PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

May 30, 2017
Report No.: AB7898

Operation Name	Chad Emergency DPO
Region	Africa
Country	Chad
Sector	Macroeconomics and Fiscal Affairs/Social Protection
Operation ID	P163968
Lending Instrument	Development Policy Grant
Borrower(s)	Republic of Chad
Implementing Agency	Ministry of Finance and Budget
Date PID Prepared	May 30, 2017
Estimated Date of Appraisal	May 30, 2017
Estimated Date of Board Approval	June 28, 2017
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Country and Sector Background

This proposed Emergency Fiscal Stabilization Operation (EFSO) is designed to support fiscal stabilization. The proposed operation is a stand-alone development policy grant in the amount of Special Drawing Rights (SDR) 51.3 million (US$65 million equivalent). The Government of Chad (GoC) remains at a critical juncture to meet the pressing financing needs of the 2017 budget in the aftermath of multiple shocks combining the oil price collapse, terrorist threats and related security costs as well as an ensuing humanitarian crisis. The reform program supports the government's response to the immediate fiscal crunch and to address some related social impacts.

The EFSO is prepared in the context of a more pronounced than expected Gross Domestic Product (GDP) contraction of 6.4 percent in 2016 and the persistence of severe fiscal pressures. Chad experienced high growth in the recent past thanks to high commodity prices and rising oil production and exports. The country also made progress in the implementation of its National Development Plan (2013-2015), achieved admission into the Extractive Industries Transparency Initiative process and reached the Heavily-indebted Poor Country (HIPC) Completion Point in June 2015. However, following average growth of +6.3 percent during 2013-2014, the oil price then started collapsing at the end-2014, sending the economy into severe recession with real GDP contracting by an estimated 6.4 percent in 2016, a figure almost twice its end-year official forecast of 3.5 percent. From an average of US$100 in 2013 and 2014, the price per barrel of Chadian crude oil declined to US$43 and US$34 respectively in 2015 and 2016. Oil revenues declined from 11.7 percent of non-oil GDP in 2014 to only 3.8 percent in 2016. Such a dramatic decline in oil receipts has led to large fiscal adjustment and to a significant increase in financing needs. The pressure on expenditures is further aggravated by security outlays emanating from the fight against terrorist groups and from the need to support regional stability. In fact, Chad has played a critical role in providing a regional public good in the form of substantial participation in regional military and stabilization missions. The security threats also have negatively impacted growth, reducing cross border trade activities. Furthermore, the government continues to host at least 750,000 refugees and returnees scattered along its borders.

The Government is demonstrating strong determination to manage what seems a much deeper and longer fiscal and social crisis than expected. The government has functioned on the basis of cash-based budget execution since early 2016, cutting public expenditure by 10.8 percent of non-oil GDP between 2014 and 2016. It revised the budget law twice (July and September 2016) to reflect the significant deterioration in liquidity. The first set of revisions included the postponement of all new public investment to the subsequent year. The second revision of the budget went further by excluding from government revenue the proceeds of an exceptional receipt from an equity sale in an oil field and by including an emergency action plan with drastic spending cuts aimed at strictly ensuring that the level of spending was consistent with the large drop in oil revenue. These measures remained in place in the Finance Law 2017. Multilateral support will be critical to the Government's fiscal adjustment plan and policy measures are expected to be broadly supported by multilateral financing from the International Monetary Fund (IMF), The International Development Association (IDA), The African Development Bank (AfDB) as well as the European Union (EU).

