary funds, the rationalization of their revenues, and the control of their expenditures. In this respect, the planned integration in the budget in 1987 of all investment is a welcome measure.

Beyond the rehabilitation of the cotton sector and the strict control of public finances, efforts to increase the productive potential of the Chadian economy are required. The investment program, in which the World Bank is closely involved, is now under preparation. The authorities need to ensure that price controls and licensing procedures do not unduly encumber the activities of small- and medium-scale enterprises in Chad, particularly in the informal sector. Efforts also need to be made to ensure that state enterprises generate savings.

The health of the Chadian economy also requires a well-managed and responsive banking system. Efforts thus need to be undertaken to improve the quality of banks' portfolios and to arrange the orderly liquidation of the large volume of nonperforming credit. If the recent large losses of external reserves are to be reversed, credit policy will have to be tight and directed only to the most productive activities.

The balance of payments will continue to be strained as long as the cotton price remains depressed. Import levels are largely determined by aid flows, and an increase in this assistance thus has little direct effect on the overall balance. However, an appropriate solution to COTONTCHAD's current problems, including the injection of sufficient amounts of external capital, should allow part of the burden to be taken from the banking system and for foreign exchange reserves to be rebuilt in the next few years.

With the appropriate adjustment program, Chad might qualify for use of the structural adjustment facility. <sup>1/</sup> Such a program might be built around the restructuring of the cotton sector and the diversification of the economy being promoted by the World Bank. It could involve the orderly implementation of an appropriate development program coordinated through a fully financed investment budget. A program could require restraint and strict controls on expenditure, and mobilization of additional revenues, and a commitment to eliminate domestic and external arrears. A better overview and rationalization of extrabudgetary funds could be needed and measures to ensure that public enterprises operate efficiently. Finally, a program could require measures to strengthen the banking system and to avoid administrative impediments to economic activity.

Chad has incurred external payments arrears because of the inadequacy of budgetary resources and not because of the nonavailability of foreign exchange. Although these arrears do not, therefore, constitute restrictions subject to Fund jurisdiction, their continued existence is a source of concern. The staff welcomes the efforts being made by Chad to reduce such arrears. The only restrictions maintained on payments and transfers for current international transactions are some limits on tourism and business travel allowances. These limits were in existence at the time Chad became a member of the Fund and are not subject to Fund approval under Article VIII.

It is recommended that the next Article IV consultation with Chad be held on the standard twelve-month cycle.

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<sup>1/</sup> Under this facility, Chad might be able to make drawings of 20 percent (equivalent to CFAF 2.5 billion), 13.5 percent (CFAF 1.7 billion), and 13.5 percent (CFAF 1.7 billion) of its quota over the next three years.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Chad, in light of the 1986 Article IV consultation with Chad conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies).

2. The Fund notes that Chad continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions other than the restrictions on tourism and business travel allowances as described in SM/86/ .

CHAD - Relations with the Fund

(As of April, 30, 1986)

I. Membership Status

(a) Date of membership: July 10, 1963

(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 30.6 million

(b) Total Fund holdings of currency: SDR 37.34 million  
(122.03 percent of quota)

(c) Fund credit: SDR 7.00 million (22.88 percent of quota)

(d) Reserve tranche position: SDR 0.26 million

(e) Current operational budget (maximum use of currency): None

(f) Lending to the Fund: None

III. Current Stand-By Arrangement and Special Facilities

(a) Current stand-by arrangement: None

(b) No previous stand-by arrangements; two ordinary credit tranche purchases amounting to SDR 5.23 million

(c) Current special facilities: Compensatory financing  
exports: SDR 7.00 million

IV. SDR Department

(a) Net cumulative allocation: SDR 9.41 million

(b) Holdings: SDR 2.36 million (25.10 percent of net cumulative allocation)

(c) Current Designation Plan (amount of maximum designation): None

CHAD - Relations with the Fund (continued)

V. Administered Accounts

(a) Trust Fund loan:           (i) Disbursed:     SDR 5.39 million  
                                 (ii) Outstanding:  SDR 2.47 million

(b) SFF Subsidy Account:   None

VI. Overdue Obligations to the Fund:   None

B. Nonfinancial Relations

VII. Exchange Rate Arrangement:   Currency pegged to French franc at  
  CFAF 50.00 = F 1

VIII. Last Article IV Consultation

The staff report for the 1985 Article IV consultation (SM/85/93) was discussed by the Executive Board on April 26, 1985. The following decision was taken:

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Chad, in light of the 1985 Article IV consultation with Chad conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes that Chad continues to maintain an exchange rate system that is free of restrictions on payments and transfers for current international transactions subject to Article VIII.

IX. Fund Action with Respect to Overdue Obligations

(a) Complaint by Managing Director under Rule K-1 and notice of failure to settle Trust Fund obligations, July 27, 1984.

(b) Mission on overdue financial obligations, August 6-15, 1984.

(c) Staff Report on the current status of overdue obligations to the Fund (EBS/84/193) discussed by the Board on September 12, September 27, and October 1, 1984.

(d) Settlement of overdue obligations:   November 8, 1984.

CHAD - Relations with the Fund (concluded)

V. Technical Assistance

FAD technical assistance for a review of the tax system, November 2-20, 1976.

FAD technical assistance in tax policy January 30-February 22, 1984.

FAD technical assistance in tax administration November 12-December 4, 1984.

FAD technical assistance in budget and treasury accounting November 12-December 18, 1984.

STA technical assistance in the balance of payments area November 20-December 6, 1984.

STA technical assistance in general economic statistics, April 26-May 18, 1985.

FAD general fiscal advisor for a period of two years beginning June 1985.

CBD advisor in the area of domestic and external debt for a period of one year beginning August 1985.

FAD technical assistance in cotton tax policy, November 18-26, 1985.

Chad - Financial Relations with the World Bank Group

Chad became a member of the Bank on April 2, 1963, with a capital subscription of SDR 124 million. Since then, seven IDA credits totaling US\$20.69 million have been fully disbursed to Chad. Three of these credits were for education (21 percent of total lending); two, for agriculture (47 percent); one, for highway maintenance (22 percent); and one, for drought relief (10 percent). As a result of the civil war, World Bank activities in Chad were interrupted in 1979, and Chad began to accumulate sizable payments arrears to the Bank. Following full payment of overdue obligations in May 1985 and with the recent improvement in the security situation, the Bank has identified priority activities which have been financed by an acceleration of disbursements under existing credits. Amendments to these credits were approved by the Executive Board on May 24, 1985. In October 1985 a Bank mission visited Chad for the purposes of reviewing economic developments and prospects, and of identifying additional productive projects in key sectors of the economy. Follow-up appraisal missions took place in February and March 1986, for an Agricultural Rehabilitation Project, and a Highway Maintenance Project. In response to the serious financial implications for Chad of the sharp fall in cotton prices, the Bank and other donors (EED, USAID, CCCE, FAC, and UNDP) participated in a meeting to discuss a report by France, CCCE, and CFDT on a cost reduction program for the cotton sector and its support through an emergency cotton program project. The Bank has also agreed to be the executing agency for a UNDP-financed study of the cotton sector, which would complement the French study and attempt to propose a detailed financial adjustment program.

Chad - Statistical Issues

1. Outstanding Statistical Issues

a. Price indices

No consumer price index is compiled in Chad. In response to the recommendations of a technical assistance mission from the Bureau of Statistics in May 1985, the range of items for which price data is collected has been extended to include nonfood products. However, thus far no survey has been carried out to establish the composition and weights of a basket of goods for a consumer price index. No wholesale price data are collected.

b. National accounts

The May 1985 technical assistance mission prepared national accounts data through 1984. The Chadian authorities have not prepared estimates for 1985, largely because they do not yet have complete data for that year.

c. Government finance

In the 1985 GFS Yearbook, the presentation for Chad covers the years 1972-76. A partial reply to the 1985 GFS questionnaire of the Bureau of Statistics could not be used for publication because of major inconsistencies in the data. The data problems have been raised in correspondence with the authorities.