Indeed, since the first quarter of 2017 the crisis has aggravated. First, the deeper than expected economic recession of 2016 seems likely to be followed by anemic growth (around zero) for 2017. Second, the GoC faces a higher than expected financing gap for 2017 of US$477 million. Third, the renegotiation of Chad's oil revenue collateralized contract with Glencore, where currently 3.2 percent of non-oil GDP are due to be paid (amortized) in 2017, is taking longer than expected and this is contributing to increasing financing needs. Fourth, ensuing liquidity constraints have disrupted debt service payments and led to substantial accumulation of external (1 percent of non-oil GDP) and domestic arrears (2.8 percent of non-oil GDP). This might lead the Government, for the first time, not to repay bonds due in the first half of 2017. Any further signal of not rolling over domestic government debt held by commercial banks could have devastating effects in terms of the country's access to borrowing. Lastly, the recent increase in domestic debt has further aggravated Chad's position of being in debt distress (as per the draft 2017 Debt Sustainability Analysis (DSA) prepared by IMF staff). Under these precarious circumstances, the needed structural reform agenda cannot progress.

Against this background, failure to act in a timely manner is likely to result in a generalized macroeconomic crisis with unpredictable social and security repercussions. Recent developments suggest an increasing risk of a disorderly fiscal adjustment featuring a more protracted investment slowdown, a further increase in domestic arrears, and an unsustainable accumulation of public debt. Failure to meet the financing needs would bring a balance of payment crisis as external arrears would accumulate in a context of close to nil international FX reserves. A generalized fiscal, financial and balance of payment crisis could also translate into a broader social, security and humanitarian crisis. And in turn, deteriorating security conditions in Chad could have serious repercussions on the already fragile sub-regional economic and social situation, with potentially very high long term costs. The fiscal crisis might also destabilize the banking sector through two channels: On the one hand, a further rise in arrears to Government suppliers would increase non-performing loans. On the other hand, additional domestic borrowing by the Government would further increase commercial banks' already high levels of direct and indirect exposure to the public finances.

Hence, the supported reforms mainly focus on reversing the fiscal deterioration. The proposed operation has fiscal stabilization as its primary objective. It supports reforms aimed at rationalizing the public wage bill and tax expenditure, inform State-Owned Enterprise (SOE) management, and enable effective public procurement. As a secondary objective, the proposed operation lays the foundation for a functioning social safety net and transfer system with the objective of targeting the vulnerable and poor and mitigating the negative effects of fiscal rationalization. The reforms pave the way towards more structural measures in a programmatic operation currently under preparation.

II. Operation Objectives

The primary Program Development Objective (PDO) of the proposed operation is to support immediate fiscal stabilization through expenditure rationalization. A second objective is to establish social protection mechanisms that help mitigate related negative social effects on the poor and vulnerable.

III. Rationale for Bank Involvement

The proposed operation is an emergency grant to be disbursed in July 2017. The operation is programmed under IDA17 with a total amount of US$65 million, to be followed by a proposed programmatic Development Policy Operation (DPO) series under IDA18 (currently under preparation), the amounts of which remain to be determined. The proposed emergency operation would support reforms aimed at rationalizing the public wage bill and tax expenditure, inform SOE management, and enable effective public procurement. Supporting fiscal management is particularly important in times of fiscal retrenchment and severe pressure on public expenditure. In order to mitigate related negative effects for the most vulnerable and poor, the operation also aims to lay the foundation for a functioning social safety net and transfer system. The EFSO builds on the reform agenda that was supported by the predecessor operations, particularly as to rationalizing public expenditure and improving the quality of public resource management. The EFSO is complemented by an additional financing operation reducing salary arrears to community teachers. Salary arrears to community teachers are significant at an estimated CFCA 11.5 billion per year, and constitute a major constraint to the delivery of quality primary education services that have contributed to further aggravating social tensions in past months. The additional financing in the amount of USD50 million complements an ongoing World Bank Support to Education Sector Project to finance payment arrears, current and next school year's subsidies.