d. Monetary accounts

The irregular and uncurrent reporting of monetary statistics by the BEAC to the Fund was discussed with the BEAC during a Bureau of Statistics technical assistance mission in November 1984, and the authorities agreed to send data on a more regular basis in the future.

e. External trade statistics

The May 1985 technical assistance mission recommended the use of mini-computers to speed data processing. Two mini-computers were received in January 1986, but it is too early to know what effects they will have on data compilation. It is desirable that the authorities implement a recommendation of the technical assistance mission that customs trade data be cross-checked with the BEAC's semiannual survey of exporters and importers.

f. Balance of payments

A technical assistance mission in the field of balance of payments statistics visited the office of the BEAC in Chad, and the report was sent in March 1985. It is understood that some improvements have been made in line with the mission's recommendations.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for Chad in the May 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Banque des Etats de l'Afrique Centrale, which during the past year have been provided on an irregular basis; few of the data are current.

The export and import data through 1982 shown in IFS are based on the balance of payments statistics. The balance of payments data for 1984 have been derived from the report on the use of the compensatory financing facility (EBS/85/200).

	<u>Status of IFS Data</u>	<u>Latest Data in May 1986 IFS</u>
Real Sector	-National Accounts	n.a.
	-Prices: CPI	n.a. <u>1/</u>
	WPI	
	-Production	n.a.
	-Employment	n.a.
	-Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	-Financing	n.a.
	-Debt	n.a.
Monetary Accounts	- Monetary Authorities	Sept. 1985
	-Deposit Money Banks	Sept. 1985
	-Other Financial Institutions	n.a. <u>1/</u>
External Sector	- Merchandise Trade:	
	Values	AA 82 (Exports AA 84)
	Prices (cotton)	March 1986
	-Balance of Payments	1984
	-International Reserves	Sept. 1985
	-Exchange rates	March 1986

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1/ The latest data on these items are for 1977.

CHAD - Basic DataArea, population, and GDP per capita

Area	1,284,000 square kilometers
Population (1982 estimate)	
Total	4.6 million
Growth rate	2.0 percent
GDP per capita	SDR 132

	1977	1982	1983	1984	1985	1986
	Estimates					Proj.
<u>Gross domestic product</u> (at current prices)						
Total (in billions of CFA francs)	161.8	187.6	214.3	231.8	294.5	322.4
Annual growth rate (in percent)						
Nominal	10.8	11.8	14.3	8.1	27.0	9.5
Real	1.5	5.4	5.6	-2.7	17.6	3.3
GDP deflator	9.3	6.2	8.2	11.0	8.0	6.0

Central government finance 1/

(In billions of CFA francs)

Revenue	14.9	...	9.2	20.0	20.8	20.1
Expenditure and net lending	18.2	...	13.5	24.3	25.6	26.5
Overall deficit (commitment basis)	-3.3	...	-4.3	-4.3	-4.8	-6.4
Change in arrears (decrease (-))	--	...	1.6	1.3	1.9	-2.8
Overall deficit (cash basis)	-3.3	...	-2.7	-3.0	2.9	-9.2
External financing	2.0	...	2.9	3.4	4.4	...
Gross disbursements	2.0	...	3.7	4.4	5.6	...
Amortization	...	...	-0.8	-1.0	-1.2	-1.1
Domestic financing (net)	1.3	...	-0.2	0.4	-1.5	...

(In percent of GDP)

Overall deficit (commitment basis)	-2.0	...	-2.0	-1.9	-1.6	-2.0
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Money and credit  
(end of period)

(In billions of CFA francs)

Net foreign assets	-2.3	2.5	9.5	24.9	15.3	...
Domestic credit	31.9	41.8	43.4	56.4	68.6	...
Net claims on Government	8.3	11.8	10.9	10.5	3.6	...
Credit to private sector	23.6	30.0	32.5	45.9	65.0	...
Money and quasi-money	23.7	34.6	42.4	67.8	71.9	...