The proposed operation has been prepared in close coordination with the IMF. The authorities have requested to cancel the current Extended Credit Facility (ECF) arrangement in exchange for a new three-year program to be supported by high access under the ECF. Chad's current three-year ECF arrangement was approved by the Executive Board on August 1, 2014 with access to 57 percent of the quota. The program was designed on the basis of high oil prices, projected to lead to a hump-shaped oil revenue path reflecting a gradual decline in oil production. The objective was to ease the medium to long term adjustment to lower oil revenue and to support the path to the HIPC Completion Point (achieved in April 2015). Due to worsening balance of payment problems, a 19 percent of quota augmentation was approved in the context of the first review, and a second augmentation of 24 percent of quota took place at the time of the combined third and fourth reviews (November 11, 2016). Total disbursements amount to 70.1 percent of quota (SDR 98.34 million). However, the deepening crisis has undermined program performance, making a strong case for program revision towards breaking the vicious cycle between fiscal adjustment - low revenues, low expenditures - and economic recession. Therefore, in contrast to the existing program, the proposed ECF envisages more gradual fiscal adjustment relying on non-oil revenue mobilization, external debt restructuring, and significantly lower reliance on domestic financing. In turn, it would entail large external financing needs – around 5 percent of GDP per year in 2017 and 2018, 4 percent in 2019 and 3 percent in 2020 – and require exceptional financing from private creditors and strong budget support from donors. Fund financing as requested amounts to access to PRGF resources under a three-year ECF of 160 percent of quota or SDR 224.32 million, which would cover about 16 percent of the estimated financing gap for 2017-20. Together with the amount outstanding from past disbursements, this would bring Chad close to the cumulative access limit of 225 percent of quota. About 40 percent of the financing gap over the next three years will have to be financed by external sources.

IV. Tentative financing

Source:	($m.)
International Development Association (IDA)	65.00

V. Institutional and Implementation Arrangements

The Negotiation Committee under the Ministry of Finance and Budget (MFB) is responsible for coordinating the supervision and monitoring of the reform program supported by the proposed operation. The Government has an inter-ministerial committee, called Negotiation Committee in charge of the coordinating the preparation of the proposed operation and for monitoring the program, chaired by the MFB. The participating ministries, departments and agencies will furnish relevant information and documentation on the status of their respective programs to the committee, which will monitor progress against program objectives. The Committee has experience in collaborating with the IMF and World Bank, as demonstrated by the successful achievement of HIPC completion and the 2015 standalone Development Policy Operation. A results framework will provide concrete indicators and empirical benchmarks to monitor progress and facilitate ex-post evaluation following the end of the program.

VI. Risks and Risk Mitigation

Political and Governance Risks are high. Increased insecurity along the borders with Nigeria and Cameroon caused by Boko Haram compound an already fragile situation at the borders with Libya, Central African Republic and, to a lesser extent, Sudan. These issues, in addition to domestic security concerns, could divert scarce institutional and financial resources away from the reform program. Insecurity and conflict could destabilize the public finances, narrow the resource envelope for pro-poor spending and increase the risk of arrears accumulation. A combination of fiscal adjustment and the impact of regional conflicts[1] could also undermine political stability. In addition, measures to contain the growth of the wage bill through the reduction of allowances as well as measures to redress dubious practices with respect the payroll may be politically challenging.

Macroeconomic risks are also high. Failure to restructure commercial debt, or a protracted or partial restructuring, pose the most immediate and severe risk to Chad's fiscal and debt sustainability. Risks also stem from additional domestic debt and arrears that may be off the books but remain to be identified through increased monitoring efforts, including planned audits in 2017. Uncertainty around future oil prices and security drives macroeconomic risks. Uncertainty around future oil prices and security drives macroeconomic risks. A further fall in oil prices would put additional pressure on fiscal accounts and compromise the government's ability to finance its planned expenditure and debt. In addition, unexpected security costs and increased expenditure demands of addressing economic disruptions could divert resources away from priority social and structural programs as well as institutional capacity-building. Furthermore, the materialization of these risks would dampen any recovery and medium term growth prospects, particularly given Chad's fiscal and economic oil dependence.

High institutional capacity for implementation and sustainability risks can be mitigated. Given the low institutional capacity in Chad, a satisfactory implementation of the major reforms such as the containing of the wage growth as well as transfers and subsidies to SOEs, may not be completed without impediments. Similarly, the clear identification of tax expenditures undertaken by the Government and which would help to create fiscal space could be slowed down if there is no adequate support. Technical assistance in the Public Financial Management (PFM) from Chad's development partners, including France, the AfDB, EU, IMF and the Economic and Monetary Community of Central Africa (*Communauté Economique et Monétaire de l'Afrique Centrale*, *CEMAC*), as well as a World Bank operation in FY18 may mitigate this risk. Environmental, social and gender-related risks are low, given the nature of the reform program.