## CHAD - Basic Data (continued)

	1977	1982	1983	1984	1985	1986 Proj.
	(In percent of GDP)					
<u>Money and quasi-money</u>	14.6	18.4	19.8	29.2	24.4	...
	(In millions of SDRs)					
<u>Public external debt 2/</u>						
Disbursed and outstanding (end of period)	...	...	...	111.6	118.6	...
In percent of GDP	...	...	...	22.6	16.7	...
Interest due 3/	...	3.7	4.4	3.6	3.0	3.8
Amortization due 4/ (in- cluding Fund repurchases)	...	3.4	4.0	7.5	9.0	6.4
Debt service ratio in percent of exports of goods and nonfactor services 5/						
Excluding IMF	...	11.0	6.6	4.1	7.1	7.8
Including IMF	...	14.5	8.5	7.7	13.4	11.4
	(In millions of SDRs)					
<u>Balance of payments 6/</u>						
Merchandise trade	-30.5	-28.3	-40.2	-17.1	-66.3	-78.1
Exports, f.o.b.	91.3	46.9	69.0	108.5	57.3	49.6
Of which: cotton	(71.9)	(27.7)	(55.2)	(94.6)	(45.8)	(36.0)
Imports, f.o.b.	-121.8	-75.2	-109.3	-125.6	-123.6	-127.7
Services (net)	-69.8	-27.0	-49.7	-60.5	-100.9	-100.7
Transfers (net)	75.9	55.5	81.8	83.4	80.8	83.1
Current account balance						
Including public transfers	-24.4	0.2	-8.1	5.7	-86.4	-95.7
Excluding public transfers	-112.3	-50.6	-95.9	-79.7	-171.4	-183.3
Capital account	17.3	1.3	13.8	5.9	58.2	71.3
Disbursements	11.6	0.4	2.3	3.8	18.6	33.4
Amortization	3.7	-3.4	-4.0	-4.8	-5.4	-5.5
Other capital 7/	2.0	4.3	15.5	6.9	45.0	43.4
Exchange rate guarantee scheme	...	3.1	3.0	4.7	3.6	--
Overall balance (deficit -)	-7.1	4.6	8.7	16.3	-24.5	-24.4
External payments arrears (outstanding, end of period)	...	...	...	51.4	54.6	...
	(In percent of GDP)					
Merchandise trade	-5.4	-5.4	-7.7	-3.3	-10.2	-10.1
Exports, f.o.b.	16.2	9.1	13.1	21.0	8.9	6.3
Imports, f.o.b.	21.6	14.5	20.8	24.3	19.1	16.4

CHAD - Basic Data (concluded)

	<u>1977</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u> Proj.
	(In percent of GDP)					
Current account balance						
Including public transfers	-4.3	--	-1.5	1.1	-13.4	-12.3
Excluding public transfers	-19.9	-9.8	-18.2	-15.4	-26.5	-23.6
Overall balance	-1.3	0.9	2.1	3.7	-4.3	-3.1
	(In millions of SDRs; end of period)					
Gross official reserves	16.2	15.8	30.8	48.6	29.6	2.0
<u>Exchange rates</u>	(CFA francs per SDR)					
End of period	285.76	370.92	436.97	470.11	415.26	...
Period average	286.82	362.79	407.35	447.89	456.15	...

Sources: Data provided by the Chadian authorities; and staff estimates.

1/ Includes consolidated operations of the Treasury, the Amortization Fund (CAA), and the National Reconstruction Fund, but excludes the stabilization funds for cotton, petroleum, and sugar. Data for 1977 does not include public debt service.

2/ Public and publicly guaranteed external debt. Complete reliable records are not available to make estimates for years prior to 1984.

3/ Arrears (net) were SDR 1.4 million in 1982, SDR 2.5 million in 1983, SDR 0.8 million in 1984, and minus SDR 0.6 million in 1985.

4/ Arrears (net) were SDR 3.4 million in 1982, SDR 3.7 million in 1983, SDR 3.0 million in 1984, and SDR 3.0 million in 1985.

5/ Scheduled debt service; arrears (net) were SDR 4.9 million in 1982, SDR 6.1 million in 1983, SDR 3.8 million in 1984, and SDR 2.4 million in 1984.

6/ The coverage of balance of payments data in 1982 is less comprehensive than in later years.

7/ Includes net errors and omissions.