Overall, the fiduciary risk of the proposed operation is rated substantial. Notwithstanding progress over the recent past, Chad's PFM system still faces a number of challenges related to the quality and timeliness of financial statements and the weak involvement of sector ministries and civil society organizations in the budget formulation process. The budget execution reports are still incomplete and control systems, both internal and external, are still weak. Recent initiatives such as the "Citizen Budget", the adoption of a new PFM Action Plan, and the measures under this operation contribute to mitigating these risks.

Stakeholder risks are substantial. The vested interests of various groups involved in the management of public resources could impede the implementation of the reforms supported by

[1] Of the more than 750,000 displaced people currently living in Chad, there are 463,000 refugees (including 366,000 from Sudan, 93,000 from the Central African Republic, and 2,000 from Nigeria), 230,000 returnees (of which 130,000 are from the Central African Republic and are 100,000 from Libya), and 70,000 long-term internally displaced persons from the 2007 conflict and subsequent cross-border attacks from Darfur. The number of refugees is equivalent to over 3.5 percent of the population, the third-highest level in the world according to UNHCR. See: WBG CPF FY16-FY20.

the proposed operation especially the rationalization of tax exemptions, the implementation of the new procurement code and the audit of payroll and the SOE portfolio. The authorities have taken initial steps to mitigate this risk. Measures are already in place to ensure greater transparency in the management of oil revenue, as confirmed by Chad's compliance with the standards of the Extractive Industries Transparency Initiative and the adoption of code of transparency and Good Governance in Public Financial Management. In addition, the new procurement code is consistent with international standards and, if implemented in full, could greatly reduce the number of single-source public procurement contracts.

Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

Failure to act may lead Chad into a prolonged crisis with severe negative impacts on poverty and social welfare. In order to stay afloat during the current economic and fiscal crisis, Chad not only needs determined fiscal adjustment and expenditure rationalization but also depends on external financing to close its large financing gap of around five percent of non-oil GDP in 2017 and 2018. This painful yet orderly process of stabilization may entail pressure on pro-poor and social spending in the short term and should be mitigated to the extent possible. However, refraining from action at this stage would push Chad into immediate disorderly adjustment, with eventual repercussions ranging from government default and financial sector collapse to social tensions, increased insecurity, disruptions of economic activity, supply shortages and aggravation of an already existing humanitarian crisis. Rather than preparing the ground for a medium term structural policy and social protection agenda through current engagement, non-action may entail medium term insecurity, instability and potentially a permanent rolling back of human development and poverty achievements, with negative externalities well beyond Chad and towards CEMAC and the region.

The proposed operation will help avoid such a dire scenario and is expected to have a broadly positive impact on poverty reduction in the medium term. Poverty is expected to decrease in the medium term, mainly through the expansion of the national social safety net system as well as increasing fiscal space for pro-poor and social spending. There may however be some upward pressures on poverty in the short term, stemming from fiscal rationing and stabilization policies entailing potential public sector job losses or a decreases in public services. The audits of the SOEs may result in an action plan to reduce their size and employment termination, and the rationalization of the public payroll system may lead to a decrease in salaries and wages, in which case there will be social costs.

In the medium term, the fiscal measures supported by the operation are expected to generate efficiency gains and fiscal space. Revenue measures aimed at widening the tax base, PFM measures to improve the efficiency of public funds, and the implementation of a modern procurement code are expected to improve the value for money of public expenditures, including pro-poor expenditures in public health, education, and agriculture. In addition, a properly targeted expansion of the social safety net system has the potential to have a significant positive impact allowing households to move out of poverty and strengthen household resilience to shocks. The overall impact on poverty therefore is expected to be slightly detrimental in the short term under the proposed operation, but is expected to be positive and more substantial in the medium and long term.

However, negative short-term effects in terms of higher poverty will likely be unavoidable. Short term increases in poverty are most likely to materialize through cuts in services such as education, health, provision of agricultural inputs, and through the generally subdued economic environment caused by continued austerity. Poor and near-poor households have few options beyond public services and their disruption would have negative consequences, though the impact is difficult to quantify. The Prior Actions related to cuts in allowances target civil servants, who are less vulnerable.

The expected medium term impact of the reforms included in this operation on gender equity is positive. Similar to poverty, in the short term, reductions in public services may be detrimental to women. In the longer term, however, increased government resources directed to health, education, and social safety nets would have positive impacts. Increased spending for health, for example, could improve maternal mortality, which at 856 deaths per 100,000 women, placing Chad at the bottom of international rankings, above only CAR and Sierra Leone.2 In addition, increased funding for education and social safety nets could increase school attendance for girls, as families with limited resources often prioritize the education of sons. Though there have been recent improvements, the 2014/15 Demographic and Health Survey shows that 44 percent of girls aged 15 to 19 have never attended school, compared to 30 percent of boys in the same age group. The implementation of the NSPS clearly identifies women as most vulnerable and aims to help them primarily through cash transfers and cash for works programs by making them the primary recipient of the benefit of the programs.

Environment Aspects

The Bank has determined that the measures supported by the proposed operation are not expected to have substantial negative impact on Chad's Environmental, Forests and Natural Resources. Although some cash for work under the social protection programs could be expected to have some small physical footprint, the Government will finance significant capacity-building activities including environmental and social safeguards through the new national institution in charge of coordinating and managing safety nets programs, the Cellule Filet Social (CFS) established on March 10, 2016. In conjunction with the Ministry of Environment and Fisheries in charge of environmental and natural resource management, the CFS will play a key role in minimizing any environmental and social adverse impacts and enhancing the positive ones derived from social protection programs. The Bank has a long history of supporting the Chad Government in its effort to protect the environment. Recently in April 2015 and May 2017, World Bank funded projects participated in the World Bank Environmental Safeguard training held in Ndjamena. As a result, the Government's institutions including the Direction of Environmental Assessment, Control and Pollution Control and National Development projects are now more knowledgeable and capable to implement World Bank environmental and social safeguard policies. The operation's focus on ensuring adequate fiscal space to preserve pro-poor spending and maintain the government's capacity for effective social protection policy could indirectly support environmental objectives by mitigating the need for rural households to resort

[2] World Health Statistics 2016, World Health Organization.

to environmentally unsustainable practices in the event of a natural disaster or a shock to agricultural production.

The Government's reform agenda encompasses a robust institutional framework for environmental protection. The NDP includes a pillar dedicated to environmental protection and adaptation to climate change built on four key elements: (i) the protection of Lake Chad and other critical ecosystems; (ii) improved land management in rural and urban areas; (iii) the mitigation of risks related to natural disasters; and (iv) the fight against desertification and the conservation of biodiversity. The 1998 Environmental Code was augmented in 2009 by a decree on pollution and environmental damage. The use of charcoal is officially forbidden in Ndjamena to minimize indoor air pollution, and the country is promoting the use of improved cooking stoves. Nevertheless, indoor air pollution remains a major health risk, and access to clean fuels is limited. The Environmental Code also defines principles for solid and hazardous waste management, though these are poorly enforced. The GoC promulgated a Forestry Law in 2008 that clearly distinguishes between conservation and production activities.

VII. Contact point

World Bank
Contact: Giuseppe Zampaglione
Title: Lead Social Protection Specialist
Tel: 5768+252 / 504-2-264-0252
Email: Gzampaglione@worldbank.org

Borrower
Contact: Abdoulaye Barh Bachar
Title: Secretary General, Finance and Budget, Ministry of Finance and Budget
Email: barh52000@yahoo.fr

VIII. For more information, contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop