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Central African Republic Public Expenditure Review (PER)

Creating Fiscal Space to Transition out of Fragility Through Growth and Poverty Reduction

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Weights and Measures

Metric System

Abbreviations and Acronyms

AICD	Africa Infrastructure Country Diagnostic
ASRP	Agency for the Stabilization and Regulation of the Prices of Petroleum
BEAC	Central Bank of Central African States
CAB	Central African Backbone
CAR	Central African Republic
CEMAC	Economic and Monetary Community of Central Africa
CFAF	CFA Franc
CICEFD	Committee in Charge of Tax and Customs Exemptions
DAD	Development Assistance Database
DDR	Disarmament, Demobilization and Reintegration
DGB	Budget Directorate General
DGPE	Directorate General of Economic Programming
DMFAS	Debt Management and Financial Analysis System
DPCM	Depot Provincial de Cession de Medicaments
DPIP	Directorate for the Multi-Year Programming of Investments
DRC	Democratic Republic of Congo
DSA	Debt Sustainability Analysis
ECASEB	Centrafican Survey for the Monitoring and Evaluation of Wellbeing
ECF	Extended Credit Facility
EDS	Health and Demography Survey
EITI	Extractive Industries Transparency Initiative
ENERCA	Central African Energy
EU	European Union
FOB	Free On Board
FOT	Free On Truck
FTI/EFA	Fast Track Initiative / Education for ALL
GDP	Gross Domestic Product
GESCO	Computerized Expenditure Management System
GIS	Geographic Information System
GIVS	Global Immunization Vision and Strategy
GNI	Gross National Income
GSM	Global System for Mobile Communications
HIPC	Heavily Indebted Poor Countries
HIV/AIDS	Human Immunodeficiency Virus / Acquired Immune Deficiency Syndrome
ICT	Information and Communication Technology
IMF	International Monetary Fund

JMP	Joint Monitoring Program
LRA	Lord Resistance Army
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MEPCI	Ministry of Economy, Planning and International Cooperation
MICS	Multi-Indicator Survey
MoFB	Ministry of Finance and Budget
MTEF	Medium Term Expenditure Framework
NCPD	National Committee for Public Debt
NGO	Non-Governmental Organization
O&M	Operations and Maintenance
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PEFA	Public Expenditure and Financial Assessment
PER	Public Expenditure Review
PEV	<i>Programme de Vaccination Elargi</i> (Routine Vaccination Program)
PIM	Public Investment Management
PIP	Public Investment Program
PIU	Project Implementation Unit
PNDIS	National Sanitary Development Plan
PPAC	Multi-Year Action Plan
PRGF/ECF	Poverty Reduction and Growth Facility / Extended Credit Facility
PRSP	Poverty Reduction Strategy Paper
SOCATEL	Central African Telecommunication Corporation
SODECA	Central African Water Corporation
SSA	Sub-Saharan Africa
TOFE	<i>Tableau des opérations financiers de l'Etat</i>
UCM	<i>Unite de Cession de Médicaments</i>
UNDP	United Nations Development Program
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations Children's Fund
VAT	Value Added Tax
WDI	World Bank Development Indicators
WHO	World Health Organization
WSS	Water Supply and Sanitation

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CENTRAL AFRICAN REPUBLIC

Public Expenditure Review (PER)

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EXECUTIVE SUMMARY

This public expenditure review, the first to be prepared for the Central African Republic in recent years, aims to assist the government in its efforts to achieve a transition out of fragility through growth and development. CAR has made notable progress since conflict ended in 2003. It successfully re-engaged with the international community; embarked on a program to restore security throughout the country that has absorbed most rebel groups; and undertook reforms in budget procedures and governance in order to create the conditions for growth and development. Real GDP growth improved after 2004 but remained below 4 percent annually. After reaching a peak in 2006, growth weakened substantially in 2008 and 2009 as a result of a series of internal and external shocks that hit the economy including the oil and food price shock and the global financial crisis. Growth rebounded in 2010 but remains vulnerable to increases in the world prices of fuel and food. Over the period 2004-2010 real per capita GDP growth averaged just 0.3 percent annually, considerably lower than in other fragile countries in Sub-Saharan Africa, and too weak to improve real incomes significantly.

Higher and sustained per capita real GDP growth that raises the incomes of the population and creates employment is needed to reduce poverty and lower the risk of reversion to conflict. Studies have shown that the risk of reversion to conflict tends to be higher in the first post-conflict decade. Despite some progress the incidence of poverty remains very high in CAR, at 63 percent of the population, and is widespread in rural areas. CAR lags significantly behind its neighbors on major health and education outcomes. The under-five mortality rate is among the highest in Sub-Saharan Africa and its net primary school enrollment rate is among the lowest. The new PRSP for the period 2011-2015 aims to provide a strategic framework for addressing these challenges. Its overachieving objective, to promote strong economic growth that directly benefits the poor and vulnerable groups so as to significantly reduce poverty, clearly recognizes the need to move the economy on a higher and pro-poor growth path in order for CAR to transition out of fragility. Table 01 below presents key macroeconomic indicators, which highlight CAR's low per capita GDP growth.

Table 01: Macroeconomic trends in CAR, 2004-2010

	2004	2005	2006	2007	2008	2009	2010	2011 Prel.	Average 2004-10
Real GDP growth, %	1.0	2.4	3.8	3.7	2.0	1.7	3.3	3.1	2.5
Real per capita GDP growth, %	-1.0	0.4	1.8	1.7	0.0	-1.9	0.8	1.6	0.3
CPI, Average %	-2.2	2.9	6.7	0.9	9.3	3.5	1.5	0.7	3.2
Terms of trade (Index, 2000=100)	67	64	62	55	43	44	44	43	54.1
Gross investment, % of GDP	6.8	9.8	10.1	10.7	12.7	13.2	15.1	12.4	11.2
Public debt, % of GDP	102.9	107.7	93.9	79.1	80.3	36.8	41.9	38.1	77.5
Domestic revenue, % of GDP	8.3	8.2	9.5	10.3	10.4	10.8	11.6	10.9	9.8
Total expenditure, % of GDP	13.8	16.9	13.9	13.2	16.2	16.2	19.4	15.9	15.6
Primary balance, % of GDP	-1.6	-2.3	0.4	1.0	-0.5	-0.3	-1.0	-1.3	-0.6
Fiscal balance, % of GDP (excl. grants)	-5.5	-8.7	-4.4	-2.9	-5.8	-5.4	-7.7	-5.0	-5.8
Current account balance, % of GDP	-6.9	-8.6	-8.3	-9.8	-9.9	-8.1	-9.9	-7.4	-8.8
Reserves, months of imports	6.3	5.2	3.8	2.1	1.9	3.3	3.2	2.6	3.7

Source: CAR Authorities and IMF

Significant productive investments in human capital and in infrastructure would help CAR foster and sustain higher economic growth. This will require significant resources. The government is also pursuing a range of reforms including in the security sector, in public financial management and of the business environment, all of which need to be financed. Given CAR's fragility, financing these investment needs and reforms through an increase in the tax burden is not a desirable option. Moreover, while CAR's external debt burden indicators have improved thanks to debt relief under the enhanced HIPC initiative and MDRI it continues to be vulnerable to GDP growth and export growth shocks which could impair its ability to service the debt. The authorities are therefore justifiably cautious in contracting new foreign debt. In addition, the poorly developed domestic financial sector means that the scope for government borrowing from the domestic market will also remain limited.

Thus, the government needs to create fiscal space in the budget to finance its reform program and productive investments in health, education, and infrastructure to spur growth. In the short to medium term CAR will continue to depend heavily on donor's grants and concessional loans to finance its reforms and priority spending program. Since 2006 official development assistance flows in CAR have risen, providing much needed financing. Over the years, however, CAR has remained a modest recipient of net ODA and the relatively low levels of project and budget support grants in the past few years suggests a need for CAR to create fiscal space for priority spending within the existing fiscal envelope.

While the burden of investment should be on the private sector the government has a key role to play in facilitating private investment and in providing the basic infrastructure that the private sector needs as well as public services to the poor. CAR faces important infrastructural challenges, with pressing needs to upgrade the power infrastructure and improve the road network. CAR's human capital is poorly developed and the government also needs to invest in health and education in order to increase the productivity of the labor force. Initial estimates developed by World Bank staff suggest that the public investments needed may reach at least US\$350 million per year over the next 10 years (table 02), about 17 percent of GDP. These estimates will have to be firmed up jointly with the authorities. Against this background, public capital expenditures are low, averaging just about 4.7 percent of GDP over the period 2004-2010.

Table 02: Indicative annual investment needs in US dollars

Sector	Amount (US\$ million)
Transport	160
ICT	86
Power	55
Water Supply & Sanitation	47
Irrigation	1
Health	Tbd
Education	Tbd
Total	349

Source: World Bank

The PER advances the notion that public spending at the appropriate level, allocated to productive areas and used efficiently, will be essential to promote rapid and broad-based economic growth in CAR . Accordingly the PER assesses CAR's public expenditures, examines trends over time, and analyzes the composition and efficiency of expenditure. At the sectoral level the PER analyzes public spending in the social and infrastructure sectors. It provides a comprehensive review of the health and education sectors, and of electricity, roads, and water supply and sanitation. The PER examines a range of critical issues and provides data and analysis to address key questions such as:

- Is there scope for CAR to increase public spending?
- How will the increased spending be financed?
- Is the current level of spending in health and education sufficient and is the allocation of resources in these sectors consistent with the government's growth and poverty reduction objectives?
- Can CAR broaden the tax base and enhance tax administration to increase domestic revenue?
- Is CAR's public investment management system efficient?

More specifically, the PER examines the central question of how to create and use fiscal space in the government budget to support long-term economic growth and poverty reduction in CAR while maintaining macro-fiscal stability. It addresses this question at five different levels. The first chapter examines the macroeconomic context for fiscal policy in CAR to determine whether its current fiscal stance is sustainable and how much adjustment may be needed to maintain fiscal sustainability. The second chapter analyzes the trends and composition of government expenditures. The following three chapters examine the key sources of CAR's fiscal space: domestic revenue mobilization, allocation efficiency of public expenditures, and the public investment management system. Box 01 provides a working definition of fiscal space for the PER.

Box 01: Defining Fiscal Space

The Fiscal Policy for Growth and Development Interim Report defines fiscal space as a government's ability to undertake spending without impairing its solvency, that is without impairing its present and future ability to service its debt. In applying this definition to CAR it is useful to make a distinction between discretionary and non-discretionary spending. Non-discretionary expenditures include expenditures such as wages and salaries, interest payments, and some transfers. When the government allocates more resources to non-discretionary expenditures it takes up more of the fiscal space that could be allocated to other categories of expenditures such as capital expenditure for enhancing health, education, and infrastructure. This PER defines fiscal space as discretionary expenditures that CAR can undertake without impairing its solvency.

Macroeconomic stability and fiscal sustainability

The government's prudent fiscal stance—anchored by targets on the domestic primary balance helped stabilize the economy after conflict ended. Macroeconomic stability was maintained, leading to the HIPC completion point in June 2009. One aspect of CAR's economic performance up until the HIPC completion point has been steady improvement in the fiscal position which, together with debt relief, helped lower the debt burden and the risk of debt distress. The relatively favorable fiscal position also enabled the government to adopt a counter-cyclical policy stance to mitigate the effects of the global economic slowdown.

However, budget execution during 2010 was marked by a sharp increase in off-budget expenditures. A growing increase in the recourse to exceptional procedures for the payment of government expenditures led to a large volume of spending outside the normal budget process, and the regularization of these expenditures has been slow. The increase in off-budget expenditures was accompanied by an accumulation of new arrears on domestic and foreign debt, and priority spending in health and education was crowded out. The domestic primary deficit jumped to 1.0 percent of GDP from 0.3 percent of GDP in 2009. The off-budget spending continued into 2011 and fiscal data for the first half

of the year indicated that, in the absence of corrective measures, the domestic primary deficit would rise further to 1.3 percent of GDP in 2011.

The government needs to restore fiscal discipline to maintain macroeconomic stability. This will be necessary to create an environment for the private sector to generate employment opportunities. The gains CAR had made in reducing public sector indebtedness eroded due to inadequate fiscal discipline and weak fiscal management. The public debt-to-GDP ratio is projected to rise to 41.9 percent of GDP in 2010 from 36.8 percent of GDP in 2009 due to the accumulation of new arrears on domestic and foreign debt. As a result, the government fiscal position is currently less than consistent with the need to maintain macroeconomic stability and stimulate economic growth.

Public expenditure trends and composition

With the incidence of poverty remaining high at 63 percent CAR faces the challenge of improving the delivery of public services to the population. Progress has been made in some areas, such as the gross primary school enrollment ratio and access to water supply, which rose; also, infant and under-five mortality rates have declined. However CAR compares poorly on most social indicators, and basic infrastructure services such electricity supply and rural roads are highly inadequate.

Over the period 2004-2010 the public wage bill grew slowly and interest payments due on foreign and domestic debt moderated thanks mostly to the HIPC debt relief. If sustained, the reduction in interest payments due and the slow growth of the wage bill will help to create fiscal space in the budget. The government made an appreciable effort to increase the share of resources allocated to economic services, which increased from 11.2 percent of the executed budget in 2008 to 16 percent in 2009 and then to 18.4 percent in 2010 in real terms. These expenditures were directed to agriculture and economic infrastructure such as roads and energy, in line with government priorities.

However, the current spending mix is less than optimal in addressing CAR's development challenges. Public spending over the period 2004-2010 was characterized by a hike in current transfers and subsidies, which increased rapidly in real terms. In terms of GDP, spending on transfers and subsidies doubled from 1.5 percent of GDP in 2004 to 3.3 percent of GDP in 2010; and its share of total expenditure jumped from 10.7 percent in 2004 to 17.0 percent in 2010. The rapid growth of transfers and subsidies is crowding out spending on goods and services and domestically-financed capital expenditures, which can support economic growth. Autonomous agencies, fuel subsidies, and the demobilization, disarmament and reintegration (DDR) program have driven expenditures on transfers and subsidies in recent years. A number of the autonomous agencies such as the Road Fund and the Agency for the Stabilization and Regulation of Petroleum Products prices (ASRP) generate revenues through fees, user charges, special taxes and custom duties which they use to finance their operations. These revenues have increased significantly over the past three years; however, there is limited information and data on the use to which these resources are put. Fuel subsidies consume a large share of expenditures because the government fixes the domestic prices of petroleum products, which tend to be lower than world prices. As the automatic price adjustment formula is not implemented consistently scarce budget resources continue to be diverted to fuel subsidies. In general, there is an imbalance between recurrent and capital spending and operational and maintenance expenditures have not been adequate to support infrastructure investment. Finally, the functional distribution of the budget over the period 2008-2010 shows that overall CAR spends a disproportionate share of the budget on administrative activities and defense at the expense of priority sectors.

The share of the budget allocated to the priority sectors rose moderately. The priority sectors are defined in the PRSP as agriculture and rural development, education, infrastructure (transport), health, and social affairs. Their combined share of the executed budget initially increased from 21.4 percent in 2008 to 24 percent in 2009, but was limited to 22.7 percent in 2010. This trend reflected mostly the decline in the allocation to the social sectors (health, education and social affairs) in 2010. To gauge more accurately the share of the budget allocated to the priority sectors it is important to take into account donor funding. Isolating donors' spending remains difficult, however, as donor-financed expenditures are executed outside the normal budget process through project implementation units.

With the help of donors capital expenditures are recovering but remain below their pre-crisis level. For the period 2004-2010 capital expenditures averaged 4.7 percent of GDP, compared to 8.3 percent of GDP in the 1990s. The recovery in capital expenditures is due primarily to donors' re-engagement following the end of conflict in 2003. In 2006, foreign-financed capital expenditure accounted for 80 percent of total capital expenditure and 28 percent of total expenditures. It reached a new peak of 83.5 percent in 2010, representing 5.7 percent of GDP, as donors provided project and budget support grants to help mitigate the economic and poverty impact of the global slowdown. For the period 2004-2010 foreign-financed capital expenditure averaged 3.4 percent of GDP. Table 03 provides figures on donor financing for CAR's budget over the period 2004-2010 in real terms.

Table 03: Donor financing (Payments basis, CFAF billions)

Budget Grants and Loans	2004	2005	2006	2007	2008	2009	2010	Average 2004-10
Project grants	7.3	24.0	22.9	16.8	22.6	24.2	35.2	21.8
Project loans	2.4	2.9	2.5	0.0	0.0	3.1	5.6	2.4
Budget support grants	13.7	2.4	63.6	11.0	9.6	12.2	10.0	17.5
Total	23.4	29.3	89.0	27.8	32.2	39.5	50.8	41.7

Source: Author's calculations

Domestically-financed capital expenditures have remained weak, representing just 1.1 percent of GDP over the period 2004-2010. Domestically-financed capital expenditures have not only been low but a large portion of these expenditures has also been significantly under-executed. The allocation of the domestically-financed capital expenditure has been directed at economic services, which includes the economic infrastructure sectors and agriculture, in line with PRSP priorities but the social sectors have been neglected. Moreover, over the period 2008-2010, almost half of the domestically-financed capital expenditures were registered as common charges, which can be a source of waste and inefficiencies.

Budget execution over the period 2008-2010 has been highly variable; but the execution rate has been particularly low on the domestically-financed capital expenditure budget across sectors, which raises concerns about the effectiveness of government capital spending and long-term growth prospects. Table 04 presents the execution rate of the total budget by functional categories which highlights the low budget execution rate in the social sectors and for the roads sub-sector.

Table 04: Execution rate of total budget, in percent (%)

	2008	2009	2010 Prel.	Average 2008-2010
Administrative services	67.7	72.6	79.9	73.4
Defense	119.6	104.8	116.5	113.7
Public security	72.0	87.9	113.7	91.2
Education	74.3	75.4	73.6	74.4
Communication	103.1	65.7	62.3	77.1
Youth, Sports & culture	55.9	68.7	124.8	83.2
Health	76.5	72.8	64.1	71.1
Social affairs	57.5	60.5	42.8	53.6
Economic services	75.1	92.8	108.5	92.1
Roads	67.9	83.7	88.3	80.0
Energy & hydraulics	444.6	101.7	208.9	251.7
Post & Telecom	62.4	195.2	188.2	148.6
Commerce & industry	75.2	75.5	111.7	87.5
Rural development	48.6	111.3	120.2	93.4
Forestry	101.3	56.4	68.5	75.4
Other economic services	75.1	84.2	58.6	72.6
Common charges	281.4	217.9	209.6	236.3
Total	109.6	102.5	105.0	105.7

Source: Author's calculations

Broadening the tax base and enhancing Tax administration

The government has made some progress in increasing domestic revenue. Since 2007 domestic revenue has increased steadily and is projected to reach 11.6 percent of GDP in 2010 up from 10.4 percent of GDP in 2008. However, CAR's domestic revenue to GDP ratio is one of the lowest in Sub-Saharan Africa. In 2009, domestic revenue averaged 17 percent of GDP in other fragile countries and 23 percent of GDP in Sub-Saharan Africa as a whole. Tax revenue, projected at 9.4 percent of GDP in 2010, is particularly low.

Domestic revenue mobilization in CAR is constrained in part by a low taxable capacity. CAR's tax revenue collection problems are to a significant extent structural. The country's low income level and low economic integration, the numerous hard-to-tax sectors (e.g., small businesses, small-holder agriculture), the difficulties in controlling the entire territory due to insecurity, and a large informal sector impose serious constraints to the mobilization of domestic revenue to its full potential. However, CAR's low domestic revenue ratio is not solely due to structural constraints; it also reflects inefficiencies in tax policy and weaknesses in tax administration. CAR's tax system is complex, with a proliferation of tax rates in each tax field, numerous tax bases, a multiplicity of tax brackets, and a tendency toward taxation on a forfeit basis. This complexity creates distortions and inequities and provides little incentives to the formalization of economic activities, which is needed to extend the tax base.

A potential for increasing tax revenue in the long run exists in several key sectors. The financial and telecommunication sectors, for instance, especially the fast growing mobile phone industry, are high value sectors that are generating incomes that could potentially increase tax revenues substantially. However, these sectors are currently under-taxed because of difficulties in assessing their tax base and also due to generous tax exemptions. The modernization of the tax framework for commercial banks and insurance companies and the stabilization of the tax regime of the

telecommunication sector are key steps that the government needs to implement to bolster growth in these sectors and secure the mobilization of tax revenues.

The forestry sector represents an additional important source of new tax revenue. Adequate taxation from the forestry sector would help to increase government revenue; it would also promote better management of forestry resources. Despite the importance of the sector in economic activity tax revenues from forestry are low. In 2009, the various duties and fees specific to the forestry sector generated about CFAF 3 billion in revenues, which represented 3 percent of domestic revenues and 0.3 percent of GDP. In 2008 forestry revenues were relatively higher, amounting to CFAF 6.3 billion and representing 6.8 percent of domestic revenue and 0.8 percent of GDP.

The new forestry code provides a legal and regulatory framework that promotes a sustainable management of the forestry sector. The fiscal regime includes a surface tax of CFAF 600 per hectare, a stumpage tax of 7 percent, and a reforestation tax of 11 percent. In addition, an exit duty is levied on log exports. In general the forestry code promotes an equitable sharing of forestry rents among the central government, private operators and local communities; however, the global economic crisis has brought to the fore potential weaknesses in the forestry fiscal regime. The use of the surface area tax as the financial variable decision in the bidding process is likely to increase the concession's fixed costs, which companies would have to pay no matter the world price of timber. The slowdown in world demand led forestry operators to ask for deferred tax payments to the government because of financial difficulties. Heavier surface area taxes, by raising further forestry companies' fixed costs, are likely to accentuate these liquidity problems.

The mining sector could also be a significant source of new tax revenue. None of the individual fiscal dispositions of CAR's mining code – the allocation for state equity participation, the signature bonus, the area tax and royalties – is by itself unusual compared with other countries. However, there is broad agreement among observers that taken together they constitute a heavy fiscal burden for the sector which, combined with the lack of infrastructure, modest public services, and security issues, may dissuade mining investments in CAR.

The final outcome of the two mining projects currently under contract, Aurafrique and Areva, would give potential foreign investors a good idea about the prospects for profitable mining investments in CAR. It is therefore essential for the government to provide a uniform and transparent fiscal treatment to these companies. In particular the government should regularize the fiscal treatment of uranium miners. Instead of levying corporate income tax at the special rate of 50 percent subject to negotiations, the government should consider applying the regular corporate tax rate of 30 percent. Similarly, the mining code should limit royalties at the standard rate of 3 to 5 percent.

The government recognizes that improving governance in extractive industries remains a priority and became a member of EITI as candidate country in 2008. CAR was accepted by the EITI Board as EITI compliant on March 1, 2011. The first EITI report was for the year 2006 and was adopted by the multi-stakeholder group in 2009. The second report, covering the years 2007, 2008 and 2009, was adopted in December 2010. Both reports cover the mining sector including artisanal mining. CAR must be revalidated by end-February 2016 and it is critical that the government continue to adhere to EITI principles.

Health, Education, and Infrastructure

Health

CAR is lagging considerably behind in health indicators which are, in most cases, below the rate of progress required by the Millennium Development Goals. There are three main reasons for this, all of them reflected in the findings of the ECASEB survey: low quality of basic health care, low utilization rates of health services by the poor and low levels of preventive care.

- **Poor quality of basic health care:** high cost, lack of medication, and inefficient treatment reinforced by the unequal distribution of doctors, nurses and midwives are cited by households as factors affecting the quality of health care.
- **Low utilization rates of health services:** the poor make little use of the prefecture or district hospitals which provide secondary care.
- **Low levels of preventive care:** CAR continues to have one of the lowest measles vaccination rate in the region and, in addition, HIV prevalence is much higher than in neighboring countries, all of which demonstrates shortcomings in preventive care. The functional distribution of health expenditures in 2008 signals the need for greater attention to disease prevention, vaccination and nutrition.

CAR spends less on health than most low income countries and countries in the sub-region. In 2008, total health expenditures in CAR were estimated at US\$20 per capita and 4.3 percent of GDP, below the average for low-income countries at 5.3 percent of GDP, and considerably lower than the average for Sub-Saharan Africa, at 6.1 percent of GDP. Despite the low spending level CAR can still achieve significant improvements in health outcomes within the current spending envelope if appropriate mechanisms, including a medium-term expenditure framework, are put in place to ensure that resources are allocated more efficiently and directed at the poorest regions and lowest income groups.

The budget execution rate in health has been relatively low. The total budget execution rate in health averaged 71 percent over the period 2008-2010, significantly lower than the execution rate for the entire budget, at 105.7 percent. The execution rate for wages and salaries was steady at 97 percent on average; the execution rate for goods and services declined throughout the period, from 68 percent to 50 percent; the execution rate for domestically-financed capital expenditure was lowest, averaging 32 percent.

The low budget execution rate reflects continued weaknesses in the budget process and inefficiencies in the expenditure chain. To some extent the budget execution rate reflects the decisions of the Treasury Committee to make resources available to the sector and inefficiencies in cash flow management. But the low budget execution rate is also the result of other factors including the long delay in starting budget execution, weaknesses in the execution of the new procurement procedures, and the difficulties encountered in the purchase of goods and materials due to the reluctance of domestic suppliers to participate in the procurement of goods and services because of unpaid government arrears.

Education

CAR has made good progress in increasing gross primary school enrollment. Despite this progress, CAR is not on track to meet the MDG for education by 2015. The net primary enrollment ratio was unchanged in 2009/10 at 63 percent; and the primary completion rate, at 36 percent in 2008/09, is considerably lower than the MDG target of 100 percent. The low level of net primary enrollment, coupled with the relatively slow pace of increase over the past two years, points to the need to strengthen the capacity of the education sector to meet the demands of universal primary education.

Disparities in enrollments in primary education between boys and girls remain large in most regions. In 2009/10 the gross enrollment ratio (GER) displayed a gender gap of 23 percentage points; for the net enrollment ratio (NER), the gender gap was 12 percentage points. The corresponding figures for 2008/09 are 25 and 16 percentage points, respectively, pointing to some gains for girls. However, girls have considerably lower primary completion and survival rates, which suggest that in many regions CAR's public primary school system is still skewed heavily in favor of the education of boys. It is in rural areas and poorest regions that girls' schooling mostly lags behind boys' schooling

Total public expenditure on education in CAR, the sum of current and capital expenditure on education by local, regional and national governments, represented 11.7 percent of total government expenditure and 1.3 percent of GDP in 2009. Available data show that education expenditure represents from 11 percent to 28 percent of total government spending in Sub-Saharan Africa (SSA), with an average of 18.3 percent (UNESCO, 2011). On average, the total amount of resources devoted to public education expenditure in CAR is lower than in most countries in the SSA region and considerably less than in most fragile countries with comparable national income levels; it is also below the EFA/FTI benchmark of 20 percent of total government expenditures.

In 2008, public expenditure on primary education accounted for about 48.4 percent of total public expenditure on education, secondary education accounted for about 29 percent and tertiary education for 21 percent. In comparison the Education Country Status Report, which provides figures up to 2005, found that in 2005 spending on primary education accounted for 49.5 percent of total public expenditures, secondary education accounted for about 27.5 percent and tertiary education for about 23 percent. Thus, over the past years the share of total public education expenditure allocated to primary education fell further below the 50 percent mark, the benchmark set by the EFA/FTI as a measure of the strength of government commitment to primary education.

Salary accounted for 97 percent of current expenditure on primary education in CAR, the highest among countries with comparable national income. Higher teacher salaries may be very effective in improving the quality of instruction by enhancing the motivation of teachers but focusing mostly on teachers' salaries is not enough to improve the quality of education. CAR needs to invest in the other determinants of education quality such as books and learning materials and maintenance and operation expenditures.

In 2009 public expenditure per student as a share of GDP per capita was estimated at 4.5 percent for primary education, 16.1 percent for secondary education and 124.1 percent for tertiary education. While the unit costs for secondary education and tertiary education are broadly comparable to those of other low income countries, the unit costs for primary education are exceptionally low in CAR. Public expenditure per tertiary student exceeds 27 times the expenditure per primary pupil. An

explanation for the tertiary education costs in CAR may be the large scholarships awarded to tertiary students.

The education budget has been largely under-executed over the period 2008-2010. The education budget execution rate averaged just 74.4 percent over this period, significantly below the execution rate of the total budget, at 105.7 percent on average but higher than the execution rate for health at 71.1 percent. As in most sectors, the execution rate is highest on wage and salary expenditures. The execution rate for goods and service expenditures, which concern the purchase of materials and supplies and operation and maintenance expenses, has been less than 50 percent on average. This suggests that schools are far from operating efficiently. By contrast, the execution rate on transfers and subsidies has increased rapidly from 20.2 percent in 2008 to 66.4 percent in 2010. This rapid increase in spending on transfers and subsidies, which include student scholarships and payments to contractual teachers, may have crowded out spending on goods and services.

Infrastructure

Enhancing infrastructure services is essential for the development of CAR's economy. It will drive growth, improve access of the population to basic services, and provide a strong basis for private sector investment. The analysis in this PER shows that CAR's per capita economy could grow up to 3.5 percent faster if infrastructure services were to reach the level of Mauritius—the lead infrastructure performer in Africa. Much of this considerable effect would come from improvements in the power sector, which is currently one of the critical constraints to growth in CAR.

The analysis estimates that it would cost about US\$349 million per year over a decade to meet CAR's infrastructure needs in power, ICT, transport, and water and sanitation. These costs amount to 17.5 percent of GDP (in 2009), similar to the costs estimated for other Central African countries but lower than the average for comparable fragile countries. CAR's infrastructure spending needs are distributed as follows:

- Spending needs are highest in the transport sector, at US\$160 million, driven by the needs of the roads sub-sector.
- The second largest needs are in ICT at US\$86 million; followed by the power sector at US\$55 million, and water supply and sanitation at US\$47 million.
- Capital expenditure needs account for about 60 percent of CAR's total infrastructure needs, and are highest in the transport sector (US\$91 million) and power sector (US\$50 million).
- Operation and maintenance spending needs account for 40 percent of the infrastructure spending needs, and are highest in the transport and ICT sectors.

These estimates are based on micro-economic models that calculate the costs of meeting country-specific economic and social targets for infrastructure services. Table 0.5 presents these targets and the estimated additional financing needed to meet them.

Table 05: indicative infrastructure targets for CAR and their estimated costs, 2006-2015

	Economic target	Social target	Estimated costs for meeting targets (US\$ million per year)		
			Capital	O&M	Total
Power	Develop 143 MW of new generation capacity to meet national access rate of 34 percent.	Increasing national electrification to 34 percent (84 percent urban and 1 percent rural).	50	5	55
ICT	Install fiber-optic links from Bangui (CAR) to N'Djamena (Chad) to allow for connectivity to the submarine cable landing in Cameroon.	Providing universal access to GSM signal and public broadband facilities.	30	56	86
Transport	To connect Bangui, cities with more than 250,000 inhabitants, and border crossings with one-lane paved roads in fair condition.	Providing rural road access to the highest-value agricultural land, and urban road access within 500 meters.	90.6	69.1	159.7
Water and sanitation	-	Achieving Millennium Development Goals of halving the population without access to improved water and improved sanitation by 2015.	36.6	10.5	47.1
TOTAL			207.2	140.6	347.8

Existing allocations, along with efficiency gains and improved cost recovery, could provide up to US\$167 million towards covering these estimated infrastructure costs. Financing could come from the following sources:

- Existing budgetary resources: When all traceable financing sources—public sector, private sector, official development assistance (ODA), and non-OECD—are put together, spending on infrastructure amounts to US\$134 million per year. The public sector, including state-owned enterprises, accounts for 64.8 percent of total infrastructure spending, with 29 percent of the spending directed to operation and maintenance, and 35.7 percent to capital expenditure. The remaining is sourced externally, mainly by ODA (31.9 percent), and to a smaller extent, by the private sector (3.3 percent). CAR already spends 7 percent of GDP on economic infrastructure, which is higher than the average for fragile countries. The transport sector alone accounts for about 65.5 percent of total annual flows to CAR's infrastructure sectors, followed by the power sector (19.1 percent), water supply and sanitation (8.1 percent) and ICT (7.3 percent). The share of spending allocated to maintenance and rehabilitation is smaller in all the sectors representing, for example, only one-fourth of total financial flows in the transport sector.
- Possible intra-sectoral reallocations: Reallocations within the power sector could result in a gain of US\$5 million annually.
- Improving execution rates: As discussed in chapter 2, budget execution rates are particularly low in the roads sub-sector. Up to US\$14 million could be gained by bringing execution levels for infrastructure projects closer to budgeted amounts.

- **Reducing operational inefficiencies:** Important spending inefficiencies relate to distribution and tariff collection losses, and to insufficient capacity in utility management. An estimated US\$8 million a year could be gained by eliminating these inefficiencies, of which US\$6 million would come from the power sector, and US\$2 million from water supply and sanitation.
- **Enhancing cost recovery:** Improving cost recovery from user charges by pricing infrastructure services closer to cost recovery levels could provide another US\$6 million. Tariff adjustments in the power and water and sanitation sectors could generate an additional US\$4 million and US\$2 million, respectively.

The analysis shows that even if all these efficiency gains and reallocations were to be realized, CAR would still face a considerable financing gap for infrastructure development. The remaining financing gap is estimated at US\$183 million. This implies that CAR needs to strategically prioritize its infrastructure investments and identify realistic options for mobilizing additional resources from outside the budget to cover the remaining financing gap.

Public Investment Management System

To grow rapidly and sustainably CAR must not only invest a substantial fraction of its output in public infrastructure and health and education, it must also do so productively. Experience has demonstrated that public investment may fail to boost economic growth and improve living conditions because of low efficiency. This could be due to factors such as poor project selection, weak enforcement of procurement procedures, and failure to complete projects. It is therefore important, in considering the case for creating additional fiscal space in the budget for investment, to undertake a diagnostic of the public investment management system.

The government recognizes the need to improve the quality of public expenditures in order to achieve its PRSP objectives and has launched a series of initiatives aimed at strengthening the effectiveness of public investments. The public investment program (PIP) is the government's key instrument for the implementation of its development strategies and policies through its contributions to fixed capital formation. Actions taken by the government to strengthen the viability of the PIP include the compilation of a manual of procedures for the elaboration of the PIP; the establishment of a programming system aimed at improving the quality of public expenditure; and the development of appropriate instruments to ensure the coherence between the PIP and national and sectoral priorities.

The diagnostic approach is a 'gap-analysis' of the actual public management (PIM) system in place in CAR relative to desirable features so as to identify those aspects of the PIM system that are weak and need attention. The assessment finds that CAR's public investment management system has many weaknesses, ranging from planning to project execution and including procurement and monitoring and evaluation, which are hampering the efficiency and effectiveness of public investments.

An Agenda for Implementation

Entering the last few years of the first decade since conflict ended in 2003 CAR is at a critical juncture. CAR needs to stimulate economic growth, raise the incomes of the population through employment, improve access to and the quality of public services, and reduce poverty. The government needs to mobilize adequate resources and allocate as well as use them efficiently to meet priority spending needs; and all this must take place in a context of macroeconomic stability and fiscal sustainability.

The reform agenda is important and broad. Many of the reforms, especially in PFM and at the sector level will be long and difficult. The government will need to stay the course and demonstrate steady and consistent progress. There are seven critical areas, all of them linked to the government reform program: macroeconomic stability, composition of government expenditures, domestic revenue mobilization, health, education, infrastructure, and public investment management. The key steps that the government should consider are presented below.

- **Restore fiscal discipline to maintain macroeconomic stability.** The hallmark of CAR's progress over the past few years has been fiscal discipline through prudent public spending. It would be critical that fiscal discipline is maintained. This will require immediate actions as well as reforms over the medium-term.
 - a. **In the short run the government should take immediate steps to adhere to established procedures for budget execution and strengthen the computerized expenditure management system.**
 - The authorities must ensure that no spending commitments take place outside the expenditure chain. The recourse to exceptional procedures to finance government expenditures should be limited to the strict minimum and these expenditures should be regularized without delay.
 - The computerized expenditure management system should be effective and used to strengthen transparency, record and provide timely information on budget execution, and support cash flow management.
 - b. **In the medium term institutional arrangements in the areas of public financial management and debt management should be strengthened significantly.**
 - In the area of public financial management the basic fiscal institutions that need particular attention are those that strengthen capacity in budget formulation, execution and reporting, such that the following can be achieved: (i) a comprehensive and credible budget that curtails off-budgetary spending and accounts; and (ii) a transparent system of accounting and control that prevents a build-up in arrears and allows for regular budget execution reports to be produced on time.
 - In the area of debt management, a strong debt management strategy and the preparation of regular debt reports would help monitor and keep debt sustainable. The National Committee for Public Debt will have to play a central role in ensuring that the government follows a prudent debt policy centered on maximizing concessional borrowing.
- **Promote a more efficient allocation of resources across spending categories by reducing and reallocating transfers and subsidies, containing the wage bill, and gradually reducing the share of administrative and security spending.**
 - Transfer and subsidy payments finance a wide range of expenditures, including pension, various payments to national and international organizations, scholarships for students abroad and the operations of the municipality of Bangui. A significant share of the transfers was also allocated to the National Assembly to cover the benefits of parliamentarians and

staff salaries. Many of these expenditures may be justified; however, given their growing size, transfer payments should be targeted more carefully in order to prevent the crowding out of essential expenditures.

- The government should demand greater transparency and accountability in the use of public resources by the regulatory agencies and enforce financial discipline on these agencies. The fuel subsidy should be reduced; it consumes a large share of expenditures and is not pro-poor. The automatic price adjustment mechanism should be implemented consistently to reduce the effect of world fuel price increases on the budget. Compensatory programs may have to be designed to ensure that the subsidy reduction does not have an overall negative welfare effect on the poor.
- To contain a rapid expansion of the wage bill reforms should be implemented to achieve a streamlined and more productive civil service. The government should build on the initial steps it has already taken to carry the civil service reform forward. Critical aspects of the civil service reform that need to be implemented include the establishment of a job nomenclature, the development of a performance assessment system, and the development of a remuneration system.
- Over the period 2008-2010 administrative services and security (defense and public security) dominated government spending. The two sectors combined consumed on average 38 percent of the resources during the period under analysis, with their share rising continuously from 35.2 percent in 2008 to nearly 42 percent of the executed budget in 2010. The government should aim to reduce spending on administration and the military. Spending should be re-directed from administrative activities and defense towards additional funding for basic service delivery by minimizing expenditures that do not directly benefit the public and by providing adequate recurrent expenditures to support capital investments in public service delivery. Given the importance of maintaining security and political stability this process should be gradual.
- **Enhance domestic revenue mobilization by simplifying tax laws, broadening the tax base, strengthening tax administration, cutting tax expenditures and fostering transparency in the management of natural resource revenues.**
 - The immediate priority should be to continue the reforms aimed at simplifying the tax system. Several important measures have been taken in the context of the 2011 Finance Law. Most notably, a simplified tax system for small enterprises is to be introduced, the second and reduced rate on VAT to be abolished, and the business license fee to be transformed into a tax on company income. These reforms should be implemented.
 - Over the medium term the focus should be on broadening the tax base through greater administrative efforts and by tightening the granting of exemptions. Once tax laws have been simplified the authorities should endeavor to increase significantly the number of taxpayers, in Bangui as well as in the provinces, and to better control their activities. To tighten exemptions it will be necessary to stop granting them and a review of the exemptions that have already been granted should be undertaken with a view to either significantly reduce them or not renew them.

- Additional steps should be taken to reduce significantly tax expenditures. The authorities should analyze the tax expenditures incurred in connection with the investment chart and related legislations. The estimates of tax expenditures should be published every year in the finance law so that policy makers and the general public are aware of them. If it is critical to provide tax incentives to companies, they should take the form of accelerated depreciation.
- In the area of forestry taxation the government should undertake a detailed analysis of the tax system for the forestry companies, assess the risks borne by forestry operators, and consider basing bids on the stumpage tax or exit duties rather than the surface area tax.
- Regarding mining, the competitiveness of CAR's revised mining code should be evaluated in relation to that of other countries rich in mineral and natural resources.
- The government should continue to foster transparency in the management of natural resource revenues by adhering fully to EITI principles. This would entail disseminating widely the EITI reports, ensuring that the reports cover all new mining operations, and involving more deeply civil society in EITI implementation.
- **Increase access to and quality of health services for the poor by better targeting allocations to the poor and under-served regions such as Region 3 Ouham-Pede in the north-west.** In the long run, more resources should be allocated to health, bringing the share of public expenditures on health to 15 percent of total government expenditures in accordance with the Abuja Declaration. In the short run the focus should be on ensuring that available resources are used effectively and efficiently.
 - Implementing innovative mechanisms in the health sector such as "Results Based Financing" will lower inefficiencies and inequities in public health spending by providing priority services in rural areas. The forthcoming World Bank operation under preparation in the health sector is built on this holistic approach which could potentially address the constraints hampering the performance of the health sector and increase the reach as well as quality of critical health services.
 - As the lack of cash is one of the main reasons for the low utilization of health facilities, demand side mechanisms should be identified to complement the results based financing approach which focuses on the supply side.
 - To improve budget execution it would be critical to appoint credit managers as soon as the budget law has been adopted by Parliament. It would also be essential to strengthen the capacity of the main actors involved, clarify their roles, and ensure that the new procurement rules are adhered to. The categories of expenditures that need attention are domestically-financed capital expenditure and goods and services, including operation and maintenance.
 - The government should strengthen the basis for strategic planning and budget management by developing a medium-term expenditure framework for the health sector to guide the allocation of resources in line with sector priorities and progress toward the MDGs.
 - Going forward the authorities should assess the potential for public-private partnerships in health as an avenue for mobilizing resources for the sector.

- **Prioritize the resources by levels of education and the nature of expenditures in order to reach national and international education targets. Ensure that committed resources are utilized effectively. To promote equity give priority to girls' education.**
 - Resources within the education sector should be reallocated toward primary education. Given the low primary completion rate as well as the low net enrollment rate, it would be desirable to increase the share of the budget allocated to primary education.
 - The distribution of expenditure in primary education should be improved by increasing the share allocated to non-salary expenditure, especially learning materials and operation and maintenance.
 - The low budget execution rate also means that fiscal space can be created within the sector by improving the allocation of resources. The execution rate for goods and service expenditures, which concern the purchase of materials and supplies and operation and maintenance expenses, has been less than 50 percent on average and should receive particular attention.
 - Over the medium-term, a medium term expenditure framework should be developed to guide the sectoral allocation of expenditures across programs and projects according to government priorities, based on adequate costing from sectoral analysis.
 - The ratio of girls to boys in primary education should be increased further, approaching equality as soon as possible. There are a number of strategies to enhance female education, including training more female teachers, promoting the benefits of female education, and providing stipends and scholarships for girls rather than for boys at the primary level.
- **Create fiscal space in the infrastructure sectors to finance infrastructure investment and operation and maintenance needs.** Efficiency gains, close to 2 percent of GDP, could be achieved through intra-sectoral reallocations of resources and greater operational efficiency in the use of the current resource envelope. However, these efficiency gains would have to be complemented by efforts to tap additional financial resources from outside the budget to cover CAR's infrastructure investment needs. Specifically,
 - a) **In the short run, the government should take steps to strengthen management capacity in public utilities and the roads fund to improve the delivery and quality of basic infrastructure services.** In particular:
 - The financial and operational capacity of SODECA and ENERCA should be strengthened by eliminating distributional losses in the power and water supply and sanitation sectors; improving the collection of electricity bills; and pricing infrastructure services to full recovery costs. With the enhanced capacity, the existing power and water supply and sanitation infrastructure should be refurbished to functioning order.
 - The financial and technical capacity of the Roads Fund should be reinforced to improve spending on maintenance and rehabilitation of the roads network.

- b) **Over the medium-term the government should strive to tap financing sources outside the budget.** Options include:
- Developing creative cross-border financing mechanisms. Such mechanisms for power generation and transmission investments, for example, as well as joint transport projects would help develop regional infrastructure corridors.
 - Attracting private sector investment into CAR's infrastructure sectors. This would bring critical technical and managerial know-how to infrastructure development and service delivery. Involving the private sector more strongly in the economy would require important reforms in the legal and regulatory framework, however.
- **Improve the public investment management system so that resources are allocated to more productive public investments.** This will entail pursuing reforms in two complementary areas:
- a) **First, over the short to medium term, efforts should be geared towards strengthening project appraisal, selection, and monitoring of project execution.** Progress in these areas will help to prioritize investment spending and enhance the impact of the investment budget on growth and poverty reduction. The manual of procedures for investment programming and the development assistance database provide a basis to build on.
- The manual of procedures provides a set of consistent guidelines for the appraisal and selection process of investment projects. These guidelines should be followed and appropriate capacity should be progressively developed to ensure that the guidelines are adequately implemented.
 - The development assistance database (DAD) should be strengthened to permit a more active monitoring of the execution of investment projects. It would be critical to ensure that donor flows are systematically recorded, the database is frequently updated, and the information is regularly published.
- b) **Second, over the medium-term, the government should place emphasis on strengthening the medium-term framework of budget policy.** The development of a medium-term expenditure framework will be essential for fully integrating the investment and the recurrent budget, improving the allocation of resources, and aligning the budget with medium-term goals. Two areas deserve particular attention.
- The macro-level MTEF should be strengthened by developing multi-year ceilings for the investment budget and including these ceilings in the Finance Law submitted to Parliament for approval.
 - Medium-term budget frameworks should be developed at the sector levels to help allocate sectoral spending across different programs and projects, based on the country's development priorities as set out in the PRSP and sector strategies.

Summary of Recommendations

The analysis presented in this report shows that there is considerable scope for enhancing the effectiveness of public expenditure to promote higher economic growth and reduce poverty. To achieve this, CAR should take steps to re-orient the budget toward more productive and efficient spending and, overall, toward a growth-oriented fiscal policy. The broad goals on the expenditure side of the budget should be more efficient social spending in health and education in accordance with sector priorities to improve human capital; and higher productive spending on infrastructure targeted at roads, power, ICT and water supply and sanitation. Fiscal space for this can be found in intra-sectoral re-allocations of resources, improving budget execution rates, reducing collection losses in public utilities, and enhancing cost recovery through adequate pricing of public utility services. On the revenue side the broad objectives should be to simplify the tax laws, broaden the tax base, improve compliance and foster transparency in the management of natural resource revenues.

The report highlights the need for setting expenditure policy in a strengthened medium-term framework that would align the budget with the government medium-term planning goals and permit progress toward the MDGs and the PRSP priorities. It also underscores the need to improve project selection, appraisal, execution and monitoring to ensure that resources are allocated to productive investments that can enhance the impact of public investments on growth and poverty reduction. The matrix below summarizes the key options for reforms and recommendations developed throughout this report.

Matrix: Summary of policy recommendations

Reform Area	Recommendations	Time frame	Expected Impact
Maintain macroeconomic stability	1) Restore fiscal discipline ○ Limit recourse to exceptional procedures to finance government expenditures to strict minimum and regularize these expenditures without delay. 2) Strengthen public financial management ○ Ensure that the computerized expenditure management system (GESCO) is operational and effective.	ST	• Government fiscal position consistent with macroeconomic stability.
Promote a more efficient allocation of public resources	3) Target better transfer and subsidy payments ○ Improve transparency and accountability in the use of public resources by regulatory agencies through regular audits. ○ Implement consistently the automatic adjustment on fuel prices.	ST/MT	• Greater transparency. • Increased fiscal space for priority spending.
	4) Contain the expansion of the wage bill through implementation of the civil service reform program.	ST/MT	• Motivated and productive civil servants.
	5) Contain interest payments due on foreign and domestic debt ○ Consolidate the mandate of the debt department. ○ Reinforce the operational capacity of domestic debt management.	ST/MT	• Increased fiscal space for priority spending.
	6) Improve the functional distribution of public expenditures ○ Redirect spending from administration and defense towards additional funding for health, education and infrastructure. ○ Provide adequate funding for operation and maintenance in priority sectors. ○ Reduce the share of expenditures classified as common charges and re-allocate then to health, education and infrastructure.	ST/MT	• Greater efficiency of public spending.
	7) Improve budget execution on non-wage expenditures ○ Nominate credit managers as soon as the budget law is approved by parliament. ○ Ensure that procurement and commitment plans are prepared in the first half of the year. ○ Enforce adherence to the new procurement procedures.	ST/MT	• Improved efficiency of public spending. • Increased public service delivery.

Reform Area	Recommendations	Time frame	Expected Impact
Improve revenue collection through broadening the tax base and achieving better compliance	8) Increase VAT revenue productivity ○ Abolish the VAT reduced rate. ○ Subject all new construction to VAT. ○ Grant domestic VAT credits only to entities subjected to the Vienna convention. ○ Remove for profit organizations among entities that are exempt of customs duties as well as multilateral and bilateral organizations.	ST/MT	• Greater VAT efficiency.
	9) Eliminate the company income tax of 20 percent on agriculture.	ST/MT	• Simplified income tax law.
	10) Rationalize excise taxes ○ Introduce an excise tax of 10 percent on the value of imported new and second-hand vehicles. ○ Eliminate all excises on luxury products, electronic apparels and food products. ○ Subject non-alcoholic beverages produced locally to the same excise rate as imported drinks.	ST/MT	• Increased excise revenues.
	11) Strengthen the forestry tax regime ○ Consider basing bids on stumpage tax of exit duties rate rather than on the surface tax. ○ Redefine the formula for calculating the FOT value so that it reflects more closely the value of logs at exit on the truck.	ST/MT	• Increased efficiency of forestry tax regime.
	12) Strengthen the mining sector fiscal regime ○ Reduce the overall fiscal burden on mining companies by limiting state equity participation to a proportional share of net benefits. ○ Regularize the fiscal treatment of uranium companies by eliminating the special corporate tax of 50 percent and by introducing a royalty of 3-5 percent. ○ Evaluate the competitiveness the revised mining code.	ST/MT	• Competitive mining tax regime.
	13) Strengthen tax administration ○ Reduce the number of tax payments and the time it takes to pay taxes. ○ Improve the responsiveness of the Large Enterprise Directorate.	ST/MT	• Tax base broadened.

Reform Area	Recommendations	Time frame	Expected Impact
	○ Reduce default rate to less than 5 percent. ○ Strengthen the recovery of balances due.		
	14) Reduce tax expenditures ○ Prepare and publish a report on all tax expenditures and estimate their costs in terms of revenue forgone. ○ Stop awarding company income tax exemptions to companies that are exploiting natural resources or producing goods and services for sale in the domestic market. ○ Replace tax incentives to companies with accelerated depreciation.	ST/MT	• Tax base broadened
	15) Foster transparency in management of natural resource revenues ○ Adhere fully to EITI principles.	ST/MT	• Greater transparency in management of mining revenues.
Improve the health status of the population	16) Increase access to and quality of health services for the poor by better targeting allocations to the poor and under-served regions ○ Implement innovative mechanisms such as results-based financing to address inefficiencies in the sector. ○ Identify demand-side mechanisms to complement results-based financing approach. ○ Improve budget execution rate. 17) Gradually increase the resources allocated to health to 15 percent of total government expenditures. ○ Develop a medium-term expenditure framework to strengthen the basis for strategic planning and budget management. ○ Evaluate the potential for public-private partnerships.	ST/MT	• Improved access, utilization and quality of health services for the poor. • Improved efficiency in allocation of health resources. • Improved health outcomes
Increase enrollment, equity and quality in education	18) Improve enrollment of children of households in the poorest income quintile. 19) Increase the ratio of girls to boys in primary education, approaching equality as soon as possible. 20) Prioritize resources by level of education and nature of expenditure and ensure that committed resources are effectively utilized. ○ Re-allocate resources within the education sector toward primary	ST/MT	• Increased primary school enrollment for the poor and girls. • Greater efficiency

Reform Area	Recommendations	Time frame	Expected Impact
	education. ○ Increase the share of the budget allocated to non-salary expenditure. ○ Improve the budget execution rate. ○ Develop a medium-term expenditure framework to guide resource allocation in the sector.		in allocation and use of resources to education.
Create fiscal space to upgrade and build new infrastructure	21) Strengthen the financial and operational management capacity of SODECA and ENERCA by: ○ Reducing distribution losses, increasing collection of bills, and improving cost recovery. ○ Improving the management of human resources. 22) Reinforce the financial and technical capacity of the Roads Fund to improve spending on maintenance and rehabilitation. ○ Ensure adequate budgeting for O&M. ○ Increase the budget execution rate in the roads sub-sector. 23) Reduce ICT prices by prioritizing the ICT backbone. 24) Attract greater private sector investment through public-private partnerships.	ST/MT	● Increased supply of electricity. ● Improved access to water supply and sanitation. ● Improved road conditions. ● Greater private sector involvement in infrastructure development.
Strengthen the Public Investment Management system	25) Strengthen project appraisal, selection and monitoring ○ Ensure that the guidelines in the manual of procedures are implemented effectively. ○ Reinforce the development assistance database (DAD) to permit a more active monitoring of execution of projects. 26) Strengthen the medium-term framework for budget policy ○ Develop multi-year ceilings for the investment budget ○ Develop medium-term budget frameworks at the sector levels to enhance the sectoral allocation of resources.	ST/MT	● Improved prioritization of investment projects. ● Improved economic and social effects. ● Strengthened medium-term framework for budget policy.

ST: short term

MT: medium term

INTRODUCTION

A. Political and Socio-Economic Situation

1. **The Central African Republic is a vast landlocked country with a rich natural resource endowment -diamonds, gold, timber, and abundant fertile land- that can spur its development.** Decades of political instability, military disturbances, poor economic management and weak governance have, however, undermined economic and social development and impoverished its population of 4.5 million people. The decade that began in 1993 was particularly unstable. Following a succession of military mutinies in the mid-1990s violence escalated sharply in 2001 and 2002, spreading across regions, and culminating in a military coup in March 2003 that brought to power Army General Francois Bozizé. These events caused substantial destruction, sizable casualties, and massive displacement of the population. The economy contracted sharply and social indicators deteriorated extensively. Life expectancy declined to 42 years from 48 years in 1990; infant mortality rose to 132 per thousand and under-five mortality reached 220 per thousand from 97 per thousand and 157 per thousand in 1995, respectively; and school enrolment fell sharply, especially in the conflict zones. The deterioration in social indicators was accompanied by a collapse of public administration in most parts of the country.

2. **Since 2003 political stability has improved noticeably and the peace process has progressed.** A new constitution was adopted by referendum in 2004, and the first presidential and legislative elections were held in 2005. President Bozizé was elected for a five-year term. Most rebel groups signed peace agreements with the government and joined the political process. The inclusive political dialogue held in Bangui in December 2008 led to the formation of a government of national unity, the launching of the disarmament, demobilization, and reintegration (DDR) process and the creation of an independent electoral commission to organize the planned general elections. The presidential and legislative elections were held in January and March 2011 and President Bozizé was re-elected. The elections have been largely peaceful and the hope is that they will lead to the formation of broad coalitions for peace and development, and thereby prevent political paralysis and renewed violence. But this is not yet assured, for the political process faces many challenges. The opposition, contesting the election results, has opted to not participate in the new government; the DDR program has not advanced as expected; and the Ugandan rebels of the Lord Resistance Army continue to launch attacks against civilian populations in the northeastern region. Consolidating peace and restoring security in the north are vital for the stability of the country.

3. **The government has embarked on efforts to accelerate economic recovery and improve the living conditions of the population as part of a broader strategy to reduce the risk of reversal to conflict.** In June 2007 CAR adopted its first full PRSP for the period 2008–10, which provided a strategic framework for poverty reduction in line with the Millennium Development Goals. The PRSP was based on four pillars, reflecting the government's key priorities to: (i) restore security, consolidate peace, and prevent conflict; (ii) promote good governance and the rule of law; (iii) rebuild and diversify the economy; and (iv) develop human capital. Implementation of the PRSP generated promising results which need to be carried forward. At the sectoral level the government adopted a new forestry code and implementing decrees to enhance transparency and competition in awarding forest concessions; the mining code was revised to address its previous weaknesses, and the government adopted a new standard form agreement to attract new investment from small as well as larger enterprises. In education, primary school enrollment has increased; and, in health, the government took steps to

improve the health status of the population including by expanding vaccination coverage and by stemming the spread of HIV/AIDS. The government also implemented a range of governance reforms to promote the rule of law, fight corruption, and increase transparency and accountability in the use of public resources. Partly as a result of these reform efforts CAR reached the HIPC completion point in June 2009.

4. **Since 2004 there has been a noticeable improvement in CAR's economic performance.** The government has endeavored to maintain a prudent fiscal stance and it implemented structural reforms in public finance and the infrastructure sectors. Real GDP growth rebounded to 3.8 percent in 2006 from 2.4 percent in 2005; over the period 2006-08, real GDP growth averaged 3.2 percent per annum, permitting a modest rebound in per capita income. The three-year program under the PRGF/ECF arrangement, launched in December 2006, was successfully completed in August 2010 with improvements in domestic revenue mobilization and public financial management. However, in 2008 and 2009 the economy was hit by a succession of domestic and external shocks that lowered per capita GDP growth, highlighting that the vulnerability of the economy to exogenous shocks remains a major impediment to growth and development.

5. **As CAR approaches the end of the first decade since conflict ended in 2003 the country is at a critical juncture.** Recent fiscal slippages are undermining important gains in public financial management reforms, weakening the foundation for the efficient allocation of scarce resources while increasing public debt. Moreover, after a moderate increase per capita real GDP growth has weakened, keeping real incomes low. Meanwhile the incidence of poverty remains high, afflicting more than two-thirds of the population, especially in rural areas where the majority of the population live. Higher and sustained per capita real GDP growth that raises the incomes of the population and creates employment opportunities is needed to reduce poverty and lower the risk of reversion to conflict, which tends to be higher in the first post-conflict decade. The new PRSP for the period 2011-2015 aims to provide a strategic framework for addressing these challenges. Its overachieving objective, to promote strong economic growth that directly benefits the poor and vulnerable groups so as to reduce significantly poverty, clearly recognizes the need to move the economy on a higher and pro-poor growth path in order to achieve a successful transition out of fragility.

6. **To achieve the ambitious growth and poverty reduction objectives of the new PRSP a higher level of public investment spending will be necessary to tackle binding constraints.** Boosting private sector investment remains central to CAR's growth prospects; but public investment is also needed in order to increase the provision of health and education services, improve access to water and sanitation, expand electricity generation capacity, develop, rehabilitate and maintain the road network, and stimulate agricultural production and productivity. A growth-oriented fiscal policy will have an important role to play in this regard. The public expenditure review estimates the government's infrastructure spending needs at \$350 million annually for the next 10 years. The need for higher investment spending will have to be balanced with the need to maintain macroeconomic stability and fiscal sustainability. This will entail greater efforts at raising domestic revenue and improving the composition of public expenditure as well as its efficiency. Furthermore, to ensure that public resources are used most effectively to stimulate long-term growth and achieve policy objectives in line with the MDGs and the PRSP, it will be necessary to strengthen the basic fiscal institutions that support a sound public financial management system and a high quality of governance.

B. Objectives, Scope and Structure of the PER

7. **The PER assesses CAR's public expenditures. It examines trends over time, analyzes the composition and efficiency of expenditure and highlights the key institutional issues that affect public investment management.** At the sectoral level the PER analyzes public spending in the social and infrastructure sectors. In agreement with the authorities, in the social sectors, the public expenditure review focuses on health and education; in the infrastructure sector, the emphasis is on electricity, roads, and water supply and sanitation.

8. **More specifically, the PER examines the central question of how to create and use fiscal space to support long-term economic growth and poverty reduction in CAR while sustaining macro-fiscal stability.** The findings would be translated into a proposed action plan for reforms to establish effective and transparent mechanisms to mobilize, allocate, and use public resources in ways that would promote broad-based economic growth, improve social indicators, and reduce poverty. Thus, through each of its five chapters, and building on the growing body of analytical work on CAR's public expenditure management system, the PER examines alternative policy options to increase the fiscal space in the budget for growth and poverty reduction:

- The first chapter presents the macroeconomic context for fiscal policy in CAR. It describes the structure of the economy, reviews recent developments, and presents the results of the fiscal sustainability analysis.
- The second chapter analyzes the trends in and the composition of government expenditures over the period 2004-2010. The evolution of government expenditures and their composition are reviewed from an economic, functional and sectoral perspective. The chapter also analyzes budget execution and suggests ways in which fiscal space can be created in the budget, namely by: broadening the tax base and strengthening tax administration, improving the allocation and composition of spending, and improving the public investment management system.
- The third chapter analyzes the scope for mobilizing additional budgetary resources from domestic revenues to finance the higher level of public investment in the infrastructure and social sectors, consistent with macroeconomic stability and fiscal sustainability.
- The fourth chapter examines the scope for creating or expanding fiscal space by improving the composition and efficiency of spending in the priority sectors. It provides a review of public expenditure in the health, education, and infrastructure sectors.
- The fifth and final chapter carries out an institutional assessment of the public investment management system in CAR following the diagnostic framework developed by Rajaram, Minh Le, Biletska, and Brumby. Each of the eight desirable features of an effective public investment management is examined in the context of CAR. The challenges CAR faces in each area are highlighted and recommendations are provided on reforms that CAR would have to implement to bring its public investment management system in line with recognized standards of efficiency and transparency in managing public investment.

CHAPTER 1: MACROECONOMIC CONTEXT

1.1 Since 2003 the Central African Republic has been striving to achieve a post-conflict transition to stability, growth, and development. Until recently the government managed economic reforms with determination and promoted fiscal discipline, which helped restore macroeconomic stability. Continued sound macroeconomic management will be central to efforts to build a growing economy that improves the welfare of the majority of the poor through sustainable employment opportunities generated by the private sector. Of critical importance is the need to achieve sustained improvements in government debt indicators which, in turn, requires that the government maintain a sound fiscal position.

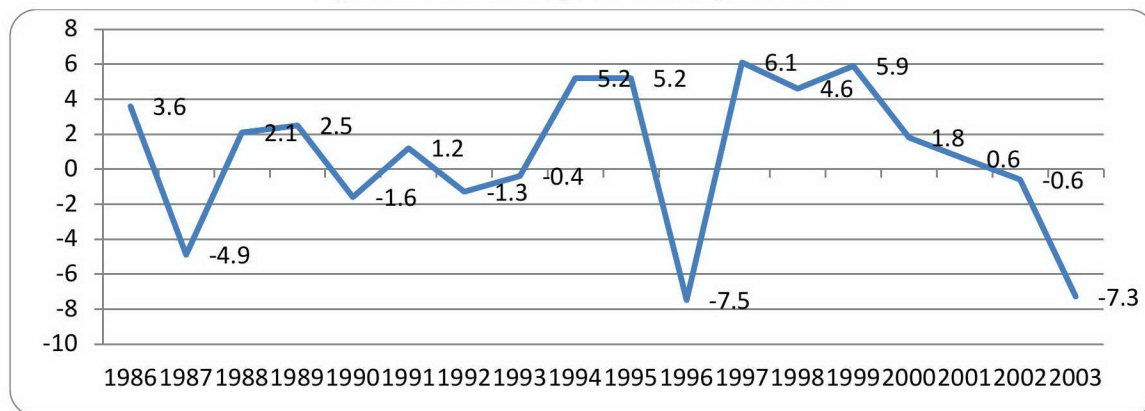
1.2 This chapter presents CAR's macroeconomic context. Section A describes the structure of CAR's economy and recent growth performance which has been characterized by high variability. Section B reviews recent economic and fiscal developments; and section C assesses economic prospects and presents the results of a fiscal sustainability analysis.

A. STRUCTURE OF THE CAR ECONOMY AND GROWTH PERFORMANCE

1.3 **A large primary sector dominates the CAR economy, accounting for 56 percent of GDP in 2010.** Within the primary sector subsistence agriculture represents 29 percent of GDP, and livestock accounts for 12 percent of GDP on average. In 2010 industry, including mining represented 15 percent of GDP and services about 29 percent of GDP. The manufacturing sector has remained minuscule, contributing around 7 percent of GDP in 2010. The country's main sources of export revenues are timber, cotton, coffee, and extractive industries. Timber accounted for about 50 percent of total export in 2008 and 41.3 percent in 2010. The CAR's extractive industry potential, which has unexploited reserves of diamonds, gold, and uranium, could be expanded to constitute a solid basis for growth and economic diversification. On average, diamonds have accounted for about 35 percent of exports over the past few years. Because it depends so heavily on two commodities -timber and diamond- for its export revenues, CAR is highly vulnerable to terms of trade shocks.

1.4 **Political instability and violent conflict combined with poor macroeconomic management and weak governance have shaped CAR's recent economic performance,** and prevented the development of the country's rich natural resource endowment. Real GDP growth has been highly volatile, reflecting the adverse effects of recurrent instability. The military mutinies in the mid-1990s caused real GDP to fall sharply by 7.5 percent in 1996 (figure 1.1). The conflict that ended in 2003 shattered again the economy, with real GDP growth declining rapidly to -7.3 percent in 2003. Deteriorations in the terms of trade combined with changing climatic conditions, which adversely affected agricultural production, compounded these effects. Heavy external borrowing to finance unproductive expenditures led to a debt hangover, with the public debt rising to 102.9 percent of GDP by 2004. As a consequence, since gaining independence in 1960, CAR has been unable to move the economy to a sustainable growth path.

Figure 1.1 : Real GDP growth in CAR, 1986-2003



Source: Ministry of Finance and Budget (MoFB)

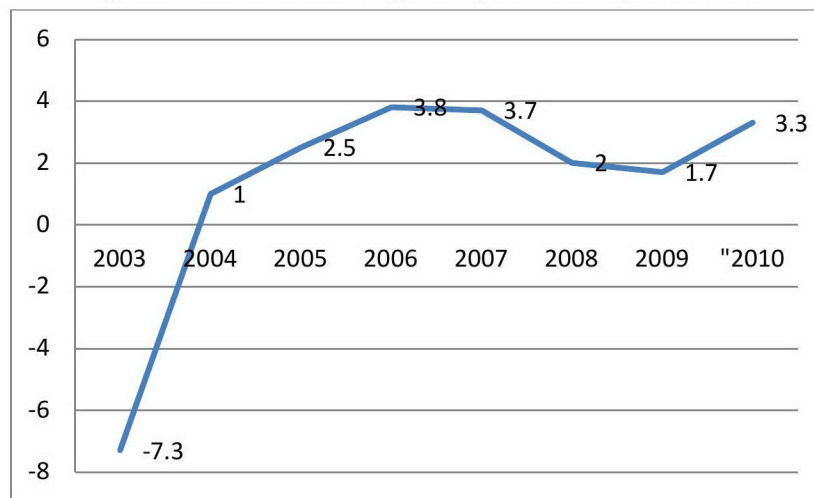
1.5 **Since 2004, supported by growing political stability and an improving policy and institutional environment, real GDP growth has been positive and less volatile.** The successful re-engagement with the international donor community in 2005-2006 resulted in technical assistance and budget and project support grants that helped launch reconstruction efforts and restore some basic services. Critical structural reform measures, most notably automatic adjustments of petroleum product prices, were implemented which helped boost domestic revenue. The HIPC and MDRI debt relief that followed the HIPC completion point in June 2009 reduced appreciably the external debt burden, opening up space in the budget for priority spending. With the implementation of PFM reforms, budget management improved, and an increasing share of budgetary resources has been allocated to economic infrastructure. Strong performance in the natural resource sectors, with a major contribution from the forestry subsector, and a rebound in the services sector contributed to the economic recovery; and rising private investment boosted the economy. Despite these improvements, CAR's economy faces a number of critical challenges as discussed below.

B. RECENT ECONOMIC AND FISCAL DEVELOPMENTS

Real GDP growth

1.6 **After a steady rise since 2004 real GDP growth fell from its peak of 3.8 percent in 2006 to 1.7 percent in 2009.** This was due in part to a series of exogenous shocks that struck the economy in 2008 and 2009. On the domestic front, a breakdown at the country's main hydro power plant triggered severe power outages and caused utilities output to contract by as much as 6.8 percent; industrial sector growth slowed as a consequence, bringing to the fore the need to rehabilitate the aging infrastructure in the power sector. On the external side the environment turned unfavorable, characterized by the global financial crisis and recession. In 2008, the terms of trade, which had been declining moderately over the previous two years, deteriorated by nearly 20 percent due to a sharp downturn in the world prices of timber and diamonds, the country's main exports. Export volumes fell by 16 percent in 2008. Timber production and export volumes fell further by 37 percent and 29 percent respectively in 2009; while production and export of diamonds declined by 18 percent in volume terms. The overall effect of these developments has been a slowdown in real GDP growth to 2 percent in 2008 and 1.7 percent in 2009. However, toward the end of 2009, the terms of trade began to improve with the reversal of food and fuel prices from their surge in 2007-08 and a pick-up in world demand for diamonds and timber, setting the economy on a path to recovery.

Figure 1.2 : CAR's real GDP growth performance, 2004-2010



Source: Author's calculations based on MoFB data

1.7 During 2010 the economy continued its recovery from the effects of the unfavorable external environment. Real GDP growth rebounded to 3.3 percent in 2010 owing to a rebound in food and cash crops production, including cotton and coffee. Continued improvement in the timber and mining sectors, which had been hit hard by the global economic slowdown, and robust growth in services led by transport and telecommunication and commerce contributed also to the GDP growth recovery. Table 1.1 summarizes recent macroeconomic trends in CAR.

Table 1.1 : Macroeconomic trends in CAR, 2004-2010

	2004	2005	2006	2007	2008	2009	2010	2011 Prel.	Average 2004-10
Real GDP growth, %	1.0	2.4	3.8	3.7	2.0	1.7	3.3	3.1	2.5
Real per capita GDP growth, %	-1.0	0.4	1.8	1.7	0.0	-1.9	0.8	1.6	0.3
CPI, Average %	-2.2	2.9	6.7	0.9	9.3	3.5	1.5	0.7	3.2
Terms of trade (Index, 2000=100)	67	64	62	55	44	62	58	62	58.8
Gross investment, % of GDP	6.8	9.8	10.1	10.7	12.7	13.2	15.1	12.4	11.2
Public debt, % of GDP	102.9	107.7	93.9	79.1	80.3	36.8	41.9	38.1	77.5
Domestic revenue, % of GDP	8.3	8.2	9.5	10.3	10.4	10.8	11.6	10.9	9.8
Total expenditure, % of GDP	13.8	16.9	13.9	13.2	16.2	16.2	19.4	15.9	15.6
Primary balance, % of GDP	-1.6	-2.3	0.4	1.0	-0.5	-0.3	-1.0	-1.3	-0.6
Fiscal balance, % of GDP (excl. grants)	-5.5	-8.7	-4.4	-2.9	-5.8	-5.4	-7.7	-5.0	-5.8
Current account balance, % of GDP	-6.9	-8.6	-8.3	-9.8	-9.9	-8.1	-9.9	-7.4	-8.8
Reserves, months of imports	6.3	5.2	3.8	2.1	1.9	3.3	3.2	2.6	3.7

Source: MoFB and IMF

Inflation and external balance

1.8 Price pressures strengthened in 2008, with average consumer price inflation accelerating to 9.3 percent from under 1 percent in 2007, but inflation has since declined. The rise in inflation in 2008 was the largest yearly increase in prices since 2000, when inflation was contained around the CEMAC convergence criterion of 3 percent. The food and fuel crisis, along with strong monetary growth accounted largely for this outcome. Since then, inflation has decelerated; falling to 3.5 percent in 2009 and further down to 1.5 percent in 2010, as the crisis eased and food prices declined with favorable agricultural production.

1.9 As export earnings fell in 2008 with the deterioration in the terms of trade, the trade deficit widened sharply to CFAF 68 billion (7.7 percent of GDP), nearly double the 2007 levels in nominal terms. The trade deficit moderated to 7.2 percent of GDP in 2009 owing to improvements in the terms of trade stemming from lower oil prices and improved diamond prices. Reflecting movements in the trade balance, the current account deficit widened to 9.9 percent of GDP in 2008 (up from 6.2 percent in 2007) and then declined to about 8.1 percent of GDP in 2009. International reserves were reduced to the equivalent of 3.3 months of imports in 2008, down from 3.8 months in 2006. The overall balance of payments swung into surplus in 2009 owing to strong inflows in the capital account (reflecting debt forgiveness and MDRI grants), which more than offset the deficits on the current and financial accounts; as a result, the reserve position improved to 3.3 months of imports from 1.8 months in 2008.

1.10 Despite the continued recovery in timber and diamond exports the current account deficit is projected to widen to 9.9 percent of GDP in 2010, reflecting rising imports. Led by petroleum products imports rose by 18 percent in 2010 compared with 17.5 percent for exports. Foreign direct investments rebounded in 2010, benefiting the mining, transport and telecommunication sectors; however, the rebound was not sufficient to offset the large deficit on the current account. As a result of these developments, foreign reserves are projected to decrease to 3.2 months of imports in 2010.

Public debt

1.11 Owing to HIPC and MDRI debt relief CAR's debt to GDP ratio has declined sharply but CAR carries a large stock of domestic arrears that constrain private sector development. CAR's total public debt-GDP ratio declined to 36.8 percent of GDP in 2009 when it reached the HIPC completion point from 80.3 percent of GDP at the end of 2008. The public debt—GDP ratio is projected at 41.9 percent of GDP in 2010 on account of the accumulation of new arrears on external debt, but is expected to decline to 38.1 percent of GDP in 2010 as the government continues to pursue a prudent debt policy centered on concessional borrowing. By contrast, domestic debt declined from 23.3 percent of GDP in 2008 to 20.4 percent of GDP in 2009, and is projected to rise to 21.2 percent of GDP in 2010 due to the accumulation of new domestic arrears. CAR's Domestic debt consists of outstanding credits to the government from commercial banks, government debt with the central bank of central African states (BEAC), budgetary arrears, public enterprise debt, and nonbanks' debt. The debt owed to commercial banks is particularly expensive, carrying interest rates varying from 15 to 17 percent per year; while the large size of budgetary arrears, mostly due to domestic suppliers, has eroded market confidence in the state.

1.12 Clearing the arrears to domestic suppliers will inject liquidity into the economy and reestablish market confidence in the state. This would help boost the economy. A clearance plan for domestic arrears has been in place since the end of 2008; and with the help of development partners, the government has started to clear these arrears with payments of about CFAF 5.5 billion in 2008 and 2009. During 2009, to make the arrears-clearance process more transparent, the government adopted an Arrears Order that establishes criteria for determining domestic suppliers' debts that are eligible for clearance and sets out the priorities and procedures in clearing the arrears. Restoring the confidence of domestic suppliers and encouraging them to participate in the bidding process for government contracts is essential to efforts to improve budget execution and public service delivery. However, limited resources make it difficult for the government to adhere fully to the established plan for domestic arrears reduction, which highlights further the need to create fiscal space in the budget.

Government expenditure and revenue

1.13 Public spending in CAR is low by regional standards and growing at a relatively moderate pace. Between 2004 and 2009 public expenditures increased by 7.2 percent in real terms on average and remained fairly stable at 15 percent of GDP. Public spending grew strongly in 2010, reflecting in part the countercyclical fiscal policy stance adopted by the government to mitigate the effects of the global slowdown on the CAR economy, bringing total expenditure to 15.6 percent of GDP over the period 2004-2010. This was still significantly less than the average of 24 percent of GDP for other fragile countries in Sub-Saharan Africa. Public spending in CAR over this period was characterized by a hike in subsidies and current transfers. In contrast, the public wage bill grew slowly; interest payments due moderated; and expenditures on goods and services remained at a fairly stable level. In response to reconstruction needs capital expenditures grew, albeit from a low base, rising from 2.7 percent of GDP in 2004 to 6.8 percent of GDP in 2010. This trend was driven mainly by foreign financing; domestically financed capital expenditures contracted during 2004-2009, before recovering in 2010.

Table 1.2 : Government Revenue and Expenditure in CAR, 2004-2011 (% of GDP)

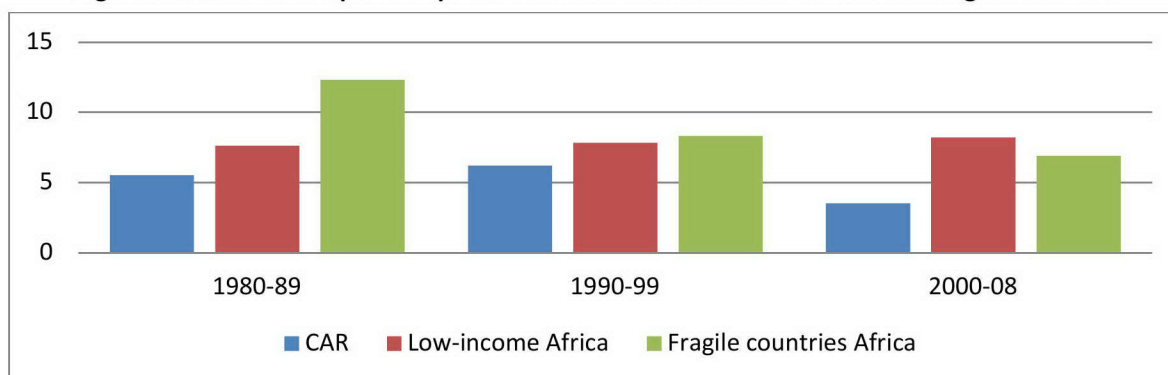
	2004	2005	2006	2007	2008	2009	2010	2011 Prel.
Domestic revenue	8.3	8.2	9.5	10.3	10.4	10.8	11.6	10.9
Tax revenues	7.2	7.1	7.8	7.3	8.0	8.7	9.4	8.5
Tax on income & profit	2.3	2.1	2.3	1.8	1.6	2.0	1.8	1.8
Domestic taxes on goods & services	3.3	3.7	3.6	5.5	6.3	6.7	7.6	5.4
<i>Of which Tax on international trade</i>	1.6	1.3	2.0	1.8	1.9	1.9	2.7	3.2
Nontax revenue	1.1	1.1	1.7	3.0	2.5	2.1	2.3	2.4
Total expenditures	13.9	16.9	13.9	13.2	16.2	16.2	19.4	15.9
Wages & salaries	5.8	5.5	4.8	4.6	4.3	4.5	4.4	4.4
Goods & services	2.7	3.1	2.0	1.8	2.7	3.0	3.8	3.5
Transfers & subsidies	1.5	2.0	1.3	1.8	2.7	2.6	3.3	3.2
Interest due	1.3	0.9	0.9	1.4	1.9	1.1	1.0	0.7
External	0.8	0.5	0.5	0.4	1.0	0.4	0.2	0.3
Domestic	0.5	0.4	0.4	1.0	0.9	0.7	0.8	0.4
Capital expenditures	2.7	5.4	4.9	3.6	4.5	4.9	6.8	4.0
Domestically-financed	1.1	1.2	1.0	1.1	1.2	1.0	1.1	1.1
Foreign-financed	1.6	4.2	3.9	2.5	3.3	4.0	5.7	3.0
Domestic primary balance	-1.6	-2.3	0.4	1.0	-0.5	-0.3	-1.0	-1.3
Overall balance, excluding grants	-5.6	-8.7	-4.4	-2.9	-5.8	-5.4	-7.7	-5.0

Source: IMF

1.14 The rapid growth of transfers and subsidies is crowding out spending on domestically financed capital expenditures. During the period of rapid increase in transfers and subsidies (2004-2008) the share of goods and services and domestically-financed capital expenditures in total expenditures declined. The share of expenditure on goods and services fell from 19.1 percent in 2004 to 16.7 percent in 2008 and the share of domestically-financed capital expenditures declined from 8.2 percent to 7.2 percent in 2008. Over the period 2004-2010, CAR invested less fixed capital than other fragile and low income countries in Sub-Saharan Africa. While the government relies heavily on donors to finance its investment program its budgetary contributions have been limited. Domestically-financed capital expenditures amounted to just 1.1 percent of GDP over the 2004-2010 period. This low level of government spending on investment represents a constraint to medium and long-term growth. In view of the country's huge infrastructure needs increasing government spending on investment will be critical

to complement donors' contribution and support private sector investment. Reducing and re-allocating inefficient subsidies would free up additional fiscal space for investment spending.

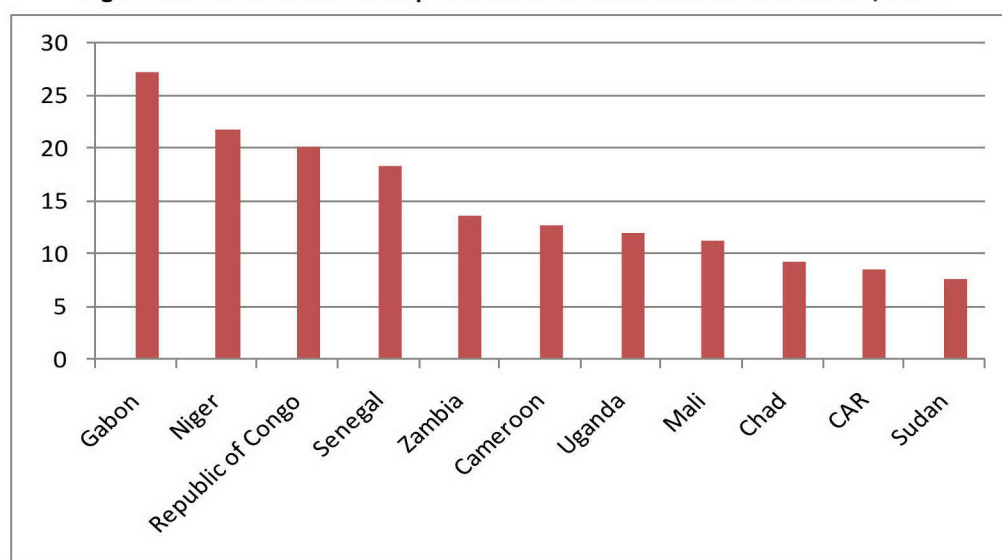
Figure 1.3 : Gross fixed public capital formation is lower in CAR than in other fragile countries



Source: Author's calculations

1.15 CAR's domestic revenue to GDP ratio is one of the lowest in Sub-Saharan Africa, which constrains the implementation of its poverty reduction strategy. Since 2007 domestic revenue has increased steadily and the preliminary estimate for 2010 is 11.6 percent of GDP up from 10.4 percent of GDP in 2008, driven by revenues from taxes on goods and services and company income. Despite this improvement, CAR lags significantly other African countries in revenue performance. In 2009, domestic revenue averaged 17 percent of GDP in other fragile countries and 23 percent of GDP in Sub-Saharan Africa. Tax revenue, projected at 9.4 percent of GDP in 2010, is particularly low. This suggests that tax policy and tax administration are of fundamental importance for creating fiscal space in the budget.

Figure 1.4 : International comparison of tax revenues as a share of GDP, 2009



Source: Author's calculations

1.16 Reforms to improve domestic revenue mobilization appear to be moving in the right directions with an initial set of measures to simplify the tax system announced in the 2011 Finance Law. Most notably, a simplified tax system for small enterprises is being introduced, the second and reduced rate on VAT is to be abolished, and the business license fee is expected to be transformed into

a tax on company income. These reforms are promising and there appears to be a strong commitment within government to continue the simplification efforts. Looking ahead, the government would need to gear these reforms toward creating a tax environment conducive to private investment through a greater simplification of income tax and a rationalization of tax administration procedures to lower tax-induced constraints to business entry and operations. In the short to medium run, simple and low taxes assessed on large tax bases with no special treatment will enable the government to generate a steady stream of revenue.

Fiscal deficit

1.17 The government has generally maintained a prudent fiscal stance—anchored by targets on the domestic primary balance; this has helped stabilize the economy. The domestic primary deficit (excluding grants, interest payments, and foreign-financed capital expenditures) declined from -1.6 percent of GDP in 2004 to -0.3 percent of GDP in 2009. The overall fiscal deficit including grants improved from -2.2 percent of GDP in 2004 to -0.1 percent of GDP in 2009; for the period 2004-2009, the overall fiscal balance including grants recorded a small surplus averaging 0.1 percent of GDP.

1.18 However, the overall budget deficit excluding grants widened to 7.7 percent of GDP in 2010 owing to a rapid increase in government spending. After falling to -2.8 percent of GDP in 2007 from -8.7 percent of GDP in 2005 the overall fiscal deficit excluding grants averaged -5.6 percent of GDP in 2008-2009 and widened to -7.7 percent of GDP in 2010. During this period, domestic revenue rose moderately from 10.4 of GDP in 2008 to 11.6 percent of GDP in 2010; while total expenditure rose more rapidly from 16.2 percent of GDP to 19.4 percent of GDP. The overall budget deficit reflected in part the increase in foreign-financed capital expenditures, which rose from 3.3 percent in 2008 to 5.7 percent in 2010; but it was also due to the counter-cyclical fiscal stance the government adopted in 2010 by increasing spending to mitigate the effects of the global slowdown on the CAR economy. Higher spending on goods and services and transfers in the run-up to the presidential and legislative elections was an additional source of pressure on the budget.

1.19 Moreover, budget execution during 2010 was marked by a sharp increase in off-budget expenditures, reflecting weakened fiscal discipline. A growing increase in the recourse to exceptional procedures for the payment of government expenditures led to a large volume of spending outside the normal budget process, and the regularization of these expenditures has been slow. The increase in off-budget expenditures was accompanied by an accumulation of new arrears on domestic and foreign debt, as discussed above, and priority spending in health and education was crowded out. The off-budget spending continued into 2011 and fiscal data for the first half of the year indicated that, in the absence of corrective measures, the domestic primary deficit would rise further to 1.3 percent of GDP in 2011 from 1.0 percent of GDP in 2010. The government needs to restore fiscal discipline to maintain macroeconomic stability.

Foreign grants

1.20 Foreign grants to support public expenditure have moderated significantly from their peak in 2006. Donors' re-engagement in CAR following the end of conflict in 2003 was accompanied by a sharp increase in foreign aid grants to support the government's budget. Foreign grants rose from 3.4 percent of GDP in 2004 to 13.4 percent of GDP in 2006. Total revenue including grants increased accordingly reaching nearly 22.9 percent of GDP in 2006 compared to 11.7 percent of GDP in 2004. Since then foreign grants, which include budget support as well project grants, have declined to an average of

about 5.1 percent of GDP over the period 2007-2010. The CAR authorities expected a rebound in 2011, with foreign grants projected at 8 percent of GDP in the 2011 Finance Law, which is unlikely to materialize.

Figure 1.5 : Fiscal developments, 2004-2010 (% of GDP)

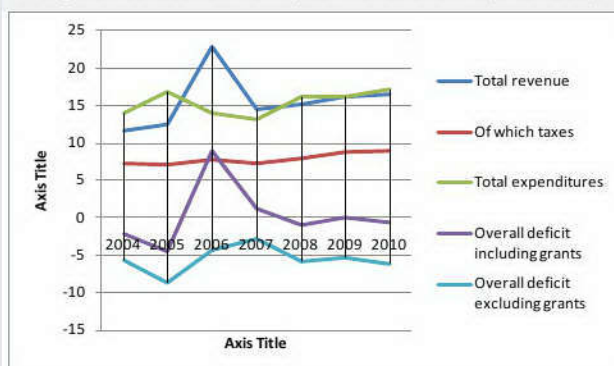
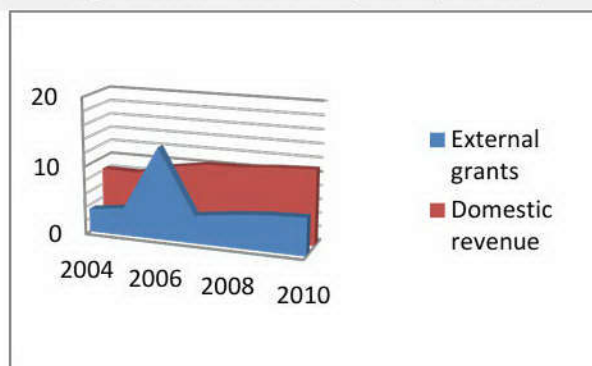


Figure 1.6 : Revenue developments (% of GDP)



Source: Author's calculations

1.21 Budget support grants have declined more rapidly from their peak compared to project grants, which have strengthened. In 2006, at its peak, budget support represented about three-quarters of total foreign grants, and 9.8 percent of GDP. However, since then, donors have expressed fiduciary concerns about the CAR's budget system and, reflecting these concerns, budget support grants have declined significantly representing just 22.2 percent of total foreign grants and 1.4 percent of GDP in 2010. In contrast, project support grants declined moderately from their peak in 2006 (3.5 percent of GDP) and then strengthened to 4.9 percent of GDP in 2010.

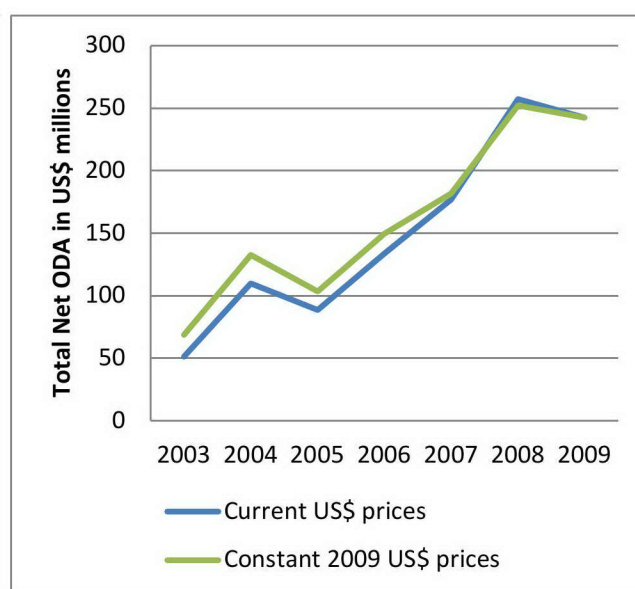
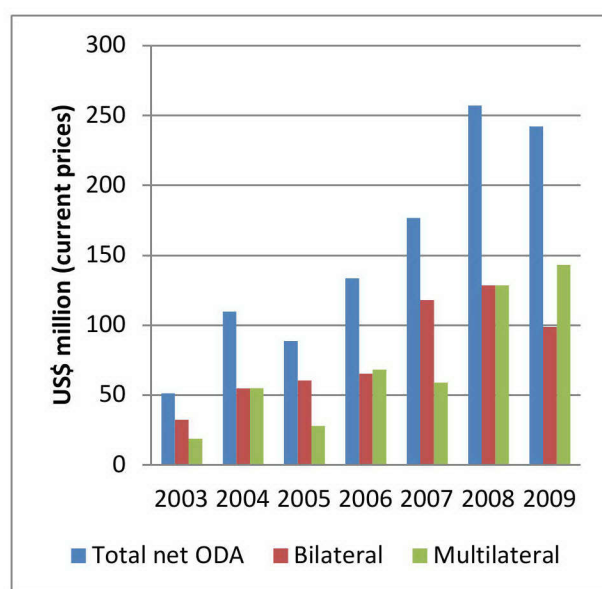
1.22 The budget and project support grants are part of the official development assistance that CAR has received since conflict ended. After a steady increase since 2006 net ODA flows to CAR fell in 2009 (Box 1.1). Compared to other fragile countries CAR has been a modest recipient of ODA. In 2008, at its peak, ODA in CAR totaled US\$ 257 million, considerably less than the average of US\$ 805 for fragile countries.

1.23 Despite their volatility net ODA flows will remain a critical component of CAR's efforts to transition out of fragility in the short to medium term. However, the relatively low levels of foreign grants imply that the government needs to create fiscal space in the budget for its growth and poverty reduction program. This could be achieved by increasing domestic revenue and by generating efficiency gains from doing more with less and in ways that are consistent with macroeconomic stability.

Box 1.1 : Trends in Net Official Development Assistance in CAR

This box summarizes recent trends in net official development assistance (ODA) to CAR. Net ODA flows in CAR increased fairly rapidly between 2006 and 2008. In 2006 net ODA increased by 44 percent in real terms and between 2006 and 2008 it rose by 35 percent on average, reaching a peak of US\$257 million in 2008. In 2009, net ODA fell by 4 percent in real terms to US\$252 million. Net ODA in CAR consists both of bilateral and multilateral assistance, with the share of the latter rising relatively more rapidly over the past two years. The main multilateral donors are IDA, African Development Fund, European Union and the International Monetary Fund. The principal bilateral donors are France, United States, Japan and Germany.

	2003	2004	2005	2006	2007	2008	2009	Average 2003-09
Total Net ODA (US\$ Million)	51.22	109.75	88.52	133.56	176.81	257.15	242.21	151.33
Net ODA per capita (US\$)	11.6	24.9	20.1	30.4	40.2	58.4	55.1	34.4
Net ODA as share of GDP (%)	4.5	8.6	6.6	9.0	10.3	13.1	11.7	9.1



Source: OECD DAC online database, September 2011

C. MEDIUM-TERM OUTLOOK

1.24 The Government is in the process of negotiating a successor ECF arrangement with the IMF that will be anchored in the Government's second generation poverty reduction strategy. The new three-year program will aim at consolidating macroeconomic stability, creating fiscal space, and strengthening policy implementation capacity. The proposed program anticipates a consolidation of the peace process and political stability; a continuation of the Government's stated policy objectives of prudent fiscal consolidation; and renewed government efforts to address the unfinished business of the structural reform agenda including, in particular, the reforms aimed at strengthening the regulatory environment for private sector investment. The medium-term outlook presented below is projected on the basis of the fiscal slippages described above.

1.25 Real GDP Growth is estimated at 3.1 percent in 2011 supported by the continued recovery in the exports of timber and diamonds. However, owing to limited donors' budget and project support, public investment contracted leading to a decline in gross investment to 12.4 percent of GDP from 15.1

percent of GDP in 2010. As a result of the decline in the public investment program, imports fell. The current account deficit is estimated at 7.4 percent of GDP in 2011 down from 9.9 percent in 2010; and the overall fiscal deficit (excluding grants) is estimated at 5.0 percent of GDP, down from 7.7 percent of GDP in 2010, reflecting a sharp reduction in government expenditure due to lower domestic revenue. Average consumer inflation is expected to remain low in 2011, estimated at 0.7 percent.

1.26 Growth could improve significantly over the medium-term, rising from 4.1 percent in 2012 to 6.0 percent by 2014, as investment rises. Higher levels of private investment are projected to drive the overall investment rate from 14.1 percent in 2012 to 16.4 percent of GDP by 2014, as policies and investments aimed at promoting broad-based growth begin to bear fruit. In this context, public investment would rise steadily from 5.3 percent of GDP in 2012 to 6.7 percent of GDP by 2014. The realization of these investment targets will require efforts to enhance project preparation and implementation capacities in the priority sector ministries.

1.27 Consistent with the medium-term policy objective of maintaining macroeconomic stability, the Government is expected to contain inflation to below the CEMAC convergence criterion of 3 percent. Improving security in the countryside will facilitate the implementation of key projects to boost agricultural production, which will put downward pressures on food prices and mitigate fuel price increases. Consumer price inflation (end-year basis) is projected to rise moderately from 1.8 percent in 2011 to 2.0 percent by 2014.

1.28 The overall deficit (excluding grants) is projected to decline over the medium term and stabilize at 4.1 percent of GDP in 2014, owing in part to steady improvements in domestic revenue mobilization. Tax revenues are projected to rise from 10.9 percent of GDP in 2011 to 12.7 percent of GDP by 2014. Non-tax revenues are expected to decline over the projected period in part due to a discontinuation of mining and telecommunications royalty payments, limiting rapid growth in domestic revenues. Formulating and implementing a comprehensive tax policy reform and strengthening the customs and tax departments would be essential to increase tax revenue while moving from trade to more domestic taxation. Consistent implementation of the automatic petroleum price adjustment mechanism would also be critical to revenue mobilization efforts.

1.29 Expenditure rationalization and measures to enhance the efficiency of public spending and value for money would be critical over the medium-term. Total expenditures are projected to average about 16.4 percent of GDP over the period 2012-14, preserving spending towards the social sectors and critical infrastructure. The government will continue to clear domestic arrears¹ with the view to rebuild private sector confidence in the state; and it will also continue its policy of reducing borrowing from the domestic commercial banks. With adequate technical assistance the government will seek to improve the efficiency of public expenditure management by strengthening (i) cashflow management; (ii) budget execution and public accounting; and (iii) the computerization of expenditure management system. The reduction in fiscal deficits will help limit domestic and external borrowing, improving prospects for debt sustainability with expected high growth in exports.

¹ Currently, domestic payment arrears amount to around 10 percent of GDP, and commercial bank debt, 1.2 percent of GDP. In 2008, the Government committed to a domestic arrears clearance plan calling for annual payments of CFAF 15 billion (1.5 percent of GDP).

Table 1.3 : Budget outlook, 2010-2014 (% of GDP)

	2010	2011 Prel.	2012 Proj.	2013 Proj.	2014 Proj.
Total revenue	18.0	13.5	16.1	17.3	18.0
Domestic revenue	11.6	10.9	11.5	12.0	12.7
Tax revenue	9.4	8.5	9.9	10.5	11.2
Nontax revenue	2.3	2.4	1.6	1.5	1.5
Grants	6.3	2.6	4.7	5.4	5.3
Program	1.4	0.0	1.0	1.6	1.6
Project	4.9	2.6	3.7	3.8	3.7
Total expenditure	19.4	15.9	15.6	16.9	16.8
Wages and salaries	4.4	4.5	4.7	4.7	4.7
Transfers and subsidies	3.3	3.2	2.1	2.1	2.1
Goods and services	3.8	3.5	2.9	2.9	2.9
Interest due	1.0	0.7	0.7	0.6	0.4
External	0.2	0.3	0.1	0.1	0.1
Domestic	0.8	0.4	0.6	0.5	0.4
Capital expenditure	6.8	4.0	5.3	6.7	6.7
Domestically-financed	1.1	1.1	1.5	1.9	2.0
Externally-financed	5.7	3.0	3.7	4.8	4.7
Overall balance					
Excluding grants	-7.7	-5.0	-4.1	-4.9	-4.1
Of which: domestic primary balance	-1.0	-1.3	0.4	0.4	1.0
Including grants	-1.4	-2.4	0.5	0.5	1.2
Identified financing	2.9	1.5	-0.7	0.5	0.1
External, net	0.7	-0.4	-0.7	0.4	0.4
Domestic, net	2.3	1.9	-0.1	0.1	-0.3

Source: IMF

1.30 **The external current account deficit (including grants) is projected to stabilize around 6.1 percent of GDP over the medium-term.** High import levels stemming from higher capital imports associated with the expanding public investment program are expected to be partly offset by a rapid expansion in exports, led by the traditional export commodities (timber and diamonds). Foreign reserve accumulation would increase reflecting strong capital inflows, including net inflows of foreign investments in the mining sector. External reserves would reach the equivalent of 4.9 months of imports by 2014, up from 2.6 months in 2011.

Table 1.4 : Balance of payments projections

	2010 Prel.	2011 Prel.	2012 Proj.	2013 Proj.	2014 Proj.
Exports of goods and services (% of GDP)	10.8	12.7	13.8	13.7	13.9
Imports of goods and services (% of GDP)	24.6	22.6	24.1	24.0	23.3
Current account balance (% of GDP)	-9.9	-7.4	-6.8	-6.1	-5.3
Gross International reserves (CFAF billion)	62.1	57.7	84.0	101.7	125.8
Gross International reserves (months of imports of goods)	3.2	2.6	3.6	4.1	4.9

Source: IMF

1.31 **Significant downside risks to the macroeconomic framework would continue to affect the medium-term outlook.** These include adverse weather conditions which could depress agricultural

output and exports; lower investment in key sectors due to the unpredictability of donor funding and inadequate budget implementation capacity in line ministries; and imprudent management of government finances. Moreover as an exporter of primary commodities CAR is exposed to shocks emanating from world commodity prices, which could increase inflation, widen the current account deficit and reduce budgetary revenues. Finally, political risks remain significant. As a fragile state CAR is prone to political stress. In particular, renewed political and social instability stemming from the discontent about the election results and limited progress in service delivery would discourage investment and slow economic activity.

D. FISCAL SUSTAINABILITY

1.32 This section analyzes CAR's current fiscal policy stance to determine whether it is sustainable and if it is not how much additional fiscal reduction would be needed to maintain fiscal sustainability. For the purpose of this analysis simulations were conducted using the revised minimum standard model-extended (RMSM-X). The model takes into account the recent economic developments described above.

1.33 Fiscal sustainability analysis addresses the shortcomings of conventional fiscal indicators by taking into account debt dynamics as well as other macroeconomic variables such as growth, inflation, foreign and domestic debt. In this analysis fiscal performance is assessed against long-run solvency requirements as well as against short-run liquidity constraints. Based on this analysis, the public sector is said to be solvent when its discounted revenues are sufficient to cover its debt (domestic and external); and the debt is sustainable if it can be serviced without incurring new debt. This suggests that a sustainable fiscal policy stance can be defined as one that does not lead to an increase in the debt-to-GDP ratio, that is, one that stabilizes the debt-to-GDP ratio under reasonable rates of growth, interest rates, and inflation. This means that it is the relationship among the real growth rate, the real interest rate on government debt, and the primary deficit that determines the evolution of the public debt ratio. In general a primary deficit leads to faster debt accumulation the higher the real interest rate and the lower the GDP growth rate. A country can stabilize its debt when the growth rate is higher than the interest rate given the primary deficit. Conversely, when the interest rate is higher than the growth rate, there must be a primary surplus to stabilize the ratio of debt to GDP; and the larger the difference between the interest rate and the growth rate the larger the necessary primary surplus.

1.34 To assess fiscal sustainability, the model calculates the primary balance² that would allow the debt-to-GDP ratio to stay constant³ given the stock of public debt at the end of the previous period, the real interest rate, and the real GDP growth rate. A measure of the required adjustment is then calculated by comparing the debt-stabilizing primary deficit with the actual (or expected) primary deficit. To conduct this analysis certain assumptions are made about the behavior of key macroeconomic variables over the simulation period of 2012-2014. These variables include the real GDP growth rate, inflation, domestic interest rate, foreign interest rate, and the real exchange rate. The assumptions, summarized in Table 1.5, derive from the medium term prospects presented above. Specifically,

- *Real GDP growth rate:* It is assumed that the rate of real economic growth will average 4.7 percent per annum over the medium-term, ranging from 4.1 percent in 2012 to 6 percent in 2014 driven by higher public investment, improved revenue mobilization and measures to

² Defined in the case of CAR to exclude grants, interest payments and externally-financed capital expenditure.

³ Central government in the case of CAR.

improve the efficiency of government spending. The effect of slower economic growth averaging 3.0 percent over the simulation period is examined in an alternative scenario.

- *Inflation rate:* Measured by the GDP deflator, the inflation rate will rise from 0.3 percent in 2011 to 2.8 percent in 2012. Thereafter, it will increase at an annual rate of 2.5 percent on average over the simulation period, remaining within the CEMAC convergence criterion of 3.0 percent.
- *Public sector debt:* The public sector debt-to-GDP ratio rose to 41.9 percent in 2010 as the government contracted new debt and accumulated arrears on both the domestic and foreign debt. It is assumed that the government will adhere to its debt reduction strategy and by 2014 the public sector debt will fall to 25 percent of GDP.
- *Domestic interest rate:* Domestic borrowing rates are high in CAR, averaging about 17 percent. However, in 2009 the government signed new conventions with each of the four commercial banks which consolidated past loans into one new loan at a lower interest rate of 9 percent. It is assumed that the domestic interest rate on government domestic debt will remain at 9 percent in nominal terms over the simulation period or about 5 percent in real terms given the assumptions about the inflation rate. The effect of higher domestic interest rate is also assessed in an alternative scenario.
- *Foreign interest rate:* Most of CAR's foreign debt has been provided at grant or concessional terms. Foreign interest rates in creditor countries are currently low due to the fact that global economic activity has been slow over the past two years. Interest rates could rise as global economic business conditions improve and demand for funds increases. It is assumed that foreign interest rates would average 5 percent in real terms over the simulation period.
- *Exchange rate:* As a member of the CFA franc zone, with the CFA franc linked to the euro, CAR lacks an independent monetary policy. Keeping a competitive real exchange rate will require controlling domestic costs. It is assumed that the real exchange rate will depreciate at a stable rate in line with domestic inflation.

Table 1.5 : Main Assumptions for Fiscal Projections

	2010	2011	2012	2013	2014
Real GDP growth (%)	3.3	3.1	4.1	4.2	5.9
GDP Inflation (%)	1.7	0.3	2.8	2.1	2.6
Real interest rate, domestic (%)	5.0	5.0	5.0	5.0	5.0
Real interest rate, foreign (%)	5.0	5.0	5.0	5.0	5.0
Devaluation rate (%), depreciation= -	-4.6	-5.6	-2.6	-3.1	-2.9

1.35 Analysis of CAR's fiscal stance under the base case assumptions indicates a favorable outcome for 2010 with a minor adjustment required for fiscal sustainability. As a net debtor, CAR would require a primary deficit equivalent to about 0.8 percent of GDP to attain fiscal sustainability in 2010. This implies a modest fiscal adjustment of about 0.2 percent of GDP relative to the actual primary deficit of 1.0 percent of GDP in that year (Table 1.6). Contributing to the outcomes in 2010 are the low debt ratios in 2009, as CAR reached the HIPC completion point in that year and benefited from additional debt relief under the MDRI. To the extent that budgetary expenditures are underestimated, because of the fact that a large volume of expenditures takes place outside the normal budget process and the regularization of these expenditures may be incomplete, adjustment burdens would be higher than

estimated. Looking beyond 2010, the adjustment burdens turned negative in 2011 and would remain negative within the next few years with expected primary surpluses over the medium term. The public debt stock (including arrears) is projected to decline to about 26 percent of GDP by 2014, down from an estimated 41.9 percent of GDP at end-2010.

Figure 1.7 : Fiscal Sustainability
(percent of GDP)

	2004-09	2010	2011	2012	2013	2014
Sustainable Primary Balance (- = deficit)	3.9	-0.8	-3.9	-1.7	-0.3	-0.6
Actual/Expected Primary Balance (- = deficit)	-1.0	-1.0	-1.3	0.4	0.4	1.0
Fiscal Sustainability Adjustment	4.9	0.2	-2.6	-2.1	-0.7	-1.6
Memorandum Items						
Public sector debt	83.5	41.9	38.1	34.1	30.0	26.2
Of which: Domestic debt	23.4	21.2	21.6	18.1	15.1	12.0
Domestic revenue	9.6	11.6	10.9	11.5	12.0	12.7
Exports	13.3	11.6	13.5	14.6	14.5	14.6

Source: World Bank staff calculations.

1.36 Simulations under alternative assumptions about the interest rates and real GDP growth rates indicate the range of fiscal adjustment burdens the government could face. Higher real interest rates would lead to higher adjustment burdens. At a real discount rate of 15 percent, roughly equivalent to the actual borrowing rate in the domestic market, the fiscal sustainability adjustment could rise to 3.4 percent of GDP (table 1.6) which would be quite difficult to achieve. Reducing real GDP growth to historical levels over the medium term, while maintaining the real interest rate at 5 percent (other things remaining unchanged), narrows the negative adjustment burdens ; this suggests that slower than expected economic growth would increase the extent of adjustment efforts needed to maintain fiscal sustainability given interest rates.

Table 1.6 : Required Fiscal Sustainability Adjustment under Alternative Interest rates and Growth rates

	Interest rates			Average GDP growth rate	
	15%	10%	5%	4.7%	3.3%
Fiscal sustainability adjustment (% of GDP)	3.4	1.8	0.2	-1.5	-1.3

Source: Author's calculations

1.37 The findings of the fiscal sustainability analysis indicate that the need for higher public investment spending to boost growth and reduce poverty will have to be balanced with the need to preserve macroeconomic stability and debt sustainability. The HIPC and MDRI debt relief has enhanced debt sustainability, and CAR is at moderate risk of debt distress for now (Box 1.2). These outcomes should be protected. Creating sufficient fiscal space for higher public investment expenditures in infrastructure and the social sectors will require an expansion of budgetary resources. Given the limited scope for domestic borrowing, maintaining debt sustainability will largely entail restraining the growth of external public debt to levels that are sustainable in the long run.

Box 1.2 : External Debt Sustainability

The last joint IMF-World Bank full debt sustainability analysis (DSA) for the Central African Republic (C.A.R.) was conducted in May 2010. An update of the DSA was issued in May 2012. Debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) at the completion point in June 2009 has alleviated CAR's debt burden and the country remains at a moderate risk of debt distress. Although somewhat higher compared to the May 2010 exercise, all baseline debt indicators remain below the thresholds with stable downward trends, but the debt position could still be vulnerable to the most extreme shock to exports, and cause the policy-related threshold for the PV of external debt-to-exports ratio to be breached. In the current update, the PV of debt-to-exports ratio is projected to reach around 105 percent in 2022 under export growth shocks. Considering the fact that CAR is categorized as having "lower debt vulnerabilities and lower capacity" under the debt sustainability framework, high concessionality is required to preserve debt sustainability.

External Debt Burden Indicators: Baseline Scenario Ratios				
	Thresholds ^{1/}	2011 Est.	2022 Proj.	2032 Proj.
<i>PV of external debt in percent of:</i>				
GDP	30	9.9	9.5	7.6
Exports	100	78.2	67.4	48.7
Revenue	200	89.0	61.3	38.7
<i>External debt service in percent of:</i>				
Exports	15	0.2	1.4	2.7
Revenue	25	0.2	1.3	2.2

Source: CAR authorities; and IMF and WB staff estimates.

1/ Policy-dependent thresholds used in the joint IMF-WB LIC DSA framework are for a weak policy performer. C.A.R. received an average rating of 2.46 in 2006-08 in the World Bank's Country Policy and Institutional Assessment (CPIA), which qualifies it as a weak policy performer.

E. POLICY RECOMMENDATIONS

1.38 The gains CAR had made in reducing public sector indebtedness have eroded due to inadequate fiscal discipline and weak fiscal management. The public debt-to-GDP ratio rose in 2010 due to a large extent to the accumulation of new arrears on domestic and foreign debt. These arrears arose as the government circumvented the normal budget process through recourse to exceptional procedures for the payment of government expenditures which led to a large volume of off-budget spending. Priority spending, which could boost growth, has also been crowded out. As a result of these developments the primary fiscal deficit is expected to deteriorate in 2011, which will require significant adjustment in order to maintain fiscal sustainability.

1.39 As a result of the accumulation of new domestic and external arrears and the large volume of off-budget expenditures the government fiscal position has been less than consistent with the need to maintain macroeconomic stability and the need for sustained economic growth. Looking forward, the government will have to reverse this trend. The following recommendations should be considered.

1.40 In the short run the priority for the government should be to ensure that macroeconomic stability is maintained: One aspect of CAR's economic performance up until the HIPC completion point has been steady improvements in the fiscal position which, together with debt relief has helped lower the debt burden and the risk of debt distress. This performance should be sustained by restoring fiscal

discipline. A worsening of the macroeconomic environment is likely to reverse the positive trends in government debt. In particular, the government should take immediate steps to adhere to established procedures for budget execution and strengthen the computerized expenditure system.

- The authorities must ensure that no spending commitments take place outside the expenditure chain. The recourse to exceptional procedures to finance government expenditures should be limited to the strict minimum and these expenditures should be regularized without delay.
- The computerized expenditure management system should be effective and used to improve transparency, record and provide timely information on budget execution, and strengthen cash flow management.

1.41 In the medium term institutional arrangements in the areas of public financial management and debt management should be strengthened significantly. Reforms are already underway in each of these areas and should be pursued vigorously.

- In the area of public financial management the basic fiscal institutions that need particular attention are those that strengthen capacity in budget formulation, execution and reporting, such that the following can be attained: (i) a comprehensive and credible budget that curtails off-budget spending; and (ii) a transparent system of accounting and control that prevents payment arrears and allows for regular budget execution reports to be produced on time.
- In the area of debt management, a strong debt management strategy and the preparation of regular debt reports would help monitor and keep debt sustainable. The National Committee for Public Debt will have to play a central role in ensuring that the government follows a prudent debt policy centered on concessional borrowing.

F. CONCLUSIONS

1.42 The analysis presented in this chapter indicates that strong and sustained economic growth will be critical to CAR's efforts to maintain fiscal sustainability in the medium term. This, in turn, will require a fiscal position that is consistent with and permits a lower public debt-to-GDP ratio. These findings suggest that in the medium term fiscal policy in CAR should focus on growth and fiscal sustainability issues. The level, composition and efficiency of public expenditures, discussed next, will play an important role in addressing these issues.

CHAPTER 2: PUBLIC EXPENDITURE TRENDS AND COMPOSITION

A. INTRODUCTION

2.1 This chapter provides an analysis of the trends and composition of public expenditures in CAR over the period 2004-2010. It evaluates budget outcomes in terms of allocation and execution and assesses the resulting composition of spending against PRSP priorities. It examines the scope for the realignment of expenditures toward growth enhancing and poverty reducing areas that could be achieved by rationalizing, phasing out or cutting untargeted programs and inefficient subsidies and by improving budget execution.

2.2 **Public expenditures in CAR are relatively low and growing at a moderate pace.** Between 2004 and 2009 total public expenditures increased by 7.3 percent on average in real terms and remained fairly stable at 15.1 percent of GDP. Public spending grew strongly in 2010, as the government adopted a countercyclical fiscal policy stance to mitigate the effects of the global slowdown on the CAR economy, bringing total expenditure to 15.6 percent of GDP over the period 2004-2010. This was still significantly less than the average of 18 percent of GDP in the 1990s and much lower than in other fragile countries in Sub-Saharan Africa, where total expenditure had averaged 24 percent of GDP. Excluding foreign-financed capital expenditures, total expenditure grew at a far slower pace, at 4.2 percent on average in real terms.

Table 2.1 : Total Public Expenditures, 2004-2010 (Billions CFAF, payments basis)

	2004	2005	2006	2007	2008	2009	2010	Average 2004-2010
Nominal	93.4	120.2	107.2	107.6	143.6	151.4	190.4	130.5
Adjusted by CPI deflator	86.2	107.8	90.1	89.6	109.5	111.4	138.1	104.7
Annual growth rate (%)	11.8	25.1	-16.4	-0.6	22.3	1.8	23.9	9.7
As percent of GDP (%)	13.9	16.9	13.9	13.2	16.2	16.2	19.4	15.6

Source: Author's estimates based on Ministry of Finance and Budget (MoFB) and IMF data

2.3 **Public spending over the period 2004-2010 was characterized by a hike in subsidies and current transfers, which increased rapidly in real terms.** In contrast, the public wage bill grew slowly; interest payments due moderated; and expenditures on goods and services fluctuated within a narrow range until 2009. In 2010, reflecting spending on the elections, expenditures on goods and services rose strongly. If sustained, the reduction in interest payments due and the slow growth of the wage bill will help to create fiscal space in the budget. Reducing and re-allocating inefficient subsidies and controlling spending on goods and services would also free up additional fiscal space. In response to reconstruction needs capital expenditures rose significantly as a share of GDP but remained below their pre-crisis level. This trend was driven mainly by foreign financing on which CAR depends heavily to finance its investment program. In contrast, domestically financed capital expenditures contracted over most of the period and remained very low. In terms of functional categories the analysis finds that in its allocation and execution the budget has favored administrative activities and defense and public security at the expense of priority sectors.

2.4 **The main recommendation from the analysis is that CAR should shift more resources toward productive activities and the social sectors.** A larger share of future fiscal space should be allocated to health, education and the infrastructure sectors. There is considerable scope for improvement in the use

of budgetary resources and the government should aim to reduce spending on administration and the military. Spending should be re-directed from administrative activities and defense towards additional funding for basic service delivery by minimizing expenditures that do not directly benefit the public and by providing adequate recurrent expenditures to support capital investments in public service delivery.

2.5 The chapter is organized as follows. It begins in section B with a discussion of data issues and the data collection exercise that had to be undertaken to permit a broader analysis of public spending. This is followed in section C with an analysis of public spending using the economic classification of the budget. It looks at how resources have been allocated between wages and salaries, transfers and subsidies, goods and services, interest payments, and capital expenditures. It seeks to determine whether expenditures are allocated in ways that would promote economic growth and effective service delivery, whether there is scope for improving the economic composition of expenditures, and whether potential savings could be achieved from curtailing inefficient expenditures. Section D provides an analysis of public spending using the functional classification. It examines the allocation of resources across and within sectors, and seeks to determine whether CAR deploys its resources in ways that would improve the delivery of education and health services as well as infrastructure services, such as electricity, and water supply and sanitation. This section also highlights issues of allocation and points out the need to align expenditure with PRSP priorities. Section E analyzes budget execution, highlighting the factors behind the varying performance between sectors. Section F provides a discussion of how CAR can create fiscal space to finance priority spending; section G concludes.

B. DATA ISSUES AND SCOPE OF ANALYSIS

2.6 CAR has taken important steps to improve the quality and timeliness of budget data. In 2008 a new budget nomenclature, developed with European Union assistance, which permits the economic and functional classifications of public expenditure, was introduced. At the same time, a new computerized expenditure management system (GESCO) was set up in the budget department with French assistance. GESCO permitted the recording and tracking of resource flows through the budget expenditure chain from commitment to the payments order (*ordonnancement*) stage, and facilitated the production of quarterly budget execution reports. In 2009 the budget and accounting nomenclatures were harmonized and the 2010 and 2011 budgets were based on the new harmonized nomenclature. Since January 2011 the computerized expenditure system covers the four stages of the budget process.

2.7 However, significant weaknesses continue to affect the accuracy and timeliness of budget data and the effectiveness of GESCO. A thorough data collection exercise had to be undertaken to permit a deeper examination of public expenditure. A major aspect of the exercise consisted of constructing consistent data series on budget execution. The Government regularly produces the TOFE (*Tableau des opérations financières et économiques de l'état*), and overtime the quality of the TOFE has improved. The TOFE provides internally consistent budget data according to the economic classification and an analysis of the trends and composition of spending by this classification over the period 2004-2010 has been possible. However, data on budget execution by the functional classification of spending is not readily available and had to be assembled to the extent possible.

2.8 Using the TOFE to ensure consistency the PER team, including government officials at the Ministry of Finance, constructed the functional forms of the executed budget for 2008, 2009, and 2010. Construction of the functional form of the executed budget for 2008 was facilitated by the availability of the budget execution law (*loi de règlement*), which reconciles payment orders from the Budget office with payment data from the *Trésor public*. For 2009 and 2010, using payment data

obtained from the *Trésor public* (the last stage on the expenditure chain), the team mapped the allocation of payments for wages and salaries, goods and services, transfers and subsidies, and domestically-financed capital expenditures to functional areas in the budget. This mapping exercise helped generate consistent budget execution data for the three-year period 2008, 2009 and 2010, thereby permitting an analysis of spending by the functional classification that is by sectors such as health, education and infrastructure. However, this exercise was unable to overcome the problem of incomplete expenditure data at the commitment and payments order stages. These data may become available once the ongoing process of accounting for all the spending that has occurred before ordonnancement, a process known as “regularization”, has been completed.

2.9 The major data issues include the following:

- A large volume of recurrent expenditure takes place outside the normal budget process and the regularization of these off-budget expenditures is not carried out systematically. As a result, the accuracy of budget execution data is not assured and complete data are available with a long lag. For example, by end-July 2010, regularized budget execution data for 2009 were still not available. A systematic recourse to exceptional procedures for the payment of government expenditures was responsible for the increase in off-budget spending; this reflects not only a lack of fiscal discipline but also the ineffectiveness of GESCO, the computerized expenditure management tool, to promote fiscal transparency, provide timely information on budget execution, and strengthen cash management.
- A direct consequence of this situation is that preparation of the budget execution law for 2009 and 2010 will be delayed further, weakening the budget control system.
- Foreign-financed capital expenditures, the second largest category of expenditure after wages and salaries, are executed outside the budget and are not captured in the budget execution reports.
- The budget reporting system is unable to identify functional spending data at the local government level, which makes it impossible to analyze the regional distribution of government spending.
- Large amounts of expenditures are classified as common charges (*dépenses non reparties*) in the budget. By definition common charges are the expenses that cannot be attributed to a specific function or sub-function and, in principle, should only apply to a small share of the budget. Common charges are, however, the largest functional category of expenditure in the budget.

2.10 These weaknesses have limited the scope and comprehensiveness of the budget analysis by the functional classification. Specifically,

- Because consistent series of budget execution data using the functional classification that are generated by GESCO exist only for three years (2008, 2009, and 2010), the functional analysis of executed budgets has been limited to these years. Prior to the advent of GESCO budget execution data were recorded manually and it has not been possible to verify the accuracy and completeness of these data to include them in the analysis.
- Moreover, the incomplete regularization of off-budget expenditures in 2009 and 2010 made it impossible to carry out a detailed analysis of functional spending of the executed budgets for these years. As a consequence it has been impossible to discuss accurately important issues such as the share of spending allocated to the purchase of manuals in primary education.

- The budget analysis focuses mainly on the expenditures of the central government.
- All total expenditures in functional form are net of debt payments and foreign-financed capital expenditures.

The budget data weaknesses underscore the critical importance of continuing the public finance management reforms and ensuring that progress made is sustained. Two areas are of particular significance. First, as noted in chapter 1, The government should ensure that GESCO is fully operational and that adequate capacity exists in the budget office and at the *Trésor public* to efficiently manage it. Secondly, adoption of annual Budget Execution Laws (*loi de règlement*) that reconcile payment orders (*ordonnancement*) from the budget office with payment data from the *Trésor public* is critical to determine whether public expenditure is executed in accordance with the approved budget. The authorities should not delay further preparation of the budget execution law for 2009 and 2010.

C. ALLOCATION OF BUDGET EXPENDITURES: ECONOMIC CLASSIFICATION

Current Expenditures

2.11 **Current primary expenditures are the dominant economic category of public spending.** Current primary expenditures, -wages and salaries, transfers and subsidies, and purchases of goods and services- grew by 6.0 percent on average in real terms during 2004-2008 and by 11.5 percent in 2009-2010. For the period 2004-2010, current primary expenditure grew on average by 7.6 percent in real terms and rose from 9.9 percent of GDP in 2004 to 11.5 percent of GDP in 2010. The share of primary current expenditure in total expenditure declined, however, from 71.4 percent in 2004 to 59.5 percent in 2010. This trend was underpinned by a significant decline in the share of the wage bill, a sharp rise in expenditures on subsidies and transfers, and a moderate increase in spending on goods and services. These trends are discussed in detail below.

Table 2.2 : Budget expenditure as a share of total expenditure in real terms, payments basis (%)

	2004	2005	2006	2007	2008	2009	2010	Average 2004-10
Current primary expenditure	71.4	62.7	58.3	61.8	60.5	62.5	59.5	62.4
Wages	41.7	32.6	34.7	34.8	26.9	27.8	22.8	31.6
Transfers	10.7	11.7	9.5	13.7	16.9	16.3	17.0	13.7
Goods & services	19.0	18.5	14.2	13.4	16.8	18.3	19.8	17.1
Interest due	9.1	5.3	6.5	10.9	11.6	6.9	5.2	7.9
External	5.8	2.8	3.9	3.3	6.3	2.7	1.1	3.7
Domestic	3.2	2.5	2.5	7.5	5.3	4.2	4.1	4.2
Capital expenditure	19.5	31.9	35.2	27.3	27.9	30.6	35.3	29.7
Domestically financed	8.2	7.0	7.0	8.6	7.2	6.1	5.8	7.1
Foreign financed	11.3	24.9	28.18	18.8	20.7	24.5	29.5	22.5

Source: Author's calculations based on IMF tables

The Public Wage Bill

2.12 **As a share of GDP the wage bill declined from a high of 5.8 percent in 2004 to 4.3 percent in 2008.** Following a sharp hike in 2004 the growth in the wage bill decelerated from 2005 to 2008. These years of negative growth were followed by positive growth in 2009 and 2010 with wage expenditure growing by 3.3 percent on average in real terms over these two years, most of the growth occurring in 2009. As a share of total expenditures the wage bill declined from 41.7 percent in 2004 to 22.8 percent

in 2010; and as a share of current primary expenditures, it declined from 58.3 percent in 2004 to 38.3 percent in 2010.

Table 2.3 : Total expenditures, growth rates in real terms, 2004-2010 (Payments basis, %)

	2004	2005	2006	2007	2008	2009	2010	Average 2004-10
Total expenditure	11.8	25.1	-16.4	-0.6	22.2	1.8	23.9	9.7
Wages & salaries	15.5	-2.0	-11.2	-0.3	-5.5	5.4	1.3	0.5
Transfers & subsidies	39.6	36.2	-32.0	43.4	50.7	-1.4	28.9	23.6
Goods & services	11.5	21.2	-35.8	-6.2	53.2	11.2	33.6	12.7
Interest due	9.8	-26.8	1.6	66.8	30.1	-38.9	-7.1	5.1
External	12.4	-39.9	17.2	-14.3	125.3	-56.1	-51.8	-1.0
Domestic	5.5	-3.3	-15.9	193.2	-12.4	-19.5	21.6	24.2
Capital expenditures	-4.4	104.9	-7.9	-22.7	24.8	11.5	43.1	21.3
Domestically-financed	-25.2	6.9	-16.6	21.5	3.5	-14.1	18.3	-0.8
Foreign-financed	19.9	176.1	-5.5	-33.7	34.6	20.4	49.3	37.3

Source: Author's calculations based on data from MoFB and IMF

2.13 Despite the overall declining trend, the wage bill remains the single largest item in the budget, accounting for 32 percent of total expenditures and more than 50 percent of current primary expenditures in 2004-2010. The security sector, in particular, exerts a strong pressure on the wage bill. In 2008, for instance, the security sector alone (Defense and Public Security) accounted for 36 percent of the total wage bill, one of the highest in the sub-region. In comparison, education and health accounted for 20.5 percent and 7.3 percent of the wage bill, respectively.

Figure 2.1 : Economic classification of the budget, Average 2004-10 (% , Payment basis)

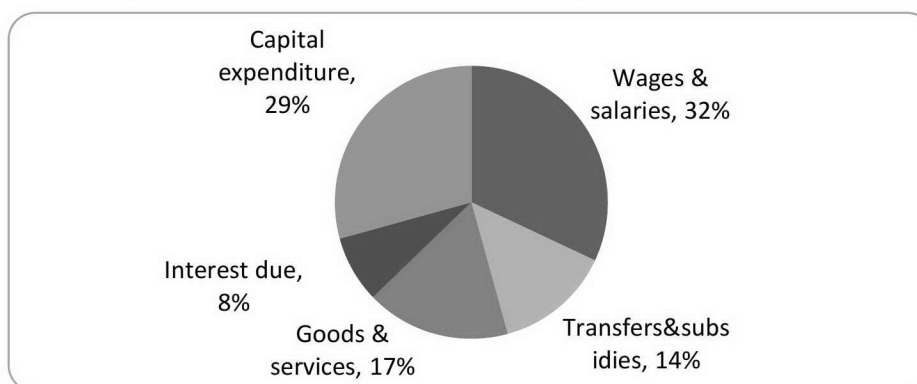
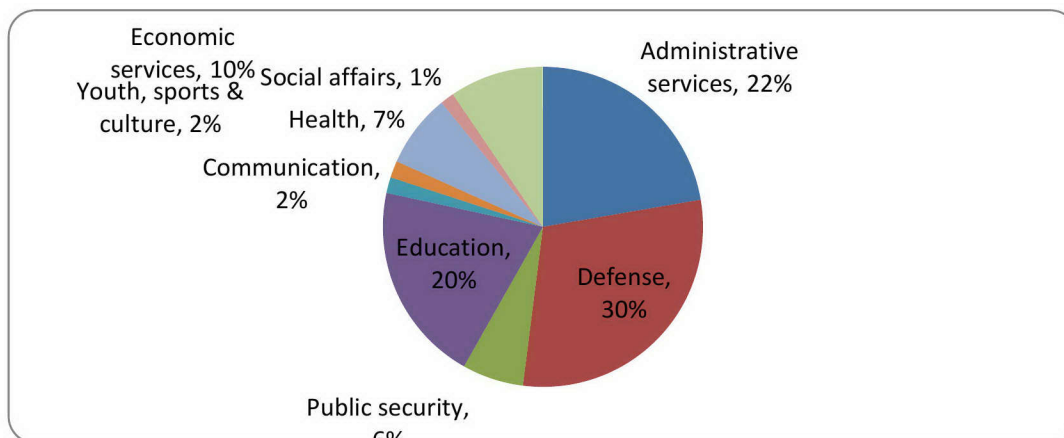


Figure 2.2 : Functional allocation of the wage bill (% , Payment basis)



Source: Author's calculations

2.14 The relatively strong rebound in 2009 suggests that the wage bill needs to be carefully monitored to contain its further expansion. The government has made the regular payment of salaries a priority; and by end-2010, it had cleared all the months of salary arrears that had accumulated since 2003. The wage bill is projected to grow by 5.5 percent in real terms in 2011, faster than the average for 2009 and 2010, as resources are provided to cover the financial costs of workers' advancement in the pay scale that took place in 1997-2003 and to pay for the recruitment of additional workers in education, health, and agriculture as well as their upgrade to full civil service status. These efforts are important; however, rapid growth in wage expenditures in the absence of sector reforms to improve the productivity of public workers, and in an environment of economic slowdown, poses the risk of crowding out government operational and capital expenditures.

2.15 The entire civil service, with 17,000 civil servants, is small in relation to the overall population but absorbs a relatively large share of public expenditures. Nevertheless, controlling the wage bill need not require reducing the wages of public workers. In fact, given that the wage indices have been compressed for many years with no pay increase to match corresponding promotions across job grades, public wages will need to grow to become more competitive with the wages of other sectors of the economy. This means that reforms need to be undertaken to achieve a streamlined and more productive civil service.

2.16 The government should build on the initial steps it has already taken (Box 2.1) to move civil service reform to its next phase. Critical aspects of the civil service reform that need to be implemented include the following:

- **The establishment of a job nomenclature:** This will permit the constitution of a robust data base to control more closely the number of civil servants. It will also facilitate the forecasting of jobs and competencies as well as the formulation of training plans for capacity-building.
- **The development of a performance assessment system:** This will provide a tool for the efficient management of human resources. Performance evaluation of the staff should be based on clearly defined objectives and expected results.
- **The development of a remuneration system:** This will be essential in order to generate salary indices based on job grades, establish a system of incentive bonuses for high performers, develop a compensation system for public workers in de-concentrated structures, and adopt an inter-ministerial allowance structure.

Box 2.1 : Civil service reform needs to be reinvigorated

The objective of civil service reform, to build a motivated civil service and improve the delivery of public services, is a critical aspect of the government's poverty reduction strategy. The key initial steps have included the following:

Adoption of a new organizational framework: The new organizational framework includes two types of organizations, one for small ministries and one for ministries with expanded responsibilities, such as finance and education. If adequately implemented the new organizational framework will improve the operational efficiency of the civil service, including by ending the proliferation of agencies with overlapping authority.

Adoption of a new civil service statute: The civil service statute defines the rights and obligations of civil servants, the structure of the civil service, the sanctions system, and the procedures for employment termination. The statute provides the basic rules of a meritocratic civil service.

A new payroll management system is operational since October 2008. The civil servant files and wage data have been merged into a single database with clear responsibilities assigned to the Ministry of Civil Service and the Ministry of Finance for the management of the database. A computer management information system, maintained by the national informatics office, facilitates and coordinates the management of the unified database. Since 2010 all salaries are paid through the banking system.

Source: Adapted from CAR HIPC completion point document, June 2009

2.17 **In addition to advancing civil service reform the authorities would need to control the military wage bill.** With a size of 9,000 staff the military alone has averaged over 30 percent of the wage bill over the past three years, more than the wage bill of the ministries of education and health combined. The training of the military, police, and paramilitary personnel envisaged in the context of the security sector reform (Box 2.2) will have important implications for the military wage bill because of the practice of tying the salaries and benefits of the personnel in training to the pay scale of the military in the countries where the training is taking place. As the training frequently occurs in countries where salaries are relatively high, the military wage bill is likely to rise further as the training program is implemented over the PRSP period.

2.18 **In the absence of additional resources the anticipated increase in the wage bill associated with the implementation of the security sector reform is likely to crowd out expenditures in infrastructure and social sectors.** Proper costing and budgeting of the security sector reform program, in particular the staffing and training of the army and police, will be critical to ensure that the military wage bill is sustainable.

Box 2.2 : Security Sector Reform (SSR) has important wage implications

The strategic goal of the Government over the period of implementation of the PRSP 2 as regards security lies in the peace and political stability consolidation process which seeks to create a secure environment favorable to a vigorous economic re-launch, particularly in rural areas. To achieve this goal, the Government intends to continue with the medium and long-term SSR activities in order to: (i) buttress security and political stability; (ii) consolidate peace and social cohesion; and (iii) reduce poverty. Regarding territorial security, the challenge is to reorganize, train, equip and turn the Security and Defense Forces (Army, State Police, Police, Customs, Waters and Forest Rangers and Private Security Agents) into professionals. The SDF will be provided with operational capacities so that they are able to reduce threats and guarantee the security of the country as well as the protection of people and property throughout the national territory. These actions will allow the SDF to guarantee the safety and peace of the population so that it can devote itself to the socio-economic activities which the country needs to reduce poverty, particularly in the rural zones. The priority actions to be undertaken are: (i) the initial and on-going training of the Army and State Police; (ii) the initial and on-going training of police officers; (iii) the building of barracks, State Police headquarters and social housing; (iv) building and equipping police stations; (v) rehabilitating and equipping forestry, hunting and fishing training units; (vi) the social reintegration of ex-combatants of both sexes and the women and children associated with the armed groups within the framework of the DDR.

Source: Draft PRSP 2 document.

Transfers and Subsidies

2.19 Spending on transfers and subsidies was a major driver of the increase in total expenditures over the period 2004-2010. Transfers and subsidies grew on average by 27.6 percent annually in real terms in 2004-2008, before slowing to 13.7 percent between 2009 and 2010. With an average growth of 23.6 percent in real terms over the period 2004-2010 transfers and subsidies have been one of the fastest growing items in the budget. In terms of GDP, spending on transfers and subsidies more than doubled from 1.5 percent of GDP in 2004 to 3.3 percent of GDP in 2010. Its share of total expenditure jumped from 10.7 percent in 2004 to 17.0 percent in 2010; and its share of current primary expenditures increased from 15.0 percent to 28.5 percent over the same period.

2.20 The rapid growth of transfers and subsidies has crowded out spending on goods and services and domestically-financed capital expenditures. During the period of rapid increase of transfers and subsidies (2004-2008) the share of goods and services and domestically-financed capital expenditures in total expenditures declined. The share of expenditure on goods and services fell from 19.1 percent in 2004 to 16.8 percent in 2008 and the share of domestically-financed capital expenditures declined from 8.2 percent to 7.2 percent.

2.21 Transfer and subsidy payments need to be targeted more carefully in order to prevent the crowding out of essential expenditures. Transfer and subsidy payments have financed a wide range of expenditures, including pension, various transfers to national and international organizations, scholarships for students abroad and the operations of the municipality of Bangui. A significant share of the transfers was also allocated to the National Assembly to cover the benefits of parliamentarians and staff salaries. Expenditures on transfers and subsidies should demonstrate a clear prioritization of needs.

2.22 In recent years, autonomous agencies, fuel subsidies, and the demobilization, disarmament and reintegration (DDR) program have driven expenditures on transfers and subsidies. A number of autonomous agencies generate revenues through fees, user charges, special taxes and custom duties which they use to finance their operations. These agencies include the Road Fund, the Agency for the Stabilization and Regulation of Petroleum Products prices (ASRP), the Regulatory and Stabilization Agency for the Water and Sanitation sector, the Regulatory Agency for the Telecommunication sector, the Regulatory Agency for the Electricity sector, and the Autonomous Agency for Rural Electrification. The revenues thus generated have increased significantly over the past three years, rising in real terms from CFAF 3.5 billion in 2008 to CFAF 7.2 billion in 2009 and CFAF 9.5 billion in 2010, which represented respectively 19.1 percent, 39.4 percent and 44.2 percent of total expenditures on transfers and subsidies. Information and data on the use to which these resources are put are very limited, however.

2.23 There is need for greater transparency and accountability in the use of public resources by the regulatory agencies. The regulatory agencies are expected to play an important role in strengthening the regulatory framework for the efficient delivery of public services; promoting private sector participation; and enhancing overall governance. It is critical to ensure that resources affected to these agencies are put to the best use possible to facilitate the execution of their missions and avoid waste and misuse. This may entail regular audit and closer monitoring of and reporting on their operations.

Table 2.4 : Transfers to regulatory agencies, Fuel subsidies, and DDR expenditures 2008-2010

	2008	2009	2010 Prel.	2008	2009	2010
	<i>(In Billions of CFAF)</i>			<i>(in % of total Transfers & Subsidies)</i>		
Roads Fund	2.66	3.25	3.53	11.0%	13.1%	11.9%
Agency for the regulation of the prices of petroleum products	0.00	2.33	4.62	0.0%	9.4%	15.6%
Regulatory agency for water & sanitation	0.00	0.02	0.04	0.0%	0.1%	0.1%
Regulatory agency for telecom	0.00	2.23	1.72	0.0%	9.0%	5.8%
Regulatory agency for electricity	0.00	0.11	1.04	0.0%	4.2%	3.5%
Agency for rural electrification	0.00	0.17	0.16	0.0%	0.7%	0.5%
Ministry of Finance	1.96	1.63	1.85	8.1%	6.6%	6.3%
Fuel subsidy	6.93	0.29	0.10	28.6%	1.2%	0.3%
DDR	0.00	0.00	1.66	0.0%	0.0%	5.6%
Total	11.55	10.03	14.72	47.7%	40.6%	49.7%

Source: Author's calculations based on MoFB data

2.24 Fuel subsidies consume a large share of expenditures. The government fixes the domestic prices of petroleum products, which tend to be lower than world prices and to remain constant at that level. In 2008, as world fuel prices rose sharply, fuel subsidies alone amounted to CFAF 6.9 billion, accounting for 28.6 percent of total expenditures on transfers and subsidies (Table 2.4) and representing nearly 1 percent of GDP. The decline in world prices in 2009 and 2010 from their 2008 peak reduced the level of fuel subsidies.

2.25 On June 1, 2008 the government adopted an automatic quarterly petroleum product pricing formula to ensure full pass-through to the consumers of all costs, distribution margins, and taxes, including VAT at the regular rate. The budgetary impact of this measure has been substantial. It simultaneously enhanced domestic revenue mobilization and reduced the level of subsidies, which fell from a peak CFAF 6.9 billion in 2008 to CFAF 0.29 billion in 2009. However, domestic prices have not been adjusted consistently to reflect changes in the world prices of fuel and, hence, fuel subsidies continue to burden the budget.

2.26 Unless the pricing formula is implemented consistently the budget will remain highly vulnerable to increases in international prices of fuel. Petroleum taxation provides an efficient way of raising revenues in a country such as CAR that has limited revenue administration capacities. The lack of consistency in the implementation of the automatic adjustment mechanism deprives the government of much needed fiscal revenues and lowers the surplus on the domestic primary balance, undermining fiscal sustainability. In addition, the loss of petroleum revenues implies less fiscal space for spending on health, education, and infrastructure. Furthermore, the subsidies on petroleum products are not pro-poor; the subsidized products are consumed mainly by relatively better-off households.

2.27 Expenditures on the DDR program have been limited so far but the overall cost of the program is likely to place a burden on the budget in the absence of additional resources. Implementation of the DDR program since its launching in 2009 has been slow. In 2009, no transfers were recorded for DDR. The expenditures recorded in 2010 were for activities aimed at improving overall security for the 2011 presidential and legislative elections. Some 8,000 fighters are expected to be demobilized for insertion into the civil population in the context of the security sector reform program.

Purchases of Goods and Services

2.28 **Spending on goods and services was an important factor behind the moderate increase in current and total expenditures.** Spending on goods and services grew in real terms from CFA francs 16.4 billion in 2004 to CFA francs 18.4 billion in 2008 and CFA francs 27.3 billion in 2010, faster than the growth in total expenditures. However, on average, the growth in expenditures on goods and services was significantly lower than the growth of total capital expenditures, which includes foreign-financed expenditures, pointing to an imbalance between recurrent and capital spending.

Figure 2.3 : Trends in goods & services and capital expenditures 2004-2010
(Billions of CFAF, payments basis)

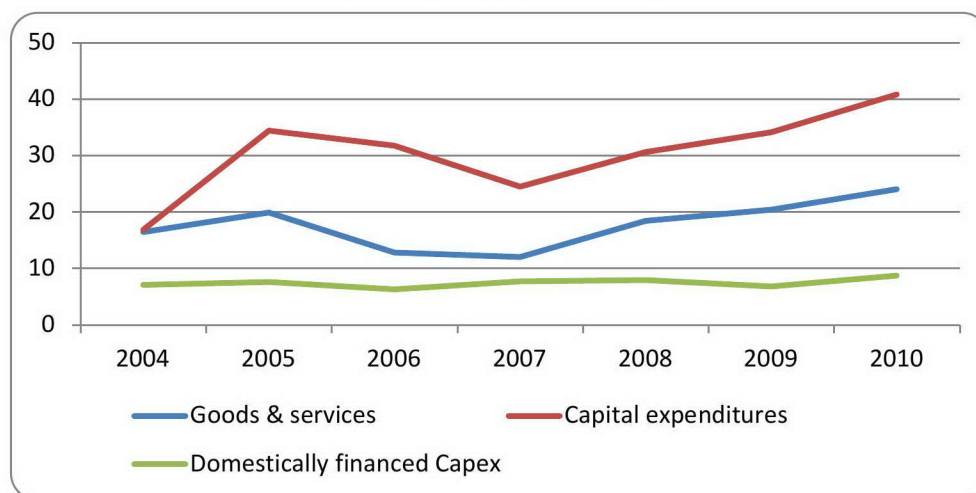
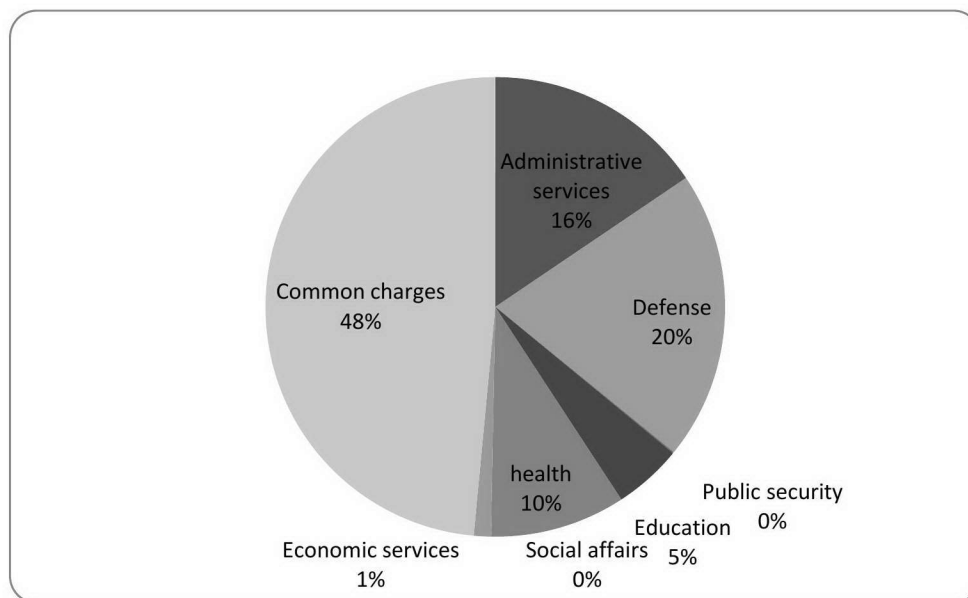


Figure 2.4 : Functional allocation of expenditures on goods & services
(average, 2008-2010, payments basis)



Source: Author's calculations based on data from MoFB

2.29 The functional distribution of spending on goods and services has been uneven with the dominance of administrative and security spending. Over the period 2008-2010, defense and security accounted for 20.4 percent of total expenditures on goods and services, and administrative services for 15.5 percent. Taken together these two sectors accounted for about 36 percent of total expenditure on goods and services over this period, compared with 4.8 percent for education, 9.5 percent for health and 1.2 percent for economic services, which include functional categories such as roads, energy, and agriculture and rural development. This dominance was most striking in 2010. In that year, the share of defense in spending on goods and services rose sharply to 26.6 percent from 12.4 percent in 2009 while the share of administrative services remained at 15.9 percent. At the same time the shares for health and education fell to 7.5 percent and 3.9 percent, respectively. These trends raise the question as to whether CAR allocates adequate resources to support the delivery of education and health services.

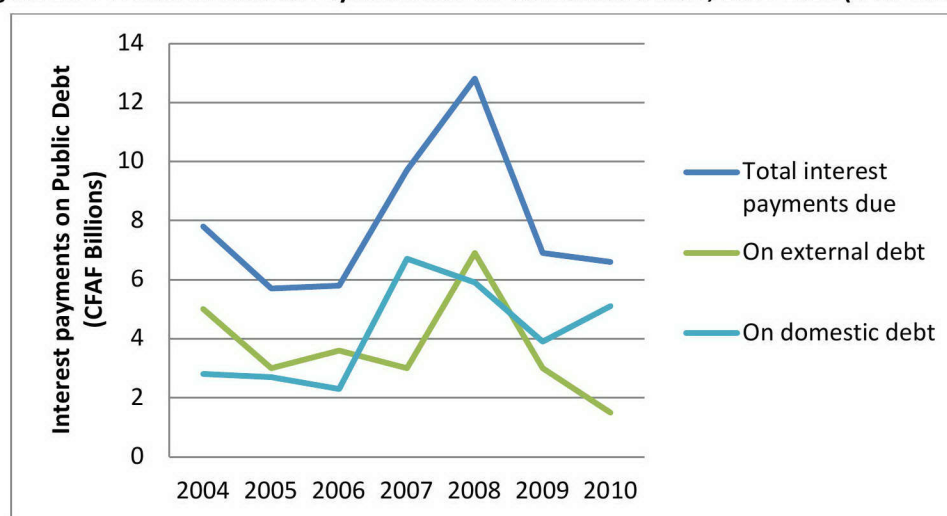
2.30 The low allocation to “economic services” suggests that operational and maintenance (O&M) expenditures have not been adequate to support infrastructure investment. In 2008, domestically-financed capital expenditures on roads amounted to CFAF 560 million; spending then rose from CFAF 300 million in 2009 to CFAF620 million in 2010. No recurrent expenditures were recorded for roads over the same period. Similarly no recurrent expenditures were recorded for reconstruction and urban infrastructure. However, as discussed above, it should be noted that a portion of resources for recurrent spending are allocated through transfers, most notably for financing the Road Fund and the regulatory agencies in the petroleum, power, and telecommunication sectors. Nevertheless the imbalance between recurrent and capital expenditures remains important even when these transfers are taken into account. Chapter 4 (Infrastructure section) highlights that road financing in CAR is a major challenge and estimates that CAR is spending on maintenance and rehabilitation around 55 percent and 10 percent less than required, respectively.

2.31 In the absence of a significant increase of funding over the coming years, resources for O&M in priority sectors will be largely insufficient. The widening imbalance will reduce the productivity of new and ongoing investment. Appropriate budgeting and actual delivery of supplies and staffing for the operation of schools and health centers will therefore be critical for the effective use of resources. Similarly, explicit plans for the cost of maintenance for the infrastructure projects that have been completed will need to be incorporated in the Finance laws submitted to Parliament.

Interest Payments

2.32 Interest payments due declined from 1.3 percent of GDP in 2004 to 1.0 percent of GDP in 2010. The decline was due to a large extent to the debt relief that CAR received from bilateral and multilateral creditors upon achieving the HIPC completion point in June 2009. In 2010 interest payments due on foreign debt accounted for just 1.1 percent of total expenditures, and represented 0.2 percent of GDP.

Figure 2.5 : Trends in Interest Payments due on Government Debt, 2004-2010 (CFAF Billions)



Source: Author's calculations based on data from MoFB

2.33 **While total interest payments due declined interest payments due on domestic debt increased in real terms from CFAF 2.8 billion in 2004 to CFAF 5.7 billion in 2010.** These interest payments are mostly on the government debt to the central bank and commercial banks. Borrowing from commercial banks is particularly expensive, with interest rates varying from 15 to 17 percent per year. The government has developed a strategy to reduce borrowing from commercial banks. In August 2009 it signed new conventions with each of the four domestic commercial banks, which consolidated past loans into one new loan with a lower interest rate (9 percent), a grace period of 6 months, and 3-year to 3½-year maturities. Reducing the weight of domestic debt will be critical to opening up a fiscal space in the budget.

2.34 **Despite the recent improvements in debt indicators risks to the government's budget remain substantial and improvements in debt management are essential to avoid future debt distress.** The government has made some progress in this regard in two areas. It has set up a computerized Debt Management and Financial Analysis System (DMFAS) in the debt department at the ministry of finance; and the inter-ministerial National Committee for Public Debt (NCPD) was created.

2.35 **The computerized Debt Management and Financial Analysis System permits the production of debt reports.** The debt records in the database contain data on domestic, external, and guaranteed debt of the central government. The database helps the debt department produce periodic debt data with short lags, providing valuable information on government debt.

2.36 **The National Committee for Public Debt will help coordinate and monitor the implementation of the government debt strategy.** The NCPD will play a central role in ensuring that the government follows a prudent debt policy centered on maximizing concessional borrowing. The creation of the NCPD will also strengthen the legal framework for domestic and external borrowing and facilitate the coordination of debt management with the conduct of macroeconomic policy.

2.37 **To ensure that the progress of recent years in public debt management is sustained, a strong focus on capacity-building and the training of the staff in the Directorate of Public Debt will be critical.** In order to further improve debt management the following activities need to be undertaken:

- **Consolidate the mandate of the debt department in the context of the NCPD.** In particular, the debt department needs to strengthen its capacity to formulate the national debt strategy and debt management, and implement the manual of procedures covering the chain of transactions involved in borrowing operations.
- **Reinforce the operational capacity of domestic debt management** to ensure that there is a full coverage of domestic debt for non-central government institutions and agencies (public and publicly guaranteed debt by institutions other than the central government, particularly public enterprises), an appropriate follow-up on the transactions, particularly in terms of closing the conventions with commercial banks on outstanding debt, and processing of data on municipal domestic debt; and
- **Reinforce the analytical capacity of debt management to provide policy makers with different scenarios and policy options.**

Capital Expenditures

2.38 **Capital expenditures have been recovering but remain below their pre-crisis level.** After rising to 5.4 percent of GDP in 2005 from 2.7 percent of GDP in 2004 capital expenditures declined steadily before picking up in 2008 to reach 6.8 percent of GDP in 2010. For the period 2004-2010 capital expenditures averaged 4.7 percent of GDP; this compares with 8.3 percent of GDP in the 1990s.

Foreign-financed Capital Expenditure

2.39 **The recovery in capital expenditures is due primarily to donors' re-engagement following the end of conflict in 2003.** Foreign-financed capital expenditure nearly tripled in 2005 from its level in 2004, rising from 1.6 percent of GDP to 4.2 percent of GDP, and accounted for 78 percent of total capital spending and 25 percent of total expenditures. In 2006, foreign-financed capital expenditure accounted for 80 percent of total capital expenditure and 28.2 percent of total expenditures. It reached a new peak in 2010, amounting to 5.7 percent of GDP, as donors provided project and budget support grants (Box 2.3) to help mitigate the economic and poverty impact of the global slowdown. For the period 2004-2010 foreign-financed capital expenditure averaged 3.6 percent of GDP.

Table 2.5 : Foreign financed Capital Expenditures, 2004-2011 (in CFAF Billions, payments basis)

	2004	2005	2006	2007	2008	2009	2010	Average 2004-10
Nominal (CFAF billions)	10.5	29.9	30.2	20.2	29.7	37.0	56.1	30.5
Adjusted by CPI deflator	9.7	26.9	25.4	16.8	22.6	27.3	40.7	24.2
Annual growth rate (%)	19.9	176.1	-5.5	-33.7	34.6	20.4	49.3	37.3
As percent of GDP (%)	1.6	4.2	3.9	2.5	3.3	4.0	5.7	3.6
As percent of total capital expenditure (%)	57.9	78.0	80.1	68.7	74.1	80.0	83.5	74.6
As percent of total expenditure (%)	11.3	24.9	28.2	18.8	20.7	24.5	29.5	22.5

Source: Author's calculations based on data from MoFB

Box 2.3 : Donor Funds for CAR Budget

Donor funds are a critical source of financing for the Central African Republic, both for investment and technical assistance. Over the period 2004-2010 donor financing recorded in the budget, excluding HIPC and MDRI debt relief, amounted on average to CFAF 41.7 billion or approximately US\$100 million annually in real terms. About US\$58 million are in grants and concessional loans for investments, and about US\$42 million in budget support. The 2011 budget projects a significant increase in donor financing to US\$67.3 million, the bulk of it in project loans and grants for investments. With this increase, donor financing will amount to US\$150 million in real terms.

Table 2.6 : Donor financing, 2004-2011 in real terms (Payments basis, CFAF billions)

Budget Grants and Loans	2004	2005	2006	2007	2008	2009	2010	Average 2004-10	2011 Budget
Project grants	7.3	24.0	22.9	16.8	22.6	24.2	35.2	21.8	25.8
Project loans	2.4	2.9	2.5	0.0	0.0	3.1	5.6	2.4	32.0
Budget support grants	13.7	2.4	63.6	11.0	9.6	12.2	10.0	17.5	9.5
Total	23.4	29.3	89.0	27.8	32.2	39.5	50.8	41.7	67.3

Source: Author's calculations based on data from MoFB

2.40 Most donor-financed investment projects are executed by recipient entities but under parallel structures not well integrated into the government public financial management system. Donor-funded investment projects are managed and executed through Project Implementation Units (PIUs). PIUs are stand-alone units created within recipient agencies to execute the investment projects; they are established with the objective of ensuring that the fiduciary requirements of donors are enforced. Thus, they tend to follow special procedures with regard to procurement, payments, and financial reporting.

2.41 As most of the donor aid is disbursed through extra-budgetary channels it is difficult to establish with precision the sectoral distribution of the actual donor-financed capital expenditures and the activities that are financed within each sector. Available data suggest that, in general, donor spending appears to have favored the priority sectors in the PRSP, including infrastructure (e.g., roads, energy, and public works), health, education and agriculture and rural development. However, a comprehensive sectoral analysis of foreign-financed capital expenditures remains difficult.

2.42 Information on external development assistance flows is improving but needs to be updated, reported more systematically, and aligned with budget data. In 2008, with the support of donors, the government set up a development assistance database (DAD) to record donor flows as part of efforts to monitor the implementation of the PRSP. The database contains donors' projects and their total cost; and for each project the database records commitments, disbursements, and actual expenditures. The creation of this database is an important development that needs to be sustained by ensuring that donor flows are systematically recorded, the database is frequently updated, and the information is published. Going forward, the data on commitments, disbursement and payments originating from PIUs should be closely aligned with budget to permit a consistent analysis of public expenditure.

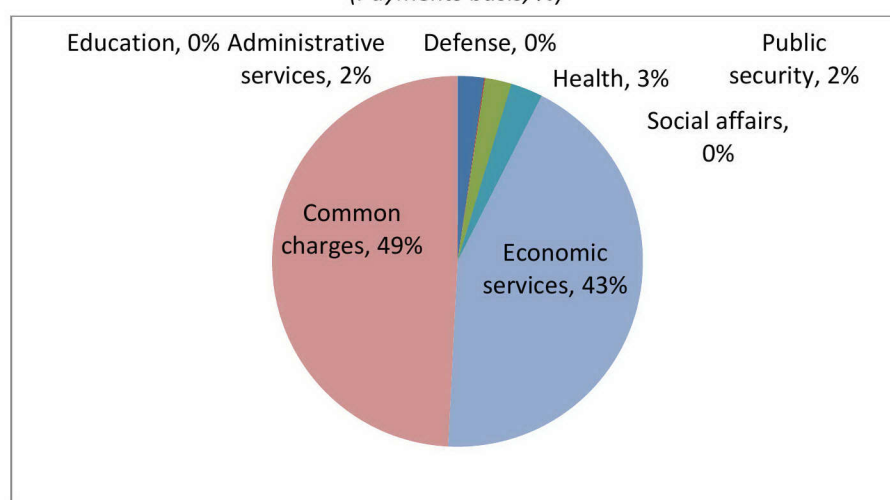
Domestically-financed capital expenditures

2.43 While total expenditures have increased domestically-financed capital expenditures have remained weak, representing just 1.1 percent of GDP over the period 2004-2010. From a relatively low level of CFAF 7.9 billion in 2008 in real terms domestically-financed capital expenditures declined to CFAF 6.8 billion in 2009 before rising to CFAF 8.1 billion in 2010. A large portion of these expenditures

represents the counterpart funds to the donor-financed projects. Domestically-financed capital expenditures have not only been low but a large portion of these expenditures has also been significantly under-executed, suggesting a crowding-out effect as well as inadequate implementation capacity in line ministries.

2.44 The allocation of the domestically-financed capital expenditure has been directed at economic services in line with PRSP priorities but the social sectors have been neglected. In terms of its composition, domestically-financed capital spending was concentrated to a significant extent on “economic services”, which includes the infrastructure sectors as well as agriculture. Economic services received on average 43 percent of the government capital budget over the period 2008-2010. However the allocation of spending to the functional sub-categories has been less than consistent. For instance, the share of roads declined from 5.4 percent to 3.2 percent in 2010 before rising to 5.2 percent in 2011; and the share of energy and water fell sharply from 16.4 percent in 2008 to 1.5 percent in 2009 and 0.6 percent in 2010. On the other hand the share of agriculture and rural development rose sharply from 1.5 percent in 2008 to 23 percent in 2009 and 23.6 percent in 2010. “Administrative services” saw their share rise steadily from 0.2 percent in 2008 to 1.9 percent in 2009 and 4.8 percent in 2010. The share of education, by contrast, has been negligible, amounting to just 0.1 percent in 2010; while the share of health increased from 1.6 percent in 2008 to 1.8 percent in 2009 and 4.9 percent in 2010.

Figure 2.6 : Functional distribution of domestically-financed capital expenditures, Average 2008-2010
(Payments basis, %)



Source: Author's calculations

2.45 Looking ahead, the domestic capital budget should be more focused on growth-enhancing investments and basic services. Given the country's large needs and the deteriorated state of the capital stock capital spending in CAR should be expected to be higher than its current level. Moreover actual spending should reflect a clear focus on investments that support economic growth and enhances the delivery of basic services, such as electricity and water and sanitation. Over the period 2008-2010 almost half of the domestically-financed capital expenditures were registered as common charges, which can be a source of waste and inefficiencies. In 2008, common charges represented 53.3 percent of the domestically-financed capital expenditures. This share fell to 45.6 percent in 2009 and rose to 48.3 percent in 2010.

Table 2.7 : Sectoral allocation of domestically financed capital expenditures, 2008-2010
(in percent of executed budget, payments basis)

	2008	2009	2010	Average 2008-10
	<i>Share of executed budget (%)</i>			
Administrative services	0.2	1.9	4.8	2.3
Defense	-	0.0	0.4	0.1
Public security	-	7.0	-	2.3
Education	-	0.0	0.1	0.0
Communication	-	0.0	-	-
Youth, Sports & culture	-	0.0	-	-
Health	1.6	1.8	4.9	2.8
Social affairs	-	0.0	-	-
Economic services	44.9	43.7	41.4	43.3
Roads	5.4	3.2	5.2	4.6
Reconstruction and urban	5.3	5.3	2.4	4.3
Energy & hydraulics	16.4	1.5	0.6	6.2
Post & Telecom	-	0.0	-	-
Commerce & industry	-	0.0	-	0.0
Rural development	1.5	23.0	23.6	16.1
Forestry	15.3	8.6	7.4	10.4
Other economic services	1.0	2.1	1.3	1.5
Common charges	53.3	45.6	48.3	49.0
Total	100.0	100.	100.0	100.0
Source: Author's calculations				

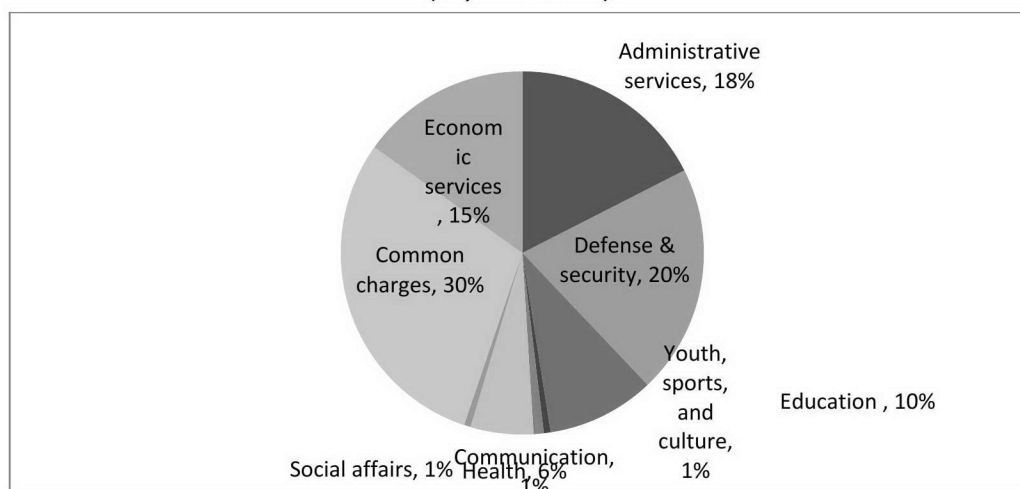
D. ALLOCATION OF BUDGET EXPENDITURES: FUNCTIONAL CLASSIFICATION

2.46 **The multi-sector category, common charges (“*dépenses non-reparties*”), stands out as the dominant functional spending category.** Officially it represents expenditures that cannot be assigned to a specific sector such as health or education in the budget nomenclature. It includes items such as interest payments and the reimbursement of principal on foreign and domestic debt, which accounts for its large size. Yet, even excluding interest payments and debt reimbursement, it remains the largest spending category, consuming more than 35 percent of government's aggregate spending in 2008. This is because it also includes items such as transfers and subsidies, goods and services, and domestically-financed capital expenditures. Common charges have been particularly prevalent under spending on goods and services and domestically- financed capital expenditures, accounting for 47 percent and 49 percent of these expenditures on average over the period 2008-2010, respectively.

2.47 **However, over the past few years, the common charges category has been declining as a share of total expenditures, reflecting in part the reduction in debt payments.** This, in turn, has made possible an increase in spending on economic services and public administration. Within economic services, roads, energy and water, and agriculture and rural development have seen their share of the budget rise relatively.

2.48 **The analysis of the functional distribution of the budget over the period 2008-2010 shows that overall CAR spends a disproportionate share of the budget on administrative activities and security.** The total share of the social sector (education, health, social affairs) spending has stagnated over the period under analysis. This is especially the case for spending on health, education and social protection services. However, a steady shift of resources toward economic infrastructure and agriculture can be observed.

Figure 2.7 : Functional allocation of total executed budget, average 2008-2010
(Payments basis)



Source: Author's calculations

Table 2.8 : Functional distribution of executed budget, 2008-2010
(In percent, payment basis)⁴

	2008	2009	2010	2011 Budget
<i>Share of executed budget (%)</i>				
Administrative services	15.4	17.6	19.4	23.8
Presidency	1.5	3.4	2.9	2.5
National Assembly				
Justice	1.3	1.4	1.3	1.5
Foreign affairs	2.2	2.2	2.6	2.8
Finance	5.5	5.5	4.3	5.9
Defense	17.3	16.1	19.6	17.4
Public security	2.5	3.0	2.5	2.2
Education	9.6	10.3	9.1	13.7
Communication	0.7	0.6	0.6	0.9
Youth, Sports & culture	0.5	0.7	1.4	1.1
Health	5.9	5.7	5.3	8.9
Social affairs	0.6	0.6	0.5	1.2
Economic services	11.2	16.0	18.4	18.4
Roads	3.7	4.0	4.2	5.0
Energy & hydraulics	2.6	3.2	5.6	2.9
Post & Telecom	0.1	2.3	2.0	2.6
Commerce & industry	0.3	0.4	0.7	0.6
Rural development	1.6	3.4	3.6	3.3
Forestry	2.4	1.6	1.5	1.9
Other economic services	0.6	1.1	0.7	2.1
Common charges	36.4	29.4	23.2	12.5
Total	100.0	100.	100.0	100.0

Source: Author's calculations based on MoFB data

⁴ Net of foreign-financed capital expenditures and interest payments.

Administrative services and Security sector

2.49 Efforts to reduce the share of the budget allocated to general administrative services and security over the next several years will be necessary to create fiscal space in the budget. Over the period 2008-2010 administrative services and security (defense and public security) dominated government spending. The two sectors combined consumed on average 38 percent of the resources during the period under analysis, with their share rising continuously from 34.2 percent in 2008 to nearly 41.5 percent of total government spending in 2010.

2.50 The dominance of these categories of expenditures was particularly pronounced in 2010. Outlays for general administrative services rose from CFAF 10.6 billion in 2008 to CFAF 16.6 billion in 2010 in real terms, an increase of more than 50 percent. The outlays in 2010 represented 19.4 percent of total expenditures, compared with 14.9 percent for health, education and social protection combined.

2.51 Given the high share of the budget dedicated to general administration services, it is important to examine closely the activities that are financed under this category. Costs related to legislative (e.g., the National Assembly) and executive bodies (e.g., the Presidency) made up about 11 percent of the budget on average during the review period. In 2010 these costs were driven by the sharp increase in the allocation of transfers to the National Assembly, which accounted for 5.3 percent of total expenditure. In addition to paying the benefits of the members of Parliament these expenditures also included allocation to the Independent Electoral Commission for the general elections. Financial and fiscal bodies led by the Ministry of Finance accounted for about 5 percent of the budget; and Foreign affairs accounted for 2 percent of the budget.

2.52 Spending on defense and public security remained relatively high over the review period, with a combined allocation of 20 percent on average. Spending on defense alone averaged 17.7 percent over the period 2008-2010. From 17.4 percent in 2008, it declined slightly to 16 percent in 2009 and rose to 19.6 percent of total expenditures in 2010. The relatively high defense spending in 2010 reflected spending for DDR and military operations to boost security in the run-up to the presidential and legislative elections.

Social Sectors

2.53 The social sectors (education, health, and social affairs) accounted for about 15.9 percent of total public expenditures on average during 2008-2010. Education was the largest of the three social sectors, at 9.7 percent of the executed budget, followed by health at 5.6 percent and social protection at 0.6 percent. The allocation for education fluctuated, rising from 9.6 percent in 2008 to 10.2 percent of the budget in 2009 and declining to 9.1 percent of the budget in 2010. The allocation for health fell continuously over the period from 6 percent of the budget in 2008 to 5.6 percent in 2009 and 5.3 percent in 2010. The allocation for social protection was the lowest, remaining largely below 1 percent of the executed budget over the period.

2.54 Overall, the total allocation for the social sectors stagnated over the 2008-2010 period, rising slightly from 16.2 percent of expenditures in 2008 to 16.4 percent in 2009 and then falling to 14.9 percent of the budget in 2010. Over this period, the education and health sectors benefitted from foreign-financed expenditures. Data from the development assistance database (DAD) indicate that over the period 2008-2010 actual donor-financed expenditures averaged about 0.5 percent of GDP for

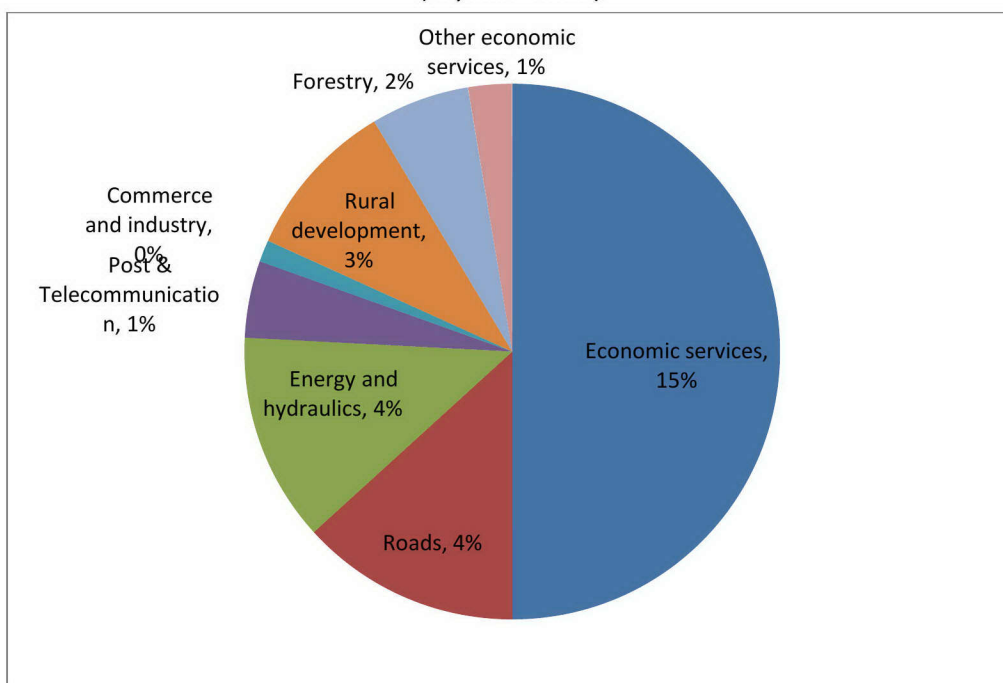
education and 1.2 percent of GDP for health. Thus, even if foreign-financed expenditures are taken into account, the allocation for education would remain largely below the allocation suggested by “Education for All” (20 percent of the budget) to achieve quality universal primary education; the allocation for health would remain much less than the target of 15 percent of the budget that heads of state agreed to in the 2001 Abuja Declaration; and the overall allocation for the social sectors would still be much less than the allocation for administrative services and security (donor financing for health and education is discussed in greater detail in chapter 4).

Economic Services

2.55 The allocation for economic services increased steadily to reach 15.2 percent of total expenditures over the period 2008-2010. The allocation for economic services increased from 11.2 percent of the executed budget in 2008 to 16 percent in 2009 and then to 18.4 percent in 2010 in real terms, driven by increased spending on infrastructure – mainly roads, energy, ICT - and on agriculture. The increased spending in the ICT, roads and energy sectors reflects the rise in transfer payments for the road fund and other regulatory authorities; for agriculture, it was due to an increase in the allocation for domestically-financed capital expenditures. The following trends and highlights stand out:

- The sharpest increase was in the ICT sector, which saw its share of the executed budget rise in real terms from zero percent in 2008 to 2.3 percent in 2009. The ICT sector has been one of the fastest growing sectors of the economy, with rising private sector investment. The increased budget spending reflected the need to strengthen the regulatory framework. However, the allocation for ICT declined to 1.9 percent of the executed budget in 2010.
- The second largest increase was in agriculture and rural development, which saw its share of the executed budget rise by about 70 percent in real terms, from 1.6 percent in 2008 to 3.4 percent in 2009 and 3.6 percent in 2010. Despite this increase, the allocation for agriculture remains modest, averaging just about 3 percent of total expenditures over the period 2008-2010, largely below the PRSP objectives in which rural development is a key priority to reduce poverty.
- Allocations to the mining, power and hydraulic sector (which includes water supply and sanitation) increased by about 61 percent in real terms, with its share of the executed budget rising from 2.6 percent in 2008 to 3.2 percent in 2009 and 5.6 percent in 2010. For the period 2008-2010 as a whole the sector accounted for 3.8 percent of the executed budget. The increased spending in the sector was due mostly to transfer payments to the regulatory agency; but there was also an increase in operation and maintenance spending.
- The share of the executed budget allocated to the road sector increased steadily from 3.7 percent in 2008 to 4.2 percent in 2010, reflecting transfers to the road fund.

Figure 2.8 : Functional distribution of the Economic Services budget, average 2008-2010
(Payments basis)



Source: Author's calculations

Priority Sectors

2.56 **Overall, the share of the budget allocated to the priority sectors rose moderately.** The priority sectors are defined in the PRSP as agriculture and rural development, education, infrastructure (transport), health, and social affairs. Their combined share of the executed budget initially increased from 21.4 percent in 2008 to 24 percent in 2009, but it was limited at 22.7 percent in 2010. This trend reflected mostly the decline in the allocation to the social sectors in 2010. It is worth noting that the decline in the allocation to the priority sectors in 2010 contrasts with the sharp increase in the combined allocation to defense and public security, suggesting a crowding out effect.

Table 2.9 : Budget allocations to priority sectors, 2008-2010 (Payments basis)

	2008	2009	2010	2011 Budget
<i>Share of executed budget (%)</i>				
Agriculture & rural development	1.6	3.4	3.6	3.3
Education	9.6	10.3	9.1	13.7
Health	5.9	5.7	5.3	8.9
Infrastructure (transport)	3.7	4.0	4.2	5.0
Social affairs	0.6	0.6	0.5	1.2
Total	21.4	24.0	22.7	33.1

Source: Author's calculations based on MoFB data

2.57 **To gauge more accurately the share of the budget allocated to the priority sectors it is important to take into account donor funding.** Donors direct their funding primarily to the priority sectors as part of their support for the government's poverty reduction strategy, and this funding

represents an important share of the budget of the priority sector ministries. Isolating donors' spending remains difficult, however, as donor-financed expenditures are executed outside the normal budget process through project implementation units as mentioned above. Table 2.10 below attempts to provide an indication of the magnitude of donors' spending in the social sectors. It presents data on donors' commitments and expenditures on development projects in education, health, rural development, and transport as recorded in the development assistance database. The data suggest that an important volume of expenditure, averaging about CFAF 31 billion in nominal terms annually (3.3 percent of GDP on average), has been financed by donors in the priority sectors over the period 2008-2010, with health and transport as the main recipients. While these data represent welcomed efforts from the government to monitor donor financing they should be treated with caution, however. They are not well aligned with the budget cycle, display considerable fluctuations from year to year, and exceed significantly the provisions of donor financing included in the finance laws.

Table 2.10: Donor funding in Priority sectors, 2008-2010 (in CFAF Billions)

	2008		2009		2010	
	Commitment	Expenditure	Commitment	Expenditure	Commitment	Expenditure
Education	1.80	0.90	25.50	3.04	1.99	8.52
Health	30.15	12.83	8.34	12.35	21.25	7.28
Rural development	10.26	8.40	13.15	3.08	1.57	0.82
Transport	44.63	11.11	0.03	9.93	38.23	14.25
Total	86.84	33.24	47.02	28.40	63.04	30.87

Source: Author's calculations based on data from Development Assistance Database (DAD), Ministry of Economy and Planning

E. BUDGET EXECUTION

2.58 Budget execution over the period 2008-2010 has been highly variable with significant under-execution and over-execution in functional areas. The total budget execution rate averaged 105.7 percent, ranging from a high of 109.6 percent in 2008 to a low of 102.5 percent in 2009.

2.59 The budget execution rates for the social sectors have been relatively low. The execution rate of the education budget averaged 74.4 percent over the period 2008-2010. The execution rate was especially low on domestically-financed capital expenditures at 1.6 percent in 2010 with no recorded expenditures in 2008 and 2009. The execution rate of the health budget fell throughout the period from 76.5 percent in 2008 to 72.8 percent in 2009 and 64.1 percent in 2010. The main factors behind this trend were the low execution of the domestically-financed capital expenditures, which average 32 percent, and the sustained decline in the execution of the goods and services budget over the period. The execution rate of the social protection budget fluctuated, ranging from a high of 60.5 percent in 2008 to a low of 42.3 percent in 2010. This was due also to the poor execution of the goods and services budget, which averaged just 6 percent over the period.

2.60 These figures suggest that the relatively low allocation to the social sectors may be due in part to inadequate budget execution, especially on the budgets for goods and services and domestically-financed capital expenditure. This outturn is worrisome because it suggests health centers and schools are not functioning as expected and domestic investment to rehabilitate existing structures or build new infrastructure is not taking place despite the pressing needs to improve service delivery. It also highlights CAR's heavy dependence on donors to finance capital expenditures in the priority sectors.

Table 2.11: Execution rate of total budget, in percent (%)

	2008	2009	2010	Average 2008-2010
Administrative services	67.7	72.6	79.9	73.4
Defense	119.6	104.8	116.5	113.7
Public security	72.0	87.9	113.7	91.2
Education	74.3	75.4	73.6	74.4
Communication	103.1	65.7	62.3	77.1
Youth, Sports & culture	55.9	68.7	124.8	83.2
Health	76.5	72.8	64.1	71.1
Social affairs	57.5	60.5	42.8	53.6
Economic services	75.1	92.8	108.5	92.1
Roads	67.9	83.7	88.3	80.0
Energy & hydraulics	444.6	101.7	208.9	251.7
Post & Telecom	62.4	195.2	188.2	148.6
Commerce & industry	75.2	75.5	111.7	87.5
Rural development	48.6	111.3	120.2	93.4
Forestry	101.3	56.4	68.5	75.4
Other economic services	75.1	84.2	58.6	72.6
Common charges	281.4	217.9	209.6	236.3
Total	109.6	102.5	105.0	105.7

Source: Author's calculations based on MoFB data

2.61 Budget execution for economic services improved but the performance of functional sub-categories has varied. The budget execution rate for economic services averaged 92 percent over the period, ranging from 75 percent in 2008 to 105 percent in 2010. Most notably,

- The execution rate in transport (roads) was among the lowest, at 80 percent on average. This under-execution may indicate weaknesses in absorptive capacity.
- The execution rate was high in mining, energy and hydraulics, at 251 percent on average, but highly variable ranging from 102 percent in 2009 to 209 percent in 2010 and 444 percent in 2008. Similarly the execution rate was high and variable in telecommunications, averaging 147percent over the period.
- In agriculture and rural development the execution rate increased sharply from 48 percent in 2008 to 111 percent in 2009 to 120 percent in 2010.

2.62 Budget execution has been consistently high in defense and rising in public security as well as in administrative services. In contrast, while improving, the budget execution rate in priority sectors has been low averaging just 75 percent over the period 2008-2010. The under-execution of the budget in the priority sectors reflected in particular the weak performance of the social sectors.

2.63 Common charges accounted for not only the largest functional share of the executed budget but the execution rate, averaging 236 percent over the same period, has also been among the highest. This strong performance contrasts sharply with the under-execution of the budget in the priority sectors and raises questions about the government's commitment to shifting resources for priority spending.

2.64 In terms of the economic classification of expenditure, the execution rate is particularly low on the domestically-financed capital budget. Execution was highest on the transfers and subsidies

budget, with a total execution rate at about 120 percent. The execution rate of the goods and services budget was at 117 percent, with a high of 124 percent in 2008 and a low of 111.3 percent in 2010. Execution of the wages and salaries budget was relatively more stable, at 102.5 percent; while execution of the domestically-financed capital expenditures was the weakest, ranging from a low of 67 percent in 2009 to a high of just 88.3 percent in 2008.

Table 2.12 : Execution rate of goods and services budget, in percent (%)

	2008	2009	2010	Average 2008-2010
Administrative services	65.9	90.4	68.4	74.9
Defense	106.4	93.2	148.7	134.1
Public security	23.5	2.3	2.6	9.5
Education	44.6	54.5	41.5	46.9
Communication	35.9	17.7	17.9	23.8
Youth, Sports & culture	0.0	0.0	0.0	0.0
Health	67.8	63.3	49.9	60.3
Social affairs	0.9	17.2	0.0	6.0
Economic services	2.2	57.2	50.9	36.8
Roads	0.0	0.0	0.0	0.0
Energy & hydraulics	0.0	596.5	580.8	392.4
Post & Telecom	0.0	709.3	0.0	236.4
Commerce & industry	24.2	0.0	238.5	87.6
Rural development	0.0	0.0	0.0	0.0
Forestry	0.0	0.0	0.0	0.0
Other economic services				
Common charges	32.6	277.6	260.1	290.1
Total	124.1	116.8	111.3	117.4

Table 2.13: Execution rate of domestically-financed capital expenditure, in percent (%)

	2008	2009	2010	Average 2008-2010
Administrative services	0.8	7.5	11.6	6.6
Defense	0.0	0.0	6.1	2.0
Public security	0.0	0.0	0.0	0.0
Education	0.0	0.0	1.6	0.5
Communication	0.0	0.0	0.0	0.0
Youth, Sports & culture	0.0	0.0	0.0	0.0
Health	37.4	21.2	38.1	32.2
Social affairs	0.0	0.0	0.0	0.0
Economic services	86.4	65.6	69.5	73.9
Roads	39.8	18.3	37.4	31.8
Energy & hydraulics	524.3	32.2	16.4	191.0
Post & Telecom	0.0	0.0	0.0	0.0
Commerce & industry	0.0	0.0	0.0	0.0
Rural development	21.0	237.1	250.2	169.4
Forestry	107.4	41.2	45.5	63.8
Other economic services				
Common charges	239.4	182.1	847.0	422.8
Total	88.3	66.9	70.0	75.1

Source: Author' calculations

F. PUBLIC INVESTMENT, FISCAL SPACE AND ECONOMIC GROWTH

2.65 **The fiscal analysis presented in the previous sections shows that over the period 2008-2010 the government achieved a moderate increase in budget allocations to priority sectors.** Most notably there has been a steady increase in expenditures allocated to economic services, including agriculture and economic infrastructure. However, overall, spending was mostly geared toward administrative activities and security; and allocation to health and education stagnated.

2.66 **Although the pace of spending increased over the period 2008-2010, public expenditure in CAR is relatively low averaging just 15.7 percent of GDP over the period 2004-2010.** Helped by foreign financing capital expenditure rebounded in response to construction needs. But not only has the level of domestically financed capital expenditure been low it has also been vastly under-executed including in the priority sectors. CAR's level of public fixed capital over the past few years lags that of other low income and fragile countries (see table 5.1)

2.67 **There is considerable scope and the need to improve the level, composition and allocation efficiency of public expenditure.** The overall low level of public expenditure, its consumption orientation (the rise of transfer payments), and the low budget execution rate on domestically-financed capital expenditure indicate that the budget is not geared toward addressing CAR's challenges to stimulate growth, enhance public service delivery and reduce poverty. Yet, as chapter 4 shows CAR faces important infrastructural challenges, with pressing needs to upgrade the power infrastructure and improve the road network. The government also needs to invest in health and education in order to build human capital for the economy and improve the well-being of the population.

2.68 **Reaching the growth objectives of the PRSP2 (7 percent annually) will require significant resources to boost public investment.** While the bulk of investment should be undertaken by the private sector the government has a key role to play in facilitating private investment and in providing basic infrastructure that the private sector needs and can rely on. Initial estimates developed by World Bank staff suggest that the public investments needed may easily exceed US\$350 million a year over the next 10 years. Against this background public capital expenditures, which averaged 4.7 percent of GDP annually over the period 2004-2010, are currently largely insufficient. The government needs to create sufficient fiscal space to finance productive investments in infrastructure, health, and education in order to boost economic growth, create employment and reduce poverty.

Table 2.14: Indicative annual investment needs in US dollars

Sector	Amount (US\$ million)
Transport	160
ICT	86
Power	55
WSS	47
Irrigation	1
Health	tbd
Education	tbd
Total	349

Source: World Bank staff

How can fiscal space be created and allocated in the CAR's budget?

2.69 It is first important to define what the concept of fiscal space entails and to clarify its relationship to the macroeconomic context. The Fiscal Policy for Growth and Development Interim Report defines fiscal space as a government's ability to undertake spending without impairing its solvency, that is without impairing its present and future ability to service its debt⁵. In applying this definition to CAR it is useful to make a distinction between discretionary and non-discretionary spending. Non-discretionary expenditures include expenditures such as wages and salaries, interest payments, and some transfers. When the government allocates more resources to non-discretionary expenditures it takes up more of the fiscal space that could be allocated to other categories of expenditures such as capital expenditure for enhancing health, education, and infrastructure. This PER defines fiscal space as discretionary expenditures that CAR can undertake without impairing its solvency.

2.70 In CAR, fiscal space without new borrowing can be achieved by improving revenue collection through broadening the tax base and through achieving better compliance, without increasing the tax burden. Chapter 3 deals with specific issues in selected areas of tax policy and administration and provides recommendations for achieving these broad objectives.

2.71 Fiscal space for human capital investments and for the need to upgrade and build new infrastructure could be achieved through re-allocation and a more efficient use of resources. This process would involve the reallocation of resources within the health, education and infrastructure sectors to priority expenditure areas. This process would also involve the reduction of distribution losses, improvement in the collection of bills, and pricing public services to cost recovery in the infrastructure sectors. Improving budget execution in the priority sectors would also be an important aspect of this process. Chapter 4 deals with these issues.

2.72 An additional aspect of fiscal space for public investment in CAR is to improve the public investment management system so that scarce public resources are not wasted. An effective public investment management system would create fiscal space as better planning, evaluation, and allocation would channel resources to more productive investments. Moreover, this process would permit better use of the fiscal space created in other areas of the budget. Chapter 5 analyses CAR's public investment management system and provides concrete recommendations for an improved PIM process.

Macroeconomic scenarios

2.73 To illustrate the growth impact of the fiscal space two macroeconomic scenarios are presented. The first, called the "Reform case" scenario, traces the growth path of the economy under a moderately well-implemented reform package that includes a higher level of productive public investments, improved recurrent and capital spending, better revenue policy and administration, improved public finance management, and more efficient use of donor funding. As these reform measures are also expected to improve the business climate they will promote private sector investment. The second scenario denoted the "low case" scenario, assumes slow and uneven progress on reforms. In this case, inertia dominates policy and policy makers are slow to respond to the need for reforms. It is a business as usual scenario which leads to lower levels of and unproductive investments.

⁵ Fiscal Policy for Growth and Development: An Interim Report. April 6, 2006

2.74 The projections show that rising domestic revenue would permit the public sector to increase investment in the reform case scenario above current level over the projection period. Implementation of measures to improve project execution capacity in line ministries helps to improve the investment budget execution rate. Public investment crowds in private investment, which is robust in the reform case scenario.

2.75 In the low case scenario there is no growth in domestic revenue and as a result the public sector is unable to increase public investment; in response, private sector investment stagnates. Lack of reform, weak implementation, and continued inefficiencies in resource allocation are not conducive to the creation of fiscal space. Investment, current expenditures, and revenues are lower and produce manageable fiscal deficits but no significant improvements in growth. Total investment averages 10.3 percent of GDP over the projection period, with public investment averaging 4.5 percent of GDP.

2.76 In the reform case scenario the government would manage to keep a fiscal deficit of 4.3 percent of GDP on average during 2012-2015. Although government expenditure increases in the reform case scenario it does not cause the overall fiscal deficit to deteriorate relative to its level in 2011. The reason for this is the stronger revenue outturn. While the revenue projection may seem optimistic it is not unrealistic. Macroeconomic stability ensures that the government debt indicators do not deteriorate; the public debt ratio is stable and declining.

2.77 Also in the reform case, medium-term growth of around 5.1 percent is accompanied by stable inflation and a manageable current account deficit. Growth is driven by agriculture, industry and services, which keeps inflation at a low level. The increase in investment raises the demand for imports which raises the trade deficit but a rise in foreign direct investment would mitigate the effects of imports on the current account deficit. The low case scenario forecasts lower growth, and smaller current account deficits. Slow progress in structural and tax reforms, combined with low public investments, would not lead to a substantial pick up of investment demand. As domestic investments and FDI would remain moderate, economic growth would remain around 3 percent over the medium term, almost the same as in 2011. Under this scenario per capita incomes would continue to stagnate.

Table 2.15: Reform Case Scenario: Key Macroeconomic Indicators

	Actual	Prel.	Est.	Projections			
	2004-09	2010	2011	2012	2013	2014	2015
Real GDP growth (%)	2.4	3.3	3.1	4.1	4.2	5.9	6.0
Agriculture	1.5	3.2	2.6	4.4	5.4	6.2	5.5
Industry	3.5	2.9	3.1	4.4	4.4	5.3	5.3
Services	3.3	3.2	3.3	5.0	6.0	6.0	6.8
Gross Investment (% of GDP)	10.1	15.1	12.4	14.1	15.9	16.4	16.5
Public		6.8	4.0	5.3	6.7	6.7	6.7
Private	5.7	8.2	8.4	8.8	9.3	9.7	9.8
Gross national savings (% of GDP)	4.1	5.1	5.0	7.3	9.8	11.1	11.2
GDP deflator (inflation, %)	3.4	1.7	0.3	2.8	2.1	2.6	2.5
Consumer inflation (% , annual average)	3.5	1.5	0.7	2.5	1.9	2.3	2.3
Domestic revenue (% of GDP)	9.6	11.6	10.9	11.5	12.0	12.7	12.8
Government expenditure (% of GDP)	15.0	19.4	15.9	15.6	16.9	16.8	16.7
Fiscal balance (% of GDP, excluding grants)	-5.4	-7.7	-5.0	-4.1	-4.9	-4.1	-4.0
Current account balance (% of GDP, incl. official transf.)	-6.0	-9.9	-7.4	-6.8	-6.1	-5.3	-5.2
Gross reserves (months of imports)	4.5	3.2	2.6	3.6	4.1	4.9	5.0
Public debt (% of GDP)	82.4	41.9	38.1	34.1	30.0	26.2	26.0

Source: Author's calculations based on IMF/World Bank data

Table 2.16: Low Case Scenario: Key Macroeconomic Indicators

	Actual	Prel.	Est.	Projections			
	2004-09	2010	2011	2012	2013	2014	2015
Real GDP growth (%)	2.4	3.3	3.1	4.1	3.0	2.9	2.8
Agriculture	1.5	3.2	2.6	4.4	2.3	2.0	1.7
Industry	3.5	2.9	3.1	4.4	3.8	3.8	3.8
Services	3.3	3.2	3.3	5.0	3.4	3.5	3.6
Gross Investment (% of GDP)	10.1	15.1	12.4	14.1	10.7	10.3	10.0
Public		6.8	4.0	5.3	4.6	4.4	4.2
Private	5.7	8.2	8.4	8.8	6.1	5.9	5.8
Gross national savings (% of GDP)	4.1	5.1	5.0	7.3	1.5	2.0	2.6
GDP deflator, (inflation, %)	3.4	1.7	0.3	2.8	2.5	2.5	2.5
Consumer inflation (% annual average)	3.5	1.5	0.7	2.5	2.5	2.3	2.3
Domestic revenue (% of GDP)	9.6	11.6	10.9	11.5	10.0	9.9	9.9
Government expenditure (% of GDP)	15.0	19.4	15.9	15.6	15.2	15.0	14.8
Fiscal balance (% of GDP, excluding grants)	-5.4	-7.7	-5.0	-4.1	-3.9	-3.8	-3.7
Current account balance (% of GDP, incl. official transf.)	-6.0	-9.9	-7.4	-6.8	-6.7	-6.6	-6.5
Gross reserves (months of imports)	4.5	3.2	2.6	3.6	3.1	2.6	2.5
Public debt (% of GDP)	82.4	41.9	38.1	34.1	29.7	26.4	24.7

Source: Author's calculations based on IMF/World Bank data

2.78 In sum, these scenarios present possible outcomes of the choice between creating and not creating fiscal space, of implementing or not the reform agenda, over the next five years. The simulation results show that the government can stimulate economic growth by raising the level of public investment if it makes the efforts to maintain macroeconomic stability, raise revenue by broadening the tax base, and improve the efficiency of public expenditure through sustained implementation of public financial reforms that strengthen capacity in budget execution and reporting.

G. SUMMARY OF RECOMMENDATIONS

Policy Recommendations

- a) **The wage bill should be carefully monitored to contain its further expansion.** Controlling the wage bill need not require reducing the wages of public workers. Given that the wage indices have been compressed for many years with no pay increase to match corresponding promotions across job grades, public wages will need to grow to become more competitive with the wages of other sectors of the economy. Reforms should be undertaken to achieve a streamlined and more productive civil service. The government should build on the initial steps it has already taken to carry the civil service reform forward. Critical aspects of the civil service reform that need to be implemented include the establishment of a job nomenclature, the development of a performance assessment system, and the development of a remuneration system.
- b) **The government should target more carefully transfer and subsidy payments to prevent the crowding out of priority expenditures.**
 - Transfer and subsidy payments are increasing rapidly. These payments have financed a wide range of expenditures, including pension, various transfers to national and international organizations, scholarships for students abroad and the operations of the municipality of Bangui. A significant share of the transfers was also allocated to the

National Assembly to cover the benefits of parliamentarians and staff salaries. Many of these expenditures may be justified; however, given their growing size, transfer payments should be targeted more carefully in order to prevent the crowding of essential expenditures.

- The government should require greater transparency and accountability in the use of public resources by regulatory agencies. It is critical to ensure that the increasing level of resources affected to these agencies is put to the best use possible to facilitate the execution of their missions and avoid waste and misuse. This may entail a regular audit of their operations.
 - The fuel subsidy consumes a large share of expenditures and is not pro-poor. The subsidized products are mainly used as industrial inputs or consumed by relatively better-off households. The government should consistently implement the automatic price adjustment to reduce the effect of world fuel price increases on the budget. Compensatory programs may have to be designed to ensure that the subsidy reduction does not have an overall negative welfare effect on the poor.
- c) **A significant increase in domestically-financed capital expenditure is needed to complement foreign-financed capital expenditure and provide a strong basis for private sector activities.** A key to achieving increased domestically-financed investment is to improve budget execution. This will require strengthening public financial management.
- d) **Efforts to reduce the share of the budget allocated to general administrative services and security over the next several years will be necessary to create fiscal space in the budget.** The government should aim to reduce spending on administration and the military. Spending should be re-directed from administrative activities and defense towards additional funding for basic service delivery by minimizing expenditures that do not directly benefit the public and by providing adequate recurrent expenditures to support capital investments in public service delivery. Given the importance of maintaining security and political stability this process should be gradual.

Recommendations for strengthening debt management

- e) **To ensure that the progress of recent years in public debt management is sustained, a strong focus on capacity-building and the training of the staff in the Directorate of Public Debt will be critical.** This should include the following activities:
- Consolidate the mandate of the debt department. In particular, the debt department needs to strengthen its capacity to formulate the national debt strategy and debt management, and implement the manual of procedures covering the chain of transactions involved in borrowing operations.
 - Reinforce the operational capacity of domestic debt management to ensure that there is a full coverage of domestic debt for non-central government institutions and agencies (public and publicly guaranteed debt by institutions other than the central government, particularly public enterprises), an appropriate follow-up on the transactions, particularly in terms of closing the “conventions” with commercial banks on outstanding debt, and processing of data on municipal domestic debt.

H. CONCLUSIONS

2.79 The analysis in this chapter shows that there is considerable scope as well as the need for improving the overall composition of public expenditures in CAR's public spending and for creating fiscal space in the budget to finance government reforms and productive investments in health, education and infrastructure. Resources could be made available for priority spending by targeting more carefully transfer and subsidy payments, containing the growth and the wage bill, reducing the weight of interest payments, improving budget execution, and reducing spending on administration and the military. Part of the fiscal space created could be used to finance productive public investments in health, education, and infrastructure.

CHAPTER 3: CREATING FISCAL SPACE BY BROADENING THE TAX BASE AND ENHANCING TAX ADMINISTRATION

A. INTRODUCTION

3.1 This chapter assesses CAR's ability to raise additional revenues to finance higher public investment in health, education, and infrastructure. The review of CAR's revenue performance indicates that to enhance the buoyancy of the tax system CAR will need to simplify its tax laws, broaden the tax base, modernize the taxation of key economic sectors, and strengthen the administrative capabilities of revenue authorities. In addition it would be important to promote accountability and transparency in revenue management, especially the management of natural resource revenues. A combination of a multiplicity of taxes, complex laws and weaknesses in tax and customs administration has severely undermined the effectiveness of the revenue system, and numerous exemptions have eroded the tax base. The outcome has been a weak tax system that generates a low level of domestic revenues which, in turn, constrains the ability of the government to implement its poverty reduction strategy and meet the requirements for achieving the Millennium Development Goals. The government has launched a number of reforms to simplify the tax system and modernize tax administration, which have begun to yield positive results; but, as the figures in Table 3.1 show, CAR needs to raise more revenue to increase the resources that it can use to fight poverty.

Table 3.1 : Domestic Revenue as Percent of GDP, 2000-2009

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total domestic revenue	8.9	8.9	10.8	7.7	8.1	8.1	9.5	10.3	10.4	10.8
Tax revenue	7.8	7.3	8.5	6.5	7.0	7.0	7.8	7.3	8.0	8.7
Nontax revenue	1.0	1.6	2.3	1.2	1.1	1.1	1.7	3.0	2.5	2.1

Source: IMF staff reports

3.2 The government's objective is to raise the domestic revenue ratio to about 14 percent of GDP over the next 4 to 5 years. This chapter argues that to meet this important goal, the government will need to continue its efforts to simplify the tax system, broaden the tax base, and improve tax administration to enhance compliance. These arguments are developed further below, beginning with a summary of the key findings and conclusions. These are then followed by a review of CAR's revenue performance, a discussion of key areas of reforms in tax administration and policy, an analysis of tax expenditures, and a review of the issues associated with forestry and mining taxation. The aim of this chapter is not to provide a critical review of CAR's tax system comprehensively but to highlight challenges and opportunities for reforms in tax policy and administration that could boost domestic revenue.

B. SUMMARY AND MAIN POINTS

3.3 The immediate priority for the government should be to continue the reforms aimed at simplifying the tax system. Several important measures have been taken in the context of the 2011 Finance Law. Most notably, a simplified tax system for small enterprises has been introduced, the second and reduced rate on VAT has been abolished, and the business license fee is being transformed into a tax on company income. These reforms are promising and there appears to be a strong commitment within government to continue the simplification efforts. Going forward, the government

would need to gear these reforms toward creating a tax environment conducive to private investment through a greater simplification of income tax and a rationalization of tax administration procedures to lower tax-induced constraints to business entry and operations.

3.4 The tax base needs to be broadened over the short and medium term through greater administrative efforts and by tightening the granting of exemptions. Once tax laws have been simplified the authorities should endeavor to increase significantly the number of taxpayers, in Bangui as well as in the provinces, and to better control their activities. To make this control possible and effective the computer system of the tax department should be extended to capture strategic entry points so as to generate a comprehensive database on taxpayers' imports. In addition, ongoing efforts to strengthen the exchange of information and enhance coordination with the customs administration, including linkages between tax and customs IT application, will need to continue. To tighten exemptions it will be necessary to stop granting them and a review of the exemptions that have already been granted should be undertaken with a view to either significantly reduce them or not renew them.

3.5 Domestic revenue mobilization in CAR is constrained in part by a low taxable capacity. CAR's tax revenue collection problems are to a significant extent structural. The country's low income level and low economic integration (due in part to its landlocked position), the numerous hard-to-tax sectors (e.g., small businesses, small-holder agriculture), the difficulties in controlling the entire territory due to insecurity, and a large informal sector impose serious constraints to the mobilization of domestic revenue to its full potential.

3.6 For these reasons, a rapid increase in tax revenue growth is unlikely in the short run. CAR has no new tax handles that it could easily tap to substantially increase tax revenues in the short run. Moreover, structural constraints are compounded by low compliance, weak revenue administration and poor governance.

3.7 However, great potential for increasing tax revenue in the long run exists in several key sectors. The financial and telecommunication sectors, for instance, especially the fast growing mobile phone industry, are high value sectors that are generating incomes that could potentially increase tax revenues substantially. However, these sectors are currently under-taxed because of difficulties in assessing their tax base and also due to generous tax exemptions. The modernization of the tax framework for commercial banks and insurance companies and the stabilization of the tax regime of the telecommunication sector are key steps that the government needs to implement to bolster growth in these sectors and secure the mobilization of tax revenues. CAR's rich natural resource endowment, which drives exports, could also be a source of significant tax revenues. In particular, once the investment projects that have been developed on the basis of the new mining code materialize, an effective implementation of the new code could result in improved revenue performance.

3.8 In the short to medium run, simple and low taxes assessed on large tax bases with no special treatment will enable the government to generate a steady stream of revenue. This means that tax policy and tax administration are of fundamental importance in order to raise additional revenues in a way that does not create distortions and impede economic growth. Reforms appear to be moving in the right directions with an initial set of measures to simplify the tax system. The government should accelerate and deepen the simplification process by moving to implement additional measures that will simplify in particular the personal income tax system and the taxation of small businesses.

3.9 **CAR should also take additional steps to reduce significantly tax expenditures.** The authorities should analyze the tax expenditures incurred in connection with the investment chart and related legislations. The estimates of tax expenditures should be published every year in the finance law so that policy makers and the general public are aware of them. Looking forward, the authorities should elaborate a plan to reduce the exemptions on international VAT and eliminate them on domestic VAT.

C. ANALYSIS OF REVENUE PERFORMANCE

3.10 **CAR's domestic revenue to GDP ratio is one of the lowest in Sub-Saharan Africa.** Irrespective of the decade and despite recent progress CAR lags significantly other African countries in revenue performance. In 2009, domestic revenue averaged 17 percent of GDP in other fragile countries and 23 percent of GDP in Sub-Saharan Africa. At 8.7 percent of GDP in 2009, CAR's tax revenue ratio is particularly low, covering just about 54 percent of total expenditures.

Table 3.2 : Tax Revenue by type of Tax, 1992 and 2009

	1992		2009	
	% of GDP	% of Total	% of GDP	% of Total
Total tax revenue	8.3	100.0	8.6	100.0
Tax on income and profit	2.0	24.7	2.6	30.4
Companies	0.5	6.1	0.5	5.7
Individuals	1.0	11.9	1.4	16.0
Other	0.6	6.7	0.7	8.7
Domestic taxes on goods and services	3.1	37.8	3.5	40.5
Turnover tax/VAT	0.5	6.4	2.7	31.4
Excise tax	0.0	0.0	0.5	6.2
Other	2.6	31.4	0.3	2.9
Taxes on international trade	3.1	37.5	2.4	27.6
Import taxes and duties	2.7	32.1	2.1	24.1
Customs duties	2.0	24.7	1.0	11.6
Other taxes and duties	0.6	7.4	1.1	13.5
Export taxes and duties	0.5	5.4	0.2	2.5

Source: IMF Staff reports

3.11 **Domestic revenue collection relies on a few taxes.** The tax department manages more than 30 types of taxes; but, in 2009, the combined receipts from tax on income and taxes on domestic goods and services accounted for more than 70 percent of tax revenues (Table 3.2) and nearly 50 percent of total domestic revenues. Domestic taxes on goods and services are the main source of revenue, with VAT playing an increasingly important role; while taxes on income and profits, consisting of personal income tax (PIT) and company income tax (CIT), constitute the second main source of revenue.

3.12 **Owing to trade liberalization reforms and the need to adhere to regional integration directives the decline in the share of trade tax revenues is expected to continue in the future.** Taxes on international trade represented 27.6 percent of total tax revenues and 2.4 percent of GDP in 2009; but while these taxes remain significant, their share in domestic revenue has declined over the years. In 1992, taxes on international trade accounted for 37.5 percent of tax revenues and 3.1 percent of GDP. Import taxes and customs duties remain an important source of revenue for the government, with a contribution of 24 percent to tax revenue and a share of 1.0 percent of GDP in 2009. Export duties are levied on diamonds, gold and timber, CAR's main exports, but account for a relatively lower share of tax

revenue and GDP. More attention would need to be given to replacing the revenue lost from trade liberalization.

3.13 Sub-national governments play a limited role in domestic revenue mobilization. Most revenue is collected by the central government. Almost all the revenue comes from Bangui, the capital city, which accounted for more than 90 percent of domestic tax revenues in 2009.

3.14 The structure of tax revenues in CAR is comparable to that of other Sub-Saharan African countries. Comparable countries in the sub-region with low level of domestic revenues are Chad and Sudan (Table 3.3). These countries have, however, important oil revenues that give them significant additional resources which are not available to CAR. CAR's structure of tax revenues is characterized by the relative importance of personal income taxation, VAT, and international trade taxes which compensate for the relatively weak contribution of company income tax. This structure of government revenue highlights the strategic importance of reforms of company income tax and taxes on personal incomes, especially the taxation of wages and salaries; a decline in these revenues could have a serious impact on the government's finances.

Table 3.3 : CAR: International Comparison of Fiscal Revenues as a Share of Non-oil GDP, 2009 1/

	CAR	Cameroon	Republic of Congo 2/	Gabon	Mali 3/	Niger	Uganda	Senegal 4/	Sudan	Chad	Zambia 5/
Tax revenues	8.6	12.7	20.1	27.3	11.3	21.8	11.9	18.4	7.7	9.3	13.7
Direct taxes	2.6	3.4	7.0	11.1	3.0	7.9	3.6	4.9	0.8	5.1	6.7
Companies	0.5		3.9		1.1	5.5	0.8	1.4		2.5	1.5
Personal	1.8		3.1		1.5	2.2	1.9	3.0		1.6	5.3
Other	0.1		0.0		0.4	0.1	1.0	0.6		1.0	0.0
Indirect taxes	3.5	6.9	7.0	4.8	4.5	10.7	7.0	10.8	4.6	2.6	5.3
VAT	2.7		6.1	2.8	2.7	8.8	4.0	7.8		2.1	3.8
Excise	0.5		1.0		0.9	0.4	3.1	1.6		0.2	1.6
Other	0.3		0.0		1.0	1.5		1.4		0.2	0.0
Trade taxes	2.4	2.4	3.7	9.5	3.0	2.7	1.2	2.8	2.2	1.5	1.7
Other	0.1	0.0	2.4	1.8	0.8	0.5	0.0	0.0	0.0	0.1	0.0

Source: IMF, 2010

1/ Excluding oil revenues

2/ 2008 data

3/ Based on 2007 budgetary data. Excludes royalties.

4/ Excise taxes include several consumption taxes, except VAT.

5/ Excludes mineral revenues

3.15 Domestic revenue mobilization in CAR is constrained by a low taxable capacity. The relative large size of non-tax revenue (20.1 percent of domestic revenue and 2.2 percent of GDP in 2009), the heavy reliance on taxation on a forfeit or presumptive basis, and the importance of taxes such as on the right to exercise a profession, point to significant difficulties in controlling the base for the taxation of personal incomes and profits. These features highlight the importance of structural constraints in CAR's medium to long-term tax revenue collection problems. In particular, CAR's low income level and low economic integration, its land-locked position, and difficulties in controlling the entire territory owing to security threats represent serious constraints to domestic revenue mobilization efforts.

3.16 However CAR's low domestic revenue ratio is not solely due to structural constraints; it also reflects inefficiencies in tax policy. CAR's tax system is highly complex, as illustrated by Table 3.4, with a proliferation of tax rates in each tax field, numerous tax bases, a multiplicity of tax brackets, and a strong tendency toward taxation on a forfeit basis. This complexity creates distortions and inequities

and provides little incentives to the formalization of economic activities, which is needed to extend the tax base.

Table 3.4 : Structure of Domestic Revenues in CAR (2009)

	In CFAF billions	Share of domestic revenue	Share of GDP (%)
TOTAL DOMESTIC REVENUES	100.7	100.0	10.8
TAX REVENUES	80.5	79.9	8.6
Tax on Income	24.5	24.3	2.6
Tax on Personal Income	12.9	12.8	1.4
Tax on companies' income, profits and capital gains	4.6	4.5	0.5
Tax on right to exercise an industrial or commercial activity	3.9	3.9	0.4
Social security contributions	2.2	2.2	0.2
Taxes on property	0.7	0.7	0.1
Minimum tax on company	0.2	0.2	0.0
Tax on Goods and Services	32.6	32.4	3.5
VAT	25.3	25.1	2.7
Domestic	13.4	13.3	1.4
Imports	8.8	8.7	0.9
Hydrocarbon	3.1	3.0	0.3
Excises	5.0	5.0	0.5
Domestic	0.8	0.8	0.1
Imports	0.0	0.0	0.0
Hydrocarbon	4.2	4.1	0.4
Taxes on purchases of diamond and gold	0.6	0.6	0.1
Selected taxes on services	1.8	1.8	0.2
Tax on transfers of funds	0.5	0.5	0.0
Social development contributions	1.3	1.3	0.1
Tax on International Trade	22.2	22.1	2.4
Taxes on goods and services	12.4	12.3	1.3
Customs duties	9.3	9.2	1.0
Import duties on hydrocarbon	1.3	1.2	0.1
Duties on investment projects	0.9	0.9	0.1
Statistical tax	0.7	0.7	0.1
Other registration fees	0.3	0.3	0.0
Export tax	2.0	2.0	0.2
Export tax on diamond and gold	1.0	1.0	0.1
Export tax on timber	1.1	1.0	0.1
Fines, Penalties and financial sentences	1.7	1.7	0.2
Assigned revenues	6.0	6.0	0.6
Special tax on petroleum products	2.3	2.3	0.2
Roads fund	2.8	2.8	0.3
Other	0.9	0.9	0.1
Other tax revenues	1.1	1.1	0.1
NON TAX REVENUE	20.2	20.1	2.2

Source: IMF, 2010

3.17 Moreover, reflecting weaknesses in tax administration, the tax authorities are unable to motivate a large majority of taxpayers to participate voluntarily in the tax system and to subject the informal sector to taxation. Non-compliance by large and especially by medium enterprises is high,

estimated at 35 percent and 60 percent respectively, against 5 percent and 10 percent for comparable countries. Another problem is the non-reimbursement of VAT credits or delays in providing VAT refunds to investors and exporters which not only affects the neutrality of this tax, but has also resulted in lower revenues.

3.18 In sum CAR's tax system and its administration are currently not meeting the key objectives of revenue-raising, efficiency and equity improvement. Weak administrative capabilities, a narrow tax base and the complexity of the tax structure are hampering domestic taxation. Many of the tax challenges that CAR has to deal with are common to many other low income countries, which include numerous hard-to-tax sectors and a large informal sector. However, as a fragile country emerging from sustained periods of instability, CAR faces particular challenges with shattered administration and tax bases and the need to accelerate economic recovery by attracting private investment. Nevertheless, experience suggests that, with political will, progress in raising domestic revenue is possible; and cross-country evidence indicates that significant additional revenue could be raised where performance is weakest.

D. MAIN AXES OF REFORMS IN THE SHORT AND MEDIUM TERM AND PRIORITIES FOR INCREASING REVENUES

3.19 The quality of policy measures to increase domestic revenue matters importantly: increasing revenue by raising taxes on a limited number of taxpayers is likely to worsen distortions and inequities and leads to wider tax evasion. Therefore, in the short to medium run the government should maintain the emphasis on simplification efforts and on controlling tax exemptions. This section focuses selectively on critical tax policy and tax administration issues, in relation to VAT, excise, and company income taxes.

Tax Administration

3.20 Improving revenue administration will be central to the government's efforts to increase domestic revenue mobilization. A key challenge is to build a tax administration that is capable of enforcing the voluntary compliance needed to enlarge the tax base. This will entail improving risk management by allocating more resources where the risks to revenue are greatest in order to mitigate them, and implementing taxpayer segmentation by tailoring interventions and services to the distinct challenges posed by large, medium and small taxpayers.

3.21 CAR can improve voluntary compliance by simplifying tax procedures and reducing the cost of compliance. Tax procedures are currently too complex and costly. The Doing Business 2011 report shows that a typical firm in CAR makes 54 tax payments in a year (Table 3.5), significantly more than the average of 41 payments in other fragile countries. The time spent paying taxes exceeds 500 hours in CAR (Table 3.6), compared to 269 for other fragile countries and 315 hours for Sub-Saharan Africa. Simplifying tax procedures and reducing cost are needed to motivate business firms to comply with their tax obligations and promote private investment. In addition to facilitating the preparation and payment of taxes the tax department needs also to improve the supply and quality of services to taxpayers.

Table 3.5 : Paying Taxes: Number of Tax Payments per Year

Countries	Total tax payments	Corporate Income Tax	Value Added Tax	Other Taxes
Burundi	32	1	12	19
Central African Republic	54	4	12	38
Comoros	20	1	12	7
Congo, Dem. Republic	32	1	12	19
Cote d'Ivoire	64	3	13	48
Eritrea	18	1	1	16
Gambia	50	1	1	48
Guinea	56	1	12	43
Guinea-Bissau	46	5	12	29
Liberia	32	4	12	16
Sao Tome & Principe	42	1	12	29
Togo	53	5	12	36
Zimbabwe	49	4	12	33
<i>Average for Sub-Saharan Africa</i>	<i>37.3</i>			

Source: Doing Business 2011, World Bank

Table 3.6 : Paying Taxes: Time (Hours per Year)

Countries	Total hours	Corporate Income Tax	Value Added Tax	Other taxes
Burundi	211	80	83	48
Central African Republic	504	24	240	240
Comoros	100	4	48	48
Congo, Dem. Republic	336	116	96	124
Cote d'Ivoire	270	30	120	120
Eritrea	216	24	96	96
Gambia	376	40	240	96
Guinea	416	32	192	192
Guinea-Bissau	208	160	24	24
Liberia	158	57	42	59
Sao Tome & Principe	424	40	192	192
Togo	270	30	120	120
Zimbabwe	242	78	68	96
<i>Average for Sub-Saharan Africa</i>	<i>315.1</i>			

Source: Doing Business 2011, World Bank

3.22 The segmentation of the taxpayer population will permit a better allocation of administrative resources and facilitate risk management approaches to compliance. The efficiency of the tax system could be improved by (i) better taking into account risks, (ii) planning controls selectively, and (iii) focusing the scarce resources on key issues such as non-compliance, VAT credits and frauds in the informal sector, which could help mobilize additional resources. The tax department should also strive to enhance the recovery rate following the fiscal controls in order to strengthen the credibility of the tax system. Due to its lack of selectivity and low coverage of risks, fiscal control has failed to achieve its objectives of mobilizing revenue and discouraging firms from abstaining to declare and pay their taxes; in addition, the inadequate follow-up to recovery of tax payments has led to the accumulation of arrears. The tax department should design and implement programs of assistance adapted to the specific needs of different categories of taxpayers, specifically for the large, medium and small enterprises, and focus on the key failures in the declaration and payments of taxes.

3.23 The detection and taxation of important economic activities operating in the informal sector will contribute to broadening the tax base. This would require strengthening capabilities in terms of collecting and analyzing data and information. To this end the tax department should reinforce the exchange of information with the customs department, develop synergies and pool resources for research and control. A more effective coordination between the tax and customs departments will enable a more comprehensive view of each taxpayer. Customs has an important role to play in managing VAT on imports.

Recommendations for strengthening tax administration

- Improve voluntary compliance by simplifying tax procedures to reduce the number of tax payments firms business have to make and the time it takes to pay the taxes.
- Ameliorate the responsiveness of the Large Enterprise Directorate by enabling their computerized services to detect and tax rapidly defaulting enterprises with the short term objective of reducing the default rate to less than 5 percent.
- Concentrate the resources for fiscal control on the principal risks: failures to declare, VAT credits and newly detected informal activities by the research and control units.
- Strengthen the recovery of balances of tax due that remain to be recovered by enforcing the coercive measures envisaged in the tax code.
- Develop an action plan to improve data collection and analysis with a view to reinvigorate the activities of research and control units and strengthen their ability to detect important taxable economic activities in the informal sector.

Domestic taxes on goods and services

Value Added Tax

3.24 There is scope for raising additional revenue from domestic taxes on goods and services. Numerous factors affect the revenue performance of VAT. CAR applies a standard VAT rate set at 19 percent; in addition, a reduced rate of 5 percent is applied to a few products, including flour and milk. Numerous exemptions are allowed and concern basic goods, delivery of medical services, newspapers and books, insurance, interests on bank deposits, and non-profit organizations recognized by the government. Transactions on urban commercial real property, which are subject to registration fees, are also exempt from VAT.

3.25 Despite some improvements in recent years the VAT revenue productivity remains relatively low, pointing to potentially significant revenue gains. Revenue collections from VAT have increased steadily since its introduction in 2000. In 2009, VAT receipts accounted for 31 percent of total tax revenues up from an average of 25 percent over the period 2000-2008. However, while the standard VAT rate in CAR is one of the highest, VAT collections are significantly less than in most other low income countries. Raising the VAT rate further is not an attractive option for CAR; the 'C-efficiency', the ratio of VAT revenue to the product of the standard rate and consumption, suggests alternative options

to increase VAT revenue⁶. The 'C-efficiency' ratio for CAR is much lower than the median for low income countries and Table 3.7 shows that by raising its C-efficiency ratio to the median CAR could increase revenue by up to 3 percent of GDP. The low C-efficiency ratio rate in CAR suggests issues both in VAT policy and VAT administration that need to be addressed.

Table 3.7 : VAT productivity

		VAT Revenue	C-Efficiency	Revenue gain from raising C-efficiency to:		
	<i>Standard VAT rate</i>	<i>(in % of GDP)</i>	<i>(%)</i>	<i>100% median</i>	<i>80% median</i>	<i>120% median</i>
Bangladesh	15	2.8	23.4	1.7	0.80	2.60
Benin	18	7.4	44.7	--	--	0.06
Burkina Faso	18	6.3	36.6	0.17	--	1.46
CAR	19	3.7	20.6	3.00	1.67	4.33
Chad	18	0.7	5.1	4.27	3.28	5.25
Ethiopia	15	6.1	42.9	--	--	0.31
Ghana	12.5	9.7	80.4	--	--	--
Guinea	18	3.3	22.6	2.20	1.10	3.31
Kenya	16	8.5	57.2	--	--	--
Madagascar	20	6.2	34.5	0.55	--	1.91
Malawi	17.5	8.1	44.1	--	--	0.19
Mali	15	7.3	52.4	--	--	--
Mozambique	17	7.1	44.7	--	--	0.07
Nepal	13	3.8	33.7	0.44	--	1.29
Niger	19	4.0	22.9	2.55	1.25	3.86
Nigeria	5	1.5	47.9	--	--	--
Pakistan	15	3.6	27.4	1.34	0.35	2.33
Rwanda	18	5.9	35.7	0.30	--	1.54
Tanzania	20	6.5	38.6	--	--	1.10
Togo	18	3.2	19.5	2.93	1.71	4.15
Uganda	18	7.3	45.9	--	--	--
Zambia	17.5	7.4	54.6	--	--	--
<i>Average low income</i>	<i>16.4</i>	<i>5.5</i>	<i>38.0</i>	<i>1.77</i>	<i>1.45</i>	<i>2.11</i>

Source: IMF 2011

3.26 CAR can increase VAT productivity and collection by eliminating the reduced rate, rationalizing exemptions to broaden the base, and improving compliance. The elimination of the reduced rate of 5 percent, which has been brought up to the standard rate of 19 percent in the 2011 Finance Law will help raise revenues. VAT receipts from the 5 percent reduced rate have totaled CFAF 365.6 million; applying the standard rate on the same products will increase VAT receipts on imports by CFAF 1.023 billion, 11 percent more than its 2009 level.

3.27 Overall, VAT exemptions in CAR are not excessive but rationalizing their use will help boost VAT receipts on imports. In 2009 VAT receipts amounted to CFAF 25.3 billion, consisting of CFAF 8.8 billion in VAT on imports and CFAF 13.3 billion in domestic VAT. The exemptions on domestic VAT totaled CFAF 258 million (1.9 percent of domestic VAT receipts), while exemptions on imports amounted

⁶ The 'C-efficiency' ratio would take the value of 100 under a single rate VAT on a broad base, but will be lower to the extent that reduced rates apply and compliance is imperfect.

to CFAF 4.7 billion (35 percent of receipts of VAT on imports); a quarter of the import exemptions were awarded to the World Food Program. Terminating the practice of providing such generous exemptions to the WFP and other international organizations will generate additional VAT revenues without impairing their activities. As discussed later the government should consider restricting as much as possible VAT exemptions on imports to entities governed by the Vienna Convention. As regards the exemptions on domestic VAT, it can be noted that the current practice of exempting commercial real estate property is not consistent with international practice and is costly in terms of revenue forgone. The standard practice, which is to subject all new constructions fully to VAT, should be followed. Constructions that are purchased by individuals who are not subject to VAT should not be eligible for VAT exemptions. Another issue is that the VAT exemption on the first tranche of water and electricity consumption is not equitable as all households, including the wealthiest, benefit from such an exemption. High-income households should not be targeted by such a measure; rather, the exemption should target households whose total consumption does not exceed the first tranche level.

Excises

3.28 As complement to VAT an excise tax is applied on a very large number of products which generates little revenue. Excises are levied on tobacco, alcohol, and a multitude of other goods such as tooth paste and perfume which contribute little to domestic revenue. However, unlike other countries, excises are not applied on consumer durables such as motor vehicles, foregoing an important source of revenue. Excluding the uniform tax on petroleum products (TUPP), excises accounted for just 1.6 percent of domestic revenues in 2009. This means that there is scope for rationalizing excise taxes to ensure that they focus on the most significant products such as tobacco and alcohol. The loss in revenue that could result from such a reform could be offset by introducing a new excise tax on motor vehicles.

3.29 Subjecting motor vehicles to excise taxation would generate significant domestic revenue. The CEMAC directive allows the imposition of excise taxes on certain motor vehicles, which are not currently taxed in CAR. Such taxation represents a potential source of revenue for the government because it is relatively easier to control the entry of vehicles in the country and also because their value is substantial, which would permit a low rate of taxation. Moreover, since these vehicles are used mostly by high income households such a tax will also be progressive. On the basis of import data it is projected that the government could collect about CFAF 543 million in additional revenue by introducing a 10 percent excise tax on motor vehicles. This tax would apply to the import of both new and used vehicles.

3.30 The government could consider raising the excise taxes on tobacco and alcohol. The nominal excise rate applied on tobacco and alcohol is 25 percent, the maximum rate permitted by the CEMAC. The effective rate is considerably lower, however. As table 3.6 illustrates the total tax as a percentage of the price of a packet of 20 cigarettes stands at just 12 percent, which is significantly lower than in many other low-income countries.

Table 3.8 : International comparison of excise tax on tobacco
(Based on the price in US\$ of a standard packet of 20 cigarettes)

Country	Cigarette packet price (US\$)	Effective excise rate (%)
CAR	0.64	12
Burundi	0.49	46
Ethiopia	1.63	45
Madagascar	0.75	51
Mozambique	0.60	34
Nigeria	1.89	27
Rwanda	0.89	36
Zambia	1.14	31

Source: IMF, 2010

3.31 However, the government should be cautious about raising the excise tax on petroleum products. Revenue from the TUPP is the difference between the administratively fixed and uniform price and the total cost of supplying petroleum products to the market, which includes VAT. Imposing an excise will reduce the TUPP revenue by the same amount and the excess of total cost over the price will have to be covered by the government in the form of subsidies, which will be costly to the budget. The authorities should first undertake a reform of the price structure of petroleum products before introducing new taxes.

Company Income Tax

3.32 The very low level of domestic revenue collected from company income taxes indicates a strong potential for improvement. In 2009, the combined yield of the minimum forfeit tax and the corporate income tax accounted for just 4.5 percent of total domestic revenues and 0.5 percent of GDP, the lowest in central Africa where the yield averaged 2.2 percent of GDP. The company income tax rate in CAR, at 30 percent, is lower than the average for CEMAC (36 percent) but higher than the average for WAEMU countries (28.7 percent). A reduced rate of 20 percent is applied on companies operating in agriculture.

3.33 The low productivity of the company income tax in CAR can be attributed to the fact that few enterprises are incorporated, the rate of informality is high, and generous tax holidays exist, especially for foreign investors. Although a reduced rate of 20 percent is applied on companies operating in the agricultural sector, none of these companies has ever made any declaration for company income tax assessment. This preferential rate distorts the allocation of capital and increase administrative and compliance costs without producing any improvement in revenue collection. Removing the reduced rate will help simplify the tax system, improve efficiency, and broaden the tax base.

3.34 Company income taxation in CAR will also benefit from greater clarity. Aside high registration fees, contradictory fiscal dispositions applied by the authorities are the main tax problems reported by private companies. Applicable tax laws should be reliable in order to encourage private companies to undertake important investments in the formal economy. Uncertainties about the tax laws not only lead to lower long term investments but also result in waste of resources associated with tax evasion and pressures exerted by companies to obtain greater tax exemptions. The authorities should elaborate general rules for accelerated amortization, draw a list of eligible assets and sectors or economic

activities with corresponding amortization rates, and include them in the general tax code to help companies follow the rules.

Policy recommendations in relation to VAT and company income tax

- Abolish the VAT reduced rate and prevent the re-introduction of a reduced rate.
- Subject all new constructions to VAT (whether the buyer is registered to VAT or not) as well as all building transactions between those who are registered to VAT.
- Grant domestic VAT credits only to entities subjected to the Vienna Convention.
- Remove for profit organizations among entities that are exempt of custom duties as well as multilateral and bilateral organizations, with the exception of those that are subjected to the Vienna Convention.
- Introduce a system of deferred VAT payment for forestry companies and gradually extend this system to other companies if necessary.
- Eliminate the company income tax of 20 percent on agriculture.
- Define the accelerated depreciation regime in the tax code.

Policy recommendations in relation to excise tax

- Introduce an excise tax of 10 percent on the value of imported new and second-hand vehicles.
- Eliminate all excises on luxury products, electronic apparels and food products, and maintain excises only on tobacco, alcohol, vehicles, and non-alcoholic beverages.
- Subject non-alcoholic beverages produced locally at the same excise rates as imported drinks.

E. TAX EXPENDITURES AND INVESTMENT INCENTIVES

Current context

3.35 Tax expenditures permeate CAR's tax system, generating distortions across a range of sectors in the economy and eroding the tax base. Tax expenditures can be found across most major revenue sources, including the VAT, customs duties, and the company income tax. In CAR exemptions can be obtained in two ways: (i) by submitting a request to the Inter-Ministerial Committee in Charge of Tax and Customs Exemptions (CICEFD), and (ii) by invoking the Investment Chart of the Ministry of Industry. Requests for a reduction in customs duties and/or VAT received by the Ministry of Finance are sent to the CICEFD for review; whereas companies seeking a reduction in direct taxes and registration fees need to invoke the investment chart.

3.36 The major sources of revenues affected by tax expenditures are customs duties and VAT. In 2007, tax expenditures under customs duties and VAT on imports alone amounted to 2 percent of GDP. However by 2009, they were reduced to about CFAF 9.2 billion, just about 1.0 percent of GDP. Tax expenditures under customs and VAT are expected to decline further in 2010. The government's efforts to bring these tax expenditures down indicate a commitment to improving tax policy.

Table 3.9 : Tax Expenditures in VAT and Customs duties (CFAF billion)

Years	Customs and VAT on imports exemptions	Domestic VAT exemptions	Total	Total customs and VAT on import receipts
2007	16.59	N/A	N/A	N/A
2008	11.85	0.66	12.52	18.36
2009	8.92	0.25	9.18	20.17
2010 1/	2.91	0.31	3.22	N/A

Source: CAR Authorities

1/ First half of the year

3.37 The substantial decline in customs and VAT tax expenditures can be attributed to the CICEFD. Since the creation of the CICEFD in 2007 tax expenditures relating to customs duties and VAT on imports have declined steadily, falling from CFAF 16.6 billion in 2007 to CFAF 8.9 billion in 2009 and CFAF [2.9] billion in 2010.

3.38 The main beneficiaries of customs and VAT tax expenditures are international organizations. Most notably, the United Nations accounted for 39 percent of these exemptions in 2009, followed by companies targeted under the investment chart (mostly telecommunication companies) with a share of 22.8 percent. Telecommunication companies alone accounted for 12 percent of the exemptions in 2009.

Table 3.10: CAR: Indirect tax exemptions by type of organization, 2008-2009 (In CFAF millions)

Organization	2008	2009
ASECNA	863	994
Ambassies	425	262
Banks	41	157
CEMAC	624	536
Investment chart	1252	938
Investment chart – Telephone	1193	1099
Mining Code	817	195
Religious organizations	124	58
State	427	147
Roads Fund	65	96
NGOs	1380	726
United Nations	4518	3510
Customs project	65	122
Protocol Agreement	62	95
Total exemptions	11857	8926
Total customs and international VAT receipts	18367	20179

Source: Ministry of Finance and Budget

3.39 The tax expenditures stemming from exemptions under the investment chart are significant and should be rationalized. The investment chart provides tax exemptions on the incomes of national and foreign companies if they undertake investments or finance projects that fall in the category of targeted industries. The total magnitude of these exemptions is difficult to measure with precision. The extent of tax holidays depends on the level of investment as well as on its location. Companies that invest less than CFAF 1 billion can be exempt for up to three years; whereas companies that invest more can be exempt for 5 years. Companies that invest outside Bangui, the capital city, are given three additional years of tax exemptions; tax holidays increase with distance from the capital. Companies are also eligible for accelerated amortization, and a 50 percent reduction in registration fees on capital transactions and tax allowances for research and development expenditures. Since 2005, 35 companies

have benefited from tax holidays on 37 investment projects totaling CFAF 205 billion. The largest investments are those undertaken in the telecommunication, transport and forestry sectors (Table 3.11).

Table 3.11: CAR: Beneficiaries of Exemptions governed by the Investment Chart, 2005-2010 (In CFAF millions)

Sector	Number of projects	Planned investments
Telephone	8	76,293
Transport of merchandises	9	63,027
Sawmill	5	37,270
Consumer goods	5	15,524
Construction	3	7,339
Industrial products	3	3,031
Medical services and products	2	1,408
Services	2	1,249
Total	37	205,141

Source: CAR Authorities

3.40 A number of companies that have received exemptions on company income tax in the last five years under the investment chart are exploiting CAR's natural resources or selling goods and services on the local market. There is no justification for allowing these companies to profit from the exploitation of natural resources without paying the normal taxes on profits; and the same argument applies to companies which target the domestic market, notably the telecommunication companies. To be sure these companies undertake considerable investments and provide precious services, but they also derive high rents from obtaining access to a relatively isolated market and should therefore pay the tax on the profits that they derive from these activities.

3.41 CAR should stop providing tax holidays on income to forestry companies and to companies such as those in telecommunication, haulage, construction and other services and should let the tax holidays in these sectors expire without extending them. The government should continue to provide accelerated amortization but under conditions that are clarified either in the investment chart or in the general tax code.

Policy Recommendations

- Prepare and publish a report summarizing all tax expenditures in the tax code, the investment chart and other relevant legislations and estimate their costs in terms of revenue forgone.
- Stop awarding company income tax exemptions to companies that are exploiting natural resources or produce goods and services for sale in the domestic market; let company income tax in these sectors expire.
- If it is critical to provide tax incentives to companies, they should take the form of accelerated depreciation.

F. FORESTRY AND MINING TAXATION

Forestry Taxation

Current context

3.42 **About 5.6 percent of the territory of the Central African Republic consists of productive forests, 80 percent of which have been allocated in 11 concessions currently under exploitation.** Forestry plays an important role in CAR's economy. It accounts for 10 percent of GDP, 50 percent of exports, and is the largest private sector employer in the country. The forestry sector, through the production and processing of timber, provides 4,000 jobs directly and work to several thousands of manual workers. From 1993 to 2001 timber production increased steadily, reaching 700,000 cubic meters. Since then production has declined significantly, averaging 537,000 cubic meters in 2007, and 554,000 cubic meters in 2008. As a result of the global economic slowdown, production fell sharply in 2009 to about 348,779 cubic meters and declined further to about 263,407 cubic meters in 2010. With the rebound in external demand, production and exports are recovering but remain below their previous peaks.

Table 3.12: Timber production and exports, in cubic meters, 2007-09

Production	2007	2008	2009
Logs	537,998	554,667	348,779
Sawnwood	92,933	76,114	62,392
Plywood	1,276	194	863
Exports			
Logs	193,213	155,164	110,853
Sawing	76,042	60,795	40,477
Plywood	513	72	70

Source: CAR Authorities

3.43 **The forestry sector represents an important source of new tax revenue.** Adequate taxation from the forestry sector would help to increase government revenue; it would also promote better management of forestry resources. Despite the importance of the sector in economic activity tax revenues from forestry are low. In 2009, the various duties and fees specific to the forestry sector generated about CFAF 3 billion in revenues, which represented 3 percent of domestic revenues and 0.3 percent of GDP. In 2008, forestry revenues were relatively stronger amounting to CFAF 6.3 billion, and representing 6.8 percent of domestic revenue and 0.8 percent of GDP.

3.44 **In 2008 the Government adopted a new forestry code which ratified the attribution of concessions through competitive bidding.** Most of the forestry companies currently operating in CAR have obtained their concessions through a bidding process based on technical and financial qualifications; and the companies were also required to submit a management plan for sustainable development. All these concessions were awarded prior to the adoption of the new forestry code. Today, only four concessions remain to be awarded under the new forestry code. Since 2008 the mechanism for allocating concessions has been outlined in a decree which assigns the responsibility for granting permits for harvesting and development to an inter-ministerial commission. The concessions are awarded for a three-year period through a provisional convention for harvesting and development during which the company must finalize its management plan, begin the development of the concession and satisfy various conditions. The provisional convention is then changed into final convention for the following 27 years for a total of 30 years renewable.

3.45 **The new forestry code provides for four taxes: surface area tax, stumpage tax, reforestation tax and exit duty.** The surface tax is CFAF 600 per hectare per year for the productive area of the concession. In addition to paying the surface tax, bidders must also include in their submission a bonus that reflects their interest for the concession. The stumpage tax, set at 7 percent, is levied on all industrial logs produced. This tax is calculated using a formula based on the mercurial value per cubic meter of the species concerned. The reforestation tax is levied on log exports using a formula based on the FOT (Free On Truck) value of exports. The reforestation tax is 11 percent. An export duty is also levied on log exports based on the FOT value of each species. The exit duty is 8 percent for logs, 4 percent for sawnwood and 1 percent for other products.

Table 3.13: Tax obligations for forestry companies in CAR

Tax	Tax base	Tax rate
Surface area tax	Productive area of the concession (ha)	CFAF 600/hectare
Stumpage tax	40% * volume of log fell * mercurial value	7%
Reforestation tax	Volume of logs exported * FOT value	11%
Exit duty	Volume of logs exported * FOT value	• 8% for logs • 4% for sawnwood • 1% for other products

Source: IMF 2010

Policy issues

3.46 **The new forestry code has been favorably received by most stakeholders in the sector.** It is seen to provide a legal and regulatory framework that promotes a sustainable management of the forestry sector. Notably, the implementing decrees adopted in April 2009 promote a concession award system based on competitive bidding for all harvesting rights; demand that information about the allocation process is to be made public so that it is transparent; and stipulate that new permit holders adopt and implement forest management plans. This framework permits awarding longer and more predictable concession contracts. Furthermore, the taxation system defined in the code provides for an equitable sharing of forestry rents among the central government, private operators and local communities.

3.47 **However, the global economic crisis has brought to the fore potential weaknesses in the forestry fiscal regime.** The use of the surface area tax as the financial variable decision in the bidding process will increase the concession's fixed costs, which companies would have to pay no matter the world price of timber. As a result of the slowdown in world demand forestry operators have had to ask for deferred tax payments to the government due to financial difficulties. Heavier surface area taxes, by raising further forestry companies' fixed costs, are likely to accentuate these liquidity problems.

3.48 **The calculation of the FOT value overestimates the tax base for exit duties.** The FOT value is calculated as the FOB (Free On Board) value less transportation costs; as such it includes all exit duties and other fees such as the verification and certification fees. Hence, because exit duties are based on the FOT value, they are estimated on a value that already includes exit duties. It will be therefore important to review the formula for the calculation of the FOT value and the exit duties may need to be adjusted to maintain revenue constant.

Policy Recommendations

- Undertake a detailed analysis of the tax system for the forestry companies, assess the risks borne by forestry operators and consider basing bids on the stumpage tax or exit duties.
- Redefine the formula for the calculation of the FOT value so that it reflects more closely the value of logs at exit on the truck.
- Request short term technical assistance to help with the implementation of the above recommendations

Mining Taxation

Current context

3.49 There are two fiscal regimes for the mining sector in CAR, one for artisanal mining and the other for companies. Two international mining companies are currently active in CAR: Axmin (Canada) and Areva (France) which have contracts for the extraction of gold and uranium respectively. Neither of the two companies has reached the production phase and hence does not pay any income tax or royalties. Three other international companies involved in the extraction of diamond and gold suspended their activities in CAR during the past three years and are not expected to resume them. The artisanal sector comprises manual and semi-mechanized miners who operate individually or collectively in a cooperative, and collectors who buy their products and sell them to purchasing bureaus. The purchasing bureau could also buy directly from the artisan. The cooperative of artisans with a production of at least CFAF 20 million are authorized to export directly. Currently the entire production of diamond and gold in CAR is artisanal.

3.50 In 2009, artisanal miners produced 310,468 carats of diamonds valued at US\$ 49.1 million. Diamond production reached a peak in 2007 with exports totaling 417,690 carats. The international economic crisis and instability within the sector resulted in a sharp contraction of production beginning in 2008. The authorities estimate that between 2008 and 2010 the number of collectors fell by 14 percent and that the number of licenses granted to artisanal miners decreased by more than 40 percent. In 2008 the number of purchasing bureaus also declined from more than 12 to about 3 today due in part to an ordinance in the revised mining code that requires purchasing bureaus to undertake real estate investments of at least CFAF 600 million and to open offices in at least five regions.

3.51 The purchasing bureaus that are incorporated into companies pay the business license tax, the minimum corporate tax at a special rate and the corporate income tax. A tax of 3 percent is levied on all the purchases made by purchasing bureaus to artisans and collectors, which in 2009 accounted for 1.4 percent of domestic revenues. Exports are subject to an exit duty of 4 percent, a bonus payment for the development of the mining sector of 1 percent and two supplementary taxes of 0.5 percent each to finance the custom administration and the Kimberly process. In 2009 export taxes on diamonds generated CFAF 1.3 billion in revenues, or 3.3 percent of domestic revenues. In the same year the three purchasing bureaus made a total of CFAF 2.4 billion in tax payments, which accounted for 6.2 percent of domestic revenues.

3.52 In contrast to the artisanal producers mining companies pay royalties on their production. The actual rates for royalties are 7 percent for diamonds, 3 percent for gold, and 4 percent for basic metals. For uranium the revised mining code does not specify royalties, which are subject to negotiations.

Companies also pay export taxes and associated fees. Companies which extract radioactive substances are liable for a corporate income tax that is 50 percent higher. Companies must also pay an area tax (taxe suéficiaire), 20 percent of which is allocated to the local administration of the site where the mine is located.

3.53 Mining companies are liable for corporate income tax and applicable registration duties but they are also eligible for some exemptions. According to the revised mining code, during the exploration phase mining companies are exempt of custom duties on productive imports; registration duties on mining transactions other than residential rents or leases; license fees; corporate income tax; and the contribution to social development. During the construction phase, before starting production, companies remain exempt of custom duties on the imports of production equipments and registration fees on mining operations and can spread registration fees on financial transactions over a year. The mining code grants all the companies that hold exploitation permit a one-year exemption for the minimum corporate tax, the business license tax and the contribution to social development. If the duration of the exploitation permit exceeds 10 years, these exemptions are granted for three years.

3.54 The mining code stipulates that mining companies must allocate to the state equity participation of 15 percent as well as 15 percent of their gross production. The state may also demand a signature bonus paid to Mining Development Fund before granting the firm an exploration permit. Some 55 percent of revenues from area taxes are allocated to the Treasury department and 45 percent to the Mining Development Fund which, jointly with the export tax of 1 percent, finances the budget of the Ministry of Mines.

Policy issues

3.55 None of the individual fiscal dispositions of CAR's mining code – the allocation for state equity participation, the signature bonus, the area tax and royalties – is by itself unusual compared with other countries. However, there is broad agreement among observers that taken together they constitute a heavy fiscal burden for the sector which, combined with the lack of infrastructure, modest public services, and security issues, may dissuade investments in CAR. To reduce the overall burden state participation should be limited and take the form of a proportional share of net benefits and not physical production. Allocating a share of the production to the state is equivalent to increasing royalties by the amount of the production share. This means that a share of the production of 15 percent will increase the effective royalties on diamond, gold, and basic metals to 22 percent, 18 percent, and 19 percent, respectively, which is excessive.

3.56 Despite various legal and contractual guarantees of exemptions and the uniformity of fiscal treatment, mining companies face important fiscal risks. The final outcome of the two mining projects currently under contract, Aurafrique and Areva, would give potential foreign investors a good idea about the prospects for profitable mining investments in CAR. It is therefore essential for the government to provide a uniform and transparent fiscal treatment. In this context the government should regularize the fiscal treatment of uranium miners. Instead of levying corporate income tax at the special rate of 50 percent subject to negotiations, the government should consider applying the regular corporate tax rate of 30 percent. Similarly the mining code should include royalties at the standard rate of 3 to 5 percent.

3.57 There is no economic justification for not taxing the benefits generated from the extraction of natural resources. CAR should consider terminating the tax holidays granted to mining companies from one to three years and replace them with an accelerated depreciation.

3.58 It would be critical to dissipate the numerous uncertainties around the taxation of the financial transactions of mining companies. In general CAR applies the principle of territoriality to the taxation of mining companies. Accordingly, it would be preferable to not levy registration fees on the transactions of companies that are not registered in CAR. However, it would be useful to tax the capital gains of assets (e.g. mining goods or real estates) which take the form of shares in foreign jurisdictions. Otherwise the mining companies could avoid all transaction of the gains on assets of CAR by depositing them in offshore organizations and by transferring shares to these entities.

3.59 The mining code stipulates that the purchasing bureaus must invest CFAF 150 million in State building and CFAF 250 million in the construction of a headquarter and open at least five branches, which is excessive. It is reasonable for the authorities to require that the purchasing bureaus be adequately capitalized; however to demand that they undertake real estate investment for the State will weaken their capital base. The authorities have justified the opening of regional offices by the desire of purchasing bureaus to grant more financing to artisanal miners. However, the imposition of high fixed costs on the purchasing bureaus, which has led to a reduction in their number from 12 to 3, has probably had the effect of seriously restraining competition in the sector. This would only reduce the resources available to artisans because the price they are able to obtain from the purchasing bureaus would be much lower.

Policy Recommendations

- Reduce the overall burden on mining companies by limiting state equity participation to a proportional share of net benefits.
- Regularize the fiscal treatment of uranium mining companies by eliminating the special corporate tax of 50 percent on the income of companies and by introducing a royalty of 3 to 5 percent.
- Eliminate the tax holidays granted to mining companies and replace them with an accelerated depreciation scheme.
- Remove all uncertainties on the fiscal treatment of the financial transactions of mining companies.
- Evaluate the competitiveness of CAR's revised mining code in relation to that of other countries rich in mineral and natural resources.

G. INSTITUTIONS AND TRANSPARENCY IN REVENUE MANAGEMENT

3.60 Tax policy reforms and effective tax administration will be central to progress in raising domestic revenue in CAR, but lasting reform requires deep institutional change. In particular transparent institutions and practices are necessary to ensure that gains made to improve revenue mobilization are entrenched and the resources mobilized are used to support growth and poverty reduction objectives.

3.61 Implementing EITI as part of a program of improved governance can help ensure that revenues from the mining sector contribute to sustainable development and poverty reduction by holding decision makers accountable for the use of those revenues. EITI principles promote the transparency of revenue flows to the government through the regular reporting of all payments by companies to all levels of government and of all revenues received at all levels of government;

independent audits, applying international auditing standards, of payments and revenues; reconciliation of any discrepancies by an independent administrator; and public dissemination of this information on a regular and consistent basis; engagement of civil society in monitoring the process and ex post independent external validation to enhance credibility.

3.62 The government recognizes that improving governance in extractive industries is a priority and became a member of EITI as candidate country in 2008. Since then CAR has been accepted by the EITI Board as EITI compliant on March 1, 2011. CAR is one of the few countries to reach this status, following a successful validation process during which an independent validator assessed the extent and quality of stakeholders (civil society, public sector, and mining operators) participation in EITI implementation. The first EITI report for the year 2006 was adopted by the multi-stakeholder group in 2009. The second report, covering the years 2007, 2008 and 2009 was adopted in December 2010. Both reports cover the mining sector, including artisanal mining. CAR must be revalidated by end-February 2016.

Recommendations

3.63 The government should continue to foster transparency in the management of mining receipts by adhering fully to EITI principles. Good governance and transparency have the potential of helping CAR increase mining revenues, which could be used to promote economic development and reduce poverty. The government should create a more transparent environment by disseminating widely the EITI reports, making them available to the general public through local newspapers and the national radio; and involving civil society more deeply in EITI implementation.

CHAPTER 4: HEALTH, EDUCATION AND INFRASTRUCTURE

This chapter provides a review of public expenditure in three priority sectors: health, education, and infrastructure. For each sector the chapter assesses progress and identifies challenges, examines the trend and composition of public expenditures, analyzes donor flows and private sector spending, and assesses the scope for realizing efficiency gains and improving the growth and poverty impact of government spending. It finds that in each of these sectors efficiency gains exist and can be achieved by improving allocation efficiency, promoting a budget management system that links financial resources to results, and aligning the pricing of infrastructure services to average costs.

HEALTH SECTOR

4.1 This section assesses the performance of the health sector in terms of key outcomes and results. It first assesses progress and challenges in the health sector and provides an overview of health conditions in the country. Access to health care and utilization of health services by the population are then examined. The review finds that cost and distance to health facilities are among the major impediments to utilization of health services. Thirdly, aspects of CAR's health system are analyzed. The analysis confirms the finding that the density of health professionals is very low and that the health workforce limitations and unequal distribution represent a key challenge to health care delivery. The analysis also highlights the need to make pharmaceuticals accessible and affordable. This is followed by a review of health care financing in CAR. In general health expenditures in CAR are low and heavily dependent on household and donor financing. A key conclusion of this section is that improving allocation efficiency with a greater focus on outcomes and strengthening budget execution will contribute to increasing fiscal space in the health budget.

4.2 Improving public health is central to CAR's challenge to accelerate economic growth and reduce poverty. In participatory poverty assessments the poor have consistently identified ill health as a cause of poverty; it lowers their welfare and reduces their capacity to participate in the growth process. Improving the health status of the population will contribute directly to overall well-being. Good health will also raise human capital levels, and this will have a positive effect on individual productivity and on economic growth. Because the poor account for a large proportion of the disease burden, improving health outcomes will require not only improving the quality of health care but also improving substantially access of poor households to health services.

B. PROGRESS AND CHALLENGES IN THE HEALTH SECTOR

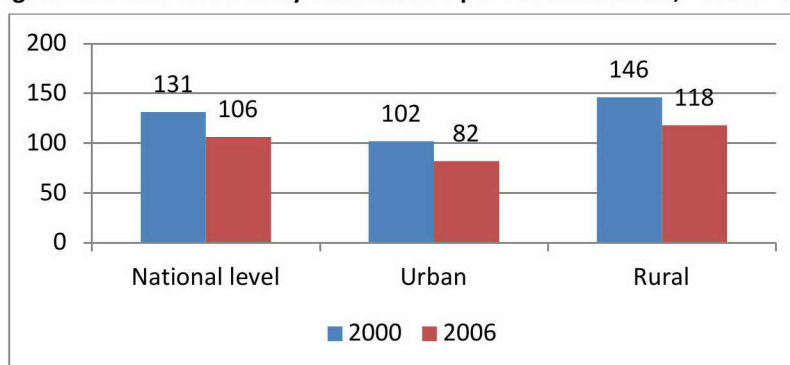
4.3 The government is striving to improve the health status of the population by focusing its agenda on a number of key issues. The government's strategic objectives are set out in the second generation National Health Development Plan (PNDS 2, 2006-2015). They are to rehabilitate and develop health infrastructure, increase the availability and quality of basic health care, reduce infant and maternal mortality, stem the spread of endemic diseases including HIV/AIDS, and strengthen the health system. Progress toward meeting the objectives for improving health outcomes is monitored through five key targets that the government aims to meet by 2015, namely : (i) 72 percent of the population has access to health care services; (ii) at least 22 percent of the very poor have access to quality health care;

(iii) the under-5 mortality rate decreases from 176 per 1000 live births to 103 percent per 1000 live births; (iv) maternal mortality decreases from 596 to 500 per 100,000 live births; and (v) the rate of morbidity and mortality from non-infectious and infectious diseases falls significantly.

4.4 Though life expectancy in CAR is still low it is improving, indicating some progress in reducing morbidity and mortality rates. In 2008, life expectancy was about 45.5 years, the lowest in the sub-region. Life expectancy in CAR had been declining over several decades, from 49 years in 1988 to 44 years in 2000 and 43 years in 2003. Several factors contributed to this trend, including the rapid spread of HIV/AIDS which raised the morbidity rate among adults and the youth; and the sustained periods of violence and civil strife, which weakened public service delivery and destroyed infrastructure. However, life expectancy has been improving in recent years; it is estimated at 48 years for female and 49 years for males in 2009 (WHO, World Health Statistics Report, 2011).

4.5 The government renewed commitment to the health sector since 2003 has led to significant progress in reducing infant and child mortality. The infant mortality rate fell from 131 per 1000 live births in 2000 to 106 per 1000 live births in 2006. Similarly the under-5 mortality rate has improved substantially, falling from a peak of 220 per 1000 lives in 2003 to 175 per 1000 live births in 2008. Despite this progress the infant and under-5 mortality rates remain high compared to other fragile countries; moreover, these rates are substantially higher in rural areas and in households with an illiterate mother. The main causes of childhood deaths are malaria, diarrhea with dehydration, malnutrition, and immunizable childhood diseases, all of which can be prevented by simple cost-effective interventions.

Figure 4.1 : Infant mortality rates: deaths per 1000 live births, 2000& 2006



Source: CAR Country Health Status Report

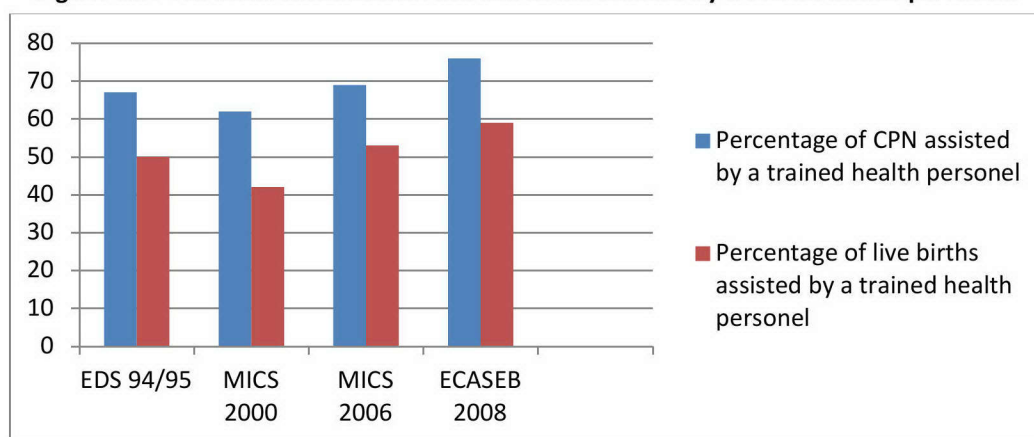
4.6 Maternal mortality has declined from its peak in 2003; however, on current trends, CAR is unlikely to meet the MDG for maternal mortality. The most recent household survey (ECASEB 2008)⁷ undertaken by the government estimated maternal mortality at 980 deaths per 100,000 live births in 2008, substantially down from its peak of 1355 deaths per 100,000 live births in 2003. Despite this decline the maternal mortality rate remains high and is still higher than in the mid-1990s when it was at 898 deaths per 100,000 live births. Most medical causes of maternal mortality, such as infections and post-partum bleeding, are easily preventable with well-organized services.

4.7 CAR can accelerate the reduction of the maternal mortality rate through the intensification of prenatal care, better assistance to childbirths, and adequate post-natal care. About 20 percent of

⁷ Enquête Centrafricaine pour le Suivi et Evaluation du Bien Etre. Household survey, 2008

Centrafrican women use family planning methods; of these, 9 percent use modern methods and 11 percent use only traditional methods (World Development Indicators, 2011). The contraceptive prevalence rate in CAR is below the Sub-Saharan average of 21 percent and far below the 33 percent average for developing countries. In rural areas, only 2.5 percent of women use contraceptive methods. Unmet need for family planning methods is estimated at 51 percent in 2008. CAR has made good progress in the area of pre-natal care. According to the ECASEB survey 76 percent of the women who gave birth in the previous 12 months completed a prenatal consultation in a health center up from 69 percent in 2006. The percentage of births attended by skilled health staff has also risen, reaching 54 percent. However, only about 67.8 percent of pregnant women in rural areas received prenatal care compared with 91.4 percent of pregnant women in urban areas; and 56.1 percent of live births in rural areas took place at home with the assistance, in most cases, of a non-trained traditional birth attendant.

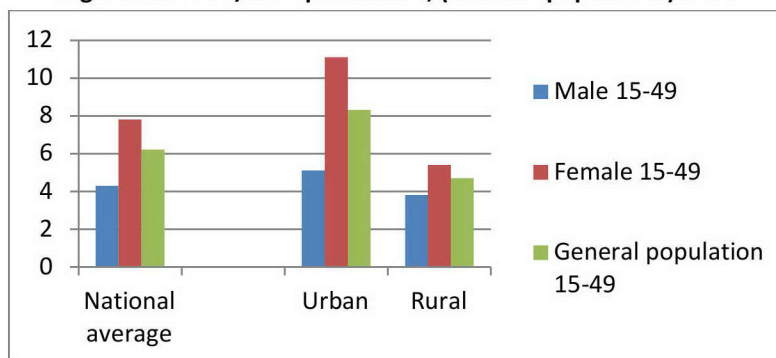
Figure 4.2 : Pre-natal consultations and live births assisted by a trained health personnel



Source: CAR Country Health Status Report

4.8 Communicable diseases account for a large proportion of deaths in CAR and the prevalence of HIV/AIDS remains high. Malaria, HIV/AIDS, and tuberculosis remain endemic and are prominent causes of mortality. Malaria afflicts 38 percent of the population; and about 32 percent of the victims are children under 5 years. But just around 37 percent of children under-5 years receive adequate malaria treatment and only 16 percent of them sleep under impregnated bednets. HIV/AIDS prevalence has declined significantly from its peak of 15 percent in 2004 but remains high, at 6.2 percent of the population in 2008. HIV/AIDS afflicts predominantly the age group 15-49; and within that age group, women in urban areas have the highest sero-prevalence rate, at 11.1 percent.

Figure 4.3 : HIV/AIDS prevalence, (% of the population) 2006



Source: CAR Country Health Status Report

4.9 CAR lags its neighbors and other fragile countries on most conventional measures of health outcomes. In terms of life expectancy and mortality, in particular, CAR ranks below the SSA average and underperforms its neighbors with the exception of the Democratic Republic of Congo (DRC). CAR also continues to have one the lowest measles vaccination rate in the region and HIV prevalence is much higher among adults and young females in CAR, which demonstrates shortcomings in preventive care. Although CAR has made good progress on the percentage of births attended by skilled health personnel it still lags most countries in the sub-region, except Chad. Most of these differences in outcomes continue to hold when per capita gross national income (GNI) is taken into account. Despite having a lower GNI per capita post- conflict countries such as Burundi, Liberia and Mozambique fare better on most measures; while the Republic of Congo, the country with the highest GNI, performs better on all measures. Chad, by contrast, despite a relatively high GNI compared to CAR, fares poorly on several measures, suggesting inadequate prioritization of public expenditures.

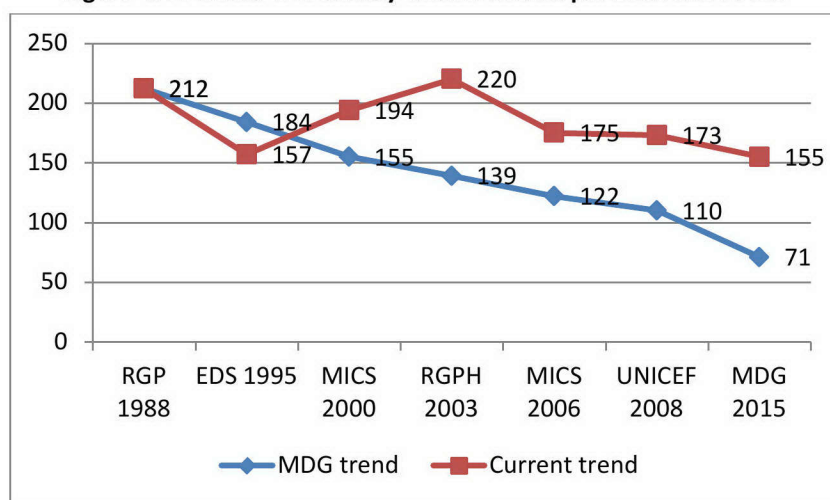
Table 4.1 : Regional comparison of health outcomes

			Infants lacking immunization against		HIV prevalence			Mortality		
	GNI per capita	Life expectancy	DTP	Measles	Youth (% ages 15-24)		Adult (% ages 15-49)	Infant	Under five	Births attended by skilled health staff
	(US\$)	Years	(% of one-year-olds)		Female	Male	Total	(per 1000 live births)	(per 1000 live births)	% of total
	2009	2010	2008	2008	2007	2007	2007	2008	2008	2004-08
CAR	450	47.7	46	38	5.5	1.1	6.3	115	173	54
Cameroon	1,190	51.7	16	20	4.3	1.2	5.1	81	131	63
Chad	600	49.2	80	77	2.8	2.0	3.5	124	209	14
Congo, Republic	2,080	53.9	11	21	2.3	0.8	3.5	80	127	86
DRC	160	48	31	33	...	...	...	126	199	74
Burundi	150	51.4	8	16	1.3	0.4	2.0	102	168	34
Liberia	160	59.1	36	36	1.3	0.4	1.7	100	145	46
Mozambique	440	48.4	28	23	8.5	2.9	12.5	90	130	48
Sierra-Leone	340	48.2	40	40	1.3	0.4	1.7	123	194	42
Sudan	1,220	58	14	21	1.0	0.3	1.4	70	109	49
Sub-Saharan Africa	1,125	52.7	29	28	...	...	...	86	144	48

Source: Human Development Report, UNDP, 2010

4.10 Although CAR's under-five mortality rate has decreased over time it remains high compared with the regional average for Sub-Saharan Africa, at 144 per 1000 live births. Moreover the under-5 mortality in the poorest quintiles is considerably higher than in richer population groups. In part because of these trends CAR is unlikely to meet the MDG of reducing under-5 mortality to 70 deaths per 1000 live births by 2015.

Figure 4.4 : Under-5 mortality trends: deaths per 1000 live births

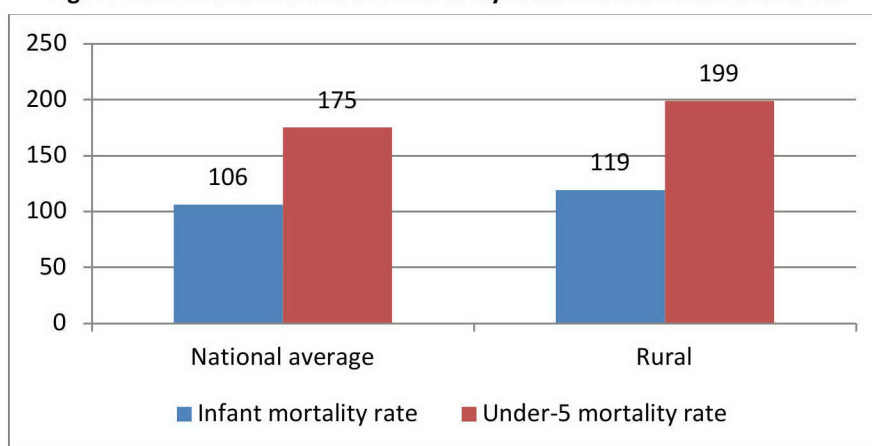


Source: CAR Country Health Status Report

RGP: Population census; EDS: Demography and Health Survey; RGPH: Population and Housing Survey

4.11 National data on infant and maternal mortality hide wide variations within the country. In general there is a strong rural-urban divide, with the infant, under-five and maternal mortality rates sharply higher in rural areas. For instance, in 2006, the infant mortality rate ranged from 66 per 1000 live births in Bangui, the capital city, to 132 deaths per 1000 live births in the poorer prefecture of Ouham in the north-east. In seven prefectures (Ombella-Mpoko, Sangha Mbaere, Ouham-Pende, Nana-Mambere, Bamingui-Bangora, Ouaka and Haut-Mbomou), the infant mortality rate was moderately high, ranging from 83 deaths per 1000 live births to 105 deaths per 1000 live births. In the eight prefectures (Lobaye, Nana-Grebizi, Mbomou, Basse-Kotto, Membre-Kadei, Haute-Kotto, Kemo and Ouham), the infant mortality rate was higher, ranging from 120 to 132 deaths per 1000 live births.

Figure 4.5 : Infant and Under-5 mortality rates in Urban and Rural areas



Source: CAR Country Health Status Report

4.12 A significant proportion of maternal and child mortality can be attributed to the poor nutritional status of mothers and children. Recent surveys show that 41 percent of children under five have chronic malnutrition and 7 percent have acute malnutrition, with higher prevalence among

children less than two and among girls. Compared to the rest of the Central Africa region stunting and chronic malnutrition are more prevalent in CAR. The main causes of malnutrition are infection-nutrition interactions, insufficient calorie supply, generalized food insecurity, and, particularly for children, inadequate nutritional practices during breast feeding and weaning. About 77 percent of children under five and 40 percent of mothers are anemic and there is widespread iodine and vitamin A deficiency.

Table 4.2 : Malnutrition prevalence and stunting in CAR

	Central Africa 1995	CAR 1994-95	Central Africa 2000	CAR 2000	Central Africa 2005	CAR 2006	Central Africa 2010	CAR 2010
Acute malnutrition	7.8	7.0	10.0	9.0	-	5.0	12.8	7.0
Stunting	23.3	27	22.3	24.0	21.4	28.0	20.5	28.0
Chronic malnutrition	43.8	34	42.3	39.0	40.8	38.0	37.8	41.0

Source: CAR Country Health Status Report

4.13 Important strides have been made in the provision of water supplies to the population but more needs to be done to prevent the spread of diseases. From 1990 to 2008 the percentage of the population with access to drinking water rose from 58 percent to 67 percent (WDI, 2011), as the government made a concerted effort to install wells in villages. However, as discussed in more details in the infrastructure section in this chapter, in many cases the condition of the CAR's wells and boreholes does not guarantee the provision of safe water, especially in the rainy season. Sanitation remains more problematic, with some 66 percent of the population lacking access to improved sanitation facilities.

4.14 The routine immunization program needs to be implemented more effectively to improve vaccination coverage. CAR has adhered to the Global Immunization Vision and Strategy (GIVS), a worldwide initiative to protect populations against the spread of diseases; and in 2006 CAR developed a multi-year action plan (PPAC) for the implementation of GIVS through the routine vaccination program (PEV). An evaluation of the implementation of PPAC over the three-year period 2008-2010 shows that the progress made in immunization coverage in 2009 has not been sustained. As table 4.3 below shows, in 2008 none of the program objectives were achieved. In 2009, coverage expanded appreciably. In one case (tetanus) the target was largely exceeded, and the target for measles was fully met. But this was due to additional rounds of intensified vaccination activities; in 2010, the intensified activities were not repeated and all the targets were largely missed. In many cases the coverage achieved was considerably lower than in 2008. For example just 62 percent of children aged 12-23 months received a dose of measles vaccine in 2010 compared with 94 percent in 2009 and 71 percent in 2008.

Table 4.3 : Vaccination coverage: objectives and results, 2008-2010

Vaccines	2008		2009		2010	
	Objective	Actual coverage	Objective	Actual coverage	Objective	Actual coverage
BCG	90	70	92	87	94	64
VPO3	90	54	92	76	94	56
PENTA3	90	51	92	76	94	57
Measles	90	71	92	94	94	62
VAA	90	60	92	93	94	64
VAT 2+	70	--	85	107	90	49

Source: CAR Country Health Status Report

C. ACCESS TO HEALTH CARE AND UTILIZATION OF HEALTH SERVICES

4.15 **Access of the population to health care services is uneven and low among the poor.** The ECASEB survey indicates that 52 percent of households have had access to health services during episodes of illness. Access was highest in urban areas, at 65.7 percent, but relatively lower in rural areas, at 43.7 percent. In five of the country's seven regions, access was estimated at more than 50 percent. In region 6, where the incidence of poverty is among the highest in the country, access to health services was found to be very low, at 29.4 percent, highlighting that in general the poor have limited access to health services.

4.16 **In the preceding four weeks 26.5 percent of individuals reported that they needed medical services but only half of them utilized the services.** The cost of health services is a major problem. About 60 percent of individuals cited the high cost of services as a major factor behind their dissatisfaction about health care services. Geographical accessibility is another problem. The ECASEB survey found that in rural areas about 48 percent of the population lives 5 kilometers and more away from the nearest health center.

4.17 **When individuals seek treatment they choose health centers and health posts for their medical consultations.** Most health facilities are government managed. Around 262 health posts and 301 health centers provide primary health care. Secondary health care is provided in five prefecture or district hospitals. Four national hospitals, all based in Bangui, provide tertiary care. The ECASEB survey reveals that during illness episodes, 35.4 percent of individuals sought health care in health centers and 24.2 percent in health posts nationally. In rural areas, for their medical consultations, 37.6 percent of individuals went to health posts and 34.6 percent to health centers. Patients appear to make little use of prefectural and regional hospitals. These findings suggest that in general, and more so in rural areas, the poor do not make use of the vast majority of the spending that is channeled into tertiary and secondary care.

Table 4.4 : Demand for health services by health facilities (in percent of individuals sampled)

	Health post	Health center	Prefectural hospital	Regional hospital	Government clinic	Private clinic	Private infirmary	Others
National	24.2	35.3	10.7	8.7	4.7	5.6	4.5	6.3
Rural	37.2	34.6	6.9	3.7	3.2	2.2	5.8	6.4
Urban	5.6	36.4	16.1	15.8	6.8	10.3	2.6	6.4

Source: ECASEB survey

D. QUALITY OF HEALTH SERVICES, THE HEALTH WORKFORCE AND SUPPLY OF ESSENTIAL MEDICINES

4.18 **CAR's density of doctors and nurses per population is very low by most measures.** CAR faces a large shortfall of qualified health professionals, especially physicians, and it is estimated that current staffing levels will have to be increased by at least 50 percent to meet international norms.

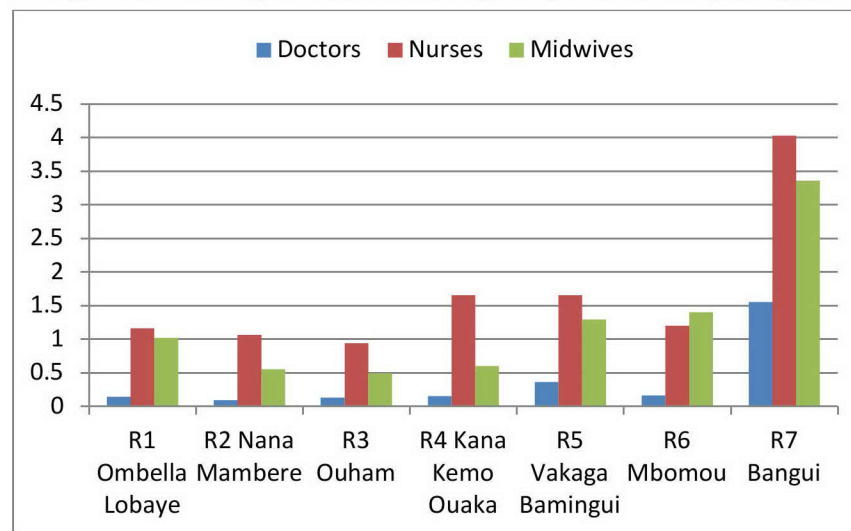
Table 4.5 : Number of health personnel and density per 10,000 habitants in CAR

	Actual number of Health personnel				Required density per international norms		
	Public sector	Private sector	Total	Ratio per 10000 habitants	WHO High recommendations (per 10,000 habitants)	WHO Low recommendations (per 10000 habitants)	National norms (per 10,000 habitants)
Doctors	207	140	347	0.78	5.50	1.00	0.40
Nurses	674		674	1.52		2.00	2.53
Midwives	500		500	1.13		1.00	1.63
Total	3010	988	1521	3.44	20.2-25.4	4.00	4.57
Total population	4,422,000						

Source: CAR Country Health Status Report

4.19 The national averages mask significant regional disparities in terms of health personnel availability. In particular there is a strong concentration of public sector medical doctors in Bangui. Whereas Bangui accounts for about 16 percent of the population, more than 67 percent of public sector doctors are located there. The density of doctors in Bangui is 12 times higher than in Region 3 (Ouham) in the north-west, the region with the highest incidence of poverty. After Bangui, Region 5 in the north has the second highest concentration of doctors. It is worth noting that Bangui, Region 5 and Region 2 are also the regions with the lowest incidence of poverty. However, as many doctors work for NGOs and religious organizations which serve areas outside of Bangui, the ratio of doctors in the regions may improve when the private sector doctors are included.

Figure 4.6 : Density of Health workers per 10,000 habitants per region



Source: Author's calculations based on data from the Country Health Status Report

4.20 The ratios of nurses and midwives per population are far higher than those of doctors but significant regional disparities exist. Around 40 percent of all public sector nurses are based in the Bangui region, a lower concentration ratio compared to doctors. Nurses are also relatively better distributed across the country than physicians. The gap between Bangui and the least well served region in terms of supply of nurses (Region 3) is 4.28, which is broadly similar to the distribution of nurses in

other countries in Sub-Saharan Africa. By contrast the concentration of midwives in the Bangui region is relatively more pronounced. More than 45 percent of midwives are located in Bangui, which has eight times more midwives than region 3, the least well supplied region.

4.21 Overall the density of medical personnel is lowest in Ouham Pede (Region 3) in the North-west. Measured in terms of monetary poverty Ouham has the highest incidence of poverty, at 78.2 percent, followed by Region 4 (71 percent), Region 1 (66 percent) and region 6 (63.3 percent). Nurses are relatively more available across the regions in CAR; but Ouham Pede stands out as the region with the lowest density of health workers. The workforce limitations and their unequal regional distribution pose a serious challenge to health care delivery to the poor.

4.22 Several factors account for the unequal distribution of health personnel between regions. Firstly, health facilities are heavily concentrated in Bangui, resulting in fewer openings for health workers in rural areas. Secondly, all the training facilities and schools for doctors, nurses and midwives are also located in Bangui; thirdly, security conditions outside Bangui remain tenuous, which may discourage health workers to locate in other regions. Finally, and above all, there appears to be no national policy in place to address the unequal distribution of health personnel. One policy should be to provide financial incentives, particularly to the highly skilled health personnel, to entice them to relocate in rural and under-served areas. The salaries of public sector doctors, nurses and midwives are comparable to those of other workers of similar education, but incentives are needed for them to provide quality services to the poor.

4.23 Religious organizations, which employ some 536 health professionals, have been relatively successful at attracting and retaining health professional to serve in rural areas. Religious organizations offer a range of financial benefits to health professionals working in rural areas including a monthly indemnity and transport allowances. NGOs, offering comparable benefits, have also been successful in recruiting health personnel to work in regions outside of Bangui.

4.24 In addition to increasing the density of health workers improving the quality of health services will also require improving access to and the use of pharmaceutical products. CAR has developed a system for supplying hospitals, health posts and health centers with essential medicines but inadequate access to these medicines hampers the effectiveness of service delivery. A public drug procurement entity (UCM) at the Ministry of Health is responsible for the purchase, distribution, storage and management of medicine. The UCM distributes essential medicine to health facilities through decentralized medical stores, (DPCM). Donors and private sector vendors intervene also in the distribution chain. Despite this effort, the availability of medicine throughout the country is limited and the regular provision of drugs to the public sector facilities is not assured. Stock-outs occur frequently and health centers may not receive their deliveries for long periods of time. For example, in 2007, Amoxicilline sirop 125 mg, Cotrimoxazole sirop 240 mg, Ibuprofène comprimé 400 mg, medicines that are normally supplied by the UCM and DPCM, were not available in health centers for the whole year.

4.25 Affordability of drugs is a major issue since most medicines are expensive and paid for out of pocket; this, coupled with weaknesses in quality control, limits access to effective medicine. Rational use of medicines by both providers and patients is also necessary to ensure improved health outcomes. Whereas a list of essential medicines exists, it is not widely disseminated.

4.26 Private for profit health services currently play a minor role in the health care delivery system in CAR. The potential for expansion of the private for profit sector is quite small and limited to the major

urban areas. However, the existing private practices can help to decrease the burden of primary care on the four national hospitals in Bangui. The main problem for the moment is the low quality of care provided and the indiscriminate financial charges to the patients. An institutional framework needs to be developed through which the government could provide better regulation and control of these health services. The private non-profit sector includes church organizations that operate in rural areas and other non-governmental organizations that are involved in promotional health services and the distribution of essential drugs. The government should tap further into the enormous potential of NGOs to contribute to the establishment of a functioning network of basic health services.

Public Private Partnerships

4.27 A public private partnership to improve health service delivery is being carried out on a pilot basis. A project financed by the French Development Agency provides the opportunity to assess the potential for public private partnerships to improve the level and quality of health services. The project seeks to determine how to improve operations and the quality of health services in six urban health centers. The Ministry of Health, the recipient agency, delegated the economic and financial management of the health centers to a private sector operator while the staff in the health centers maintains their civil servant status. The staff will receive productivity bonuses to boost their salaries and the resulting efficiency gains are expected to help improve the quality of services in these centers. An adequate evaluation of this pilot would allow the government to draw the appropriate lessons and policy recommendations.

4.28 In summary, the quality of health services in CAR is low, with low availability of medication, inadequate infrastructure and insufficient supply of health care personnel. The table below shows the reasons for patients' dissatisfaction with the health system, leading to the low utilization of services. In addition to geographical remoteness and high cost of access the low utilization rates are caused by the provision of low-quality care due to lack of equipment and supplies and lack of trained staff, especially in rural areas.

Table 4.6 : Reasons for patients' dissatisfaction with the health system in CAR

	Dissatisfied patients (%)	Unclean services	Long wait	Lack of trained staff	Too expensive	Lack of medicine	Inefficient treatment	Poor reception	Long distance	Others
National	53.6	7.2	27.0	14.3	57.2	27.2	21.4	10.3	18.8	1.3
Rural	56.9	7.1	20.5	18.0	57.8	31.4	24.7	6.5	22.6	1.0
Urban	49.0	7.5	37.9	8.1	56.1	20.2	15.9	16.7	12.5	1.8

Source: ECASEB

E. PUBLIC HEALTH EXPENDITURES IN CAR

4.29 In 2008 total health expenditures in CAR were estimated at US\$20 per capita and 4.3 percent of GDP⁸. Total health expenditures are defined as the sum of private and public expenditures, the latter including expenditures from central and local governments as well as donor financing. As defined, total health expenditures in CAR are below the average for low income countries and considerably lower than the average for Sub-Saharan Africa. Regional comparisons between levels of health expenditures show

⁸ CAR is in the process of developing its health national accounts. The data used in this sub-section are from the World Health Organization (WHO), World Bank Development Indicators (WDI) and the Ministry of finance and Budget (MoFB).

that CAR's spending levels are also on average lower than those of neighboring countries. However, as a share of GDP, CAR spent as much on health as Kenya and Ethiopia and spent considerably more than the Republic of Congo.

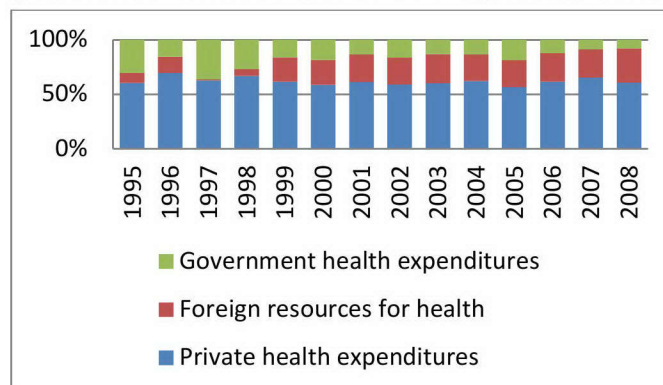
Table 4.7 : Public health expenditures ratios in CAR in 2008

Country	Total health expenditure per capita (US\$)	Total health expenditure (% of GDP)	Public health expenditure (% of total health expenditure)	Out of pocket expenditure (% of total health expenditure)
Burundi	19	13.0	40.0	38.1
Cameroon	65	5.3	22.7	73.5
CAR	20	4.3	39.3	57.7
Chad	49	6.4	50.6	47.8
Congo, Republic	81	2.7	49.9	50.1
DRC	13	7.3	54.2	39.2
Ethiopia	14	4.3	51.9	38.5
Guinea	21	5.5	13.6	85.9
Kenya	33	4.2	36.3	49.2
Liberia	26	11.9	33.0	35.0
Mali	39	5.6	47.1	52.6
Mozambique	21	4.7	75.2	7.0
Niger	21	5.9	57.7	40.7
Sudan	97	6.9	33.1	64.1
Uganda	44	8.4	17.4	54.0
Sub-Saharan Africa	74	6.1	42.9	36.5
Average				
Low income average	25	5.3	41.9	47.9

Source: WHO 2008, WDI 2011

4.30 Private funds, consisting mainly of household out of pocket expenditures, are the largest source of financing of health expenditures in CAR. As figure 4.7 below illustrates private funds account on average for about 60 percent of total health expenditures, considerably higher than the average for Sub-Saharan Africa and low income countries. Household expenditures represent more that 90 percent of private sector health expenditures. Other private sector contributions to health care financing are from private health centers and private enterprises which cover a share of the medical costs of their employees and contribute to the construction of health facilities in the regions where they are located. However precise data on these contributions are not readily available.

Figure 4.7 : Sources of Health Care Financing in CAR, 1995-2008



Source: WHO, various years

4.31 Over the last few years donor aid has become an important source of financing of health expenditures, accounting for more than 30 percent of total health expenditures in 2008. Data for 2009 and 2010 indicate that CAR's dependence on donors to finance health expenditures is growing. This subsection examines government, households and donors' expenditures on health.

Government Health Expenditures

4.32 Government expenditures in the health sector over the period 2008-2010, excluding foreign-financing, have been low⁹. From CFAF 4.43 billion in real terms in 2008, government health expenditures declined to CFAF 4.3 billion in 2009 and are estimated at CFAF 4.5 billion in 2010. Government health expenditures have been low and declining as a share of total expenditures, from 6 percent in 2008 to 5.3 percent in 2010; and have been less than 1 percent of GDP. Health expenditures are projected at CFAF 10.64 billion in the 2011 Finance Law, a 66 percent increase over the previous year in real terms, and representing an increase to 1 percent of GDP from 0.6 percent of GDP in 2010. The economic and functional composition of government health expenditures is examined below.

Table 4.8 : Trends in CAR health expenditures, 2008-2011 (Payments basis, CFAF billions)¹⁰

	2008	2009	2010 Prel.	2011
	<i>Actual (CFAF billion)</i>			<i>Budget</i>
Nominal national health expenditure	5.81	5.86	6.26	10.64
Adjusted by CPI deflator	4.43	4.31	4.54	7.52
Growth real health expenditures		-2.5	5.2	65.6
Health expenditures (% of total expenditures)	6.0	5.6	5.3	8.8
Total health expenditures (% of GDP)	0.7	0.6	0.6	1.0
Total real national expenditures	74.10	76.43	85.29	85.20

Source: Author's calculations based on data from MoFB

Economic Composition

4.33 The increase in government spending on health in 2010 was driven by domestically-financed capital expenditures, which more than doubled compared to their level in 2009. However, although domestically-financed capital expenditures rose in 2010 after remaining unchanged in 2008-2009, they have been very low, averaging just 5.1 percent of government expenditures in health. The wage bill increased in real terms, by 5.6 percent in 2009 and 3.1 percent in 2010. By contrast, expenditures on goods and services declined steeply, by 10.3 percent in 2009 and 7.8 percent in 2010.

Table 4.9 : Health expenditures by economic classification, 2008-2010 (Payments basis, CFAF billions)

	2008	% of total	2009	% of total	2010	% of total
Wages & salaries	2.15	48.6	2.27	52.7	2.34	51.5
Goods & services	2.14	48.4	1.92	44.5	1.77	31.9
Transfers & subsidies	0.00	0.0	0.00	0.00	0.00	0.0
Domestically-financed capital expenditures	0.13	2.9	0.12	2.8	0.43	9.5
Total	4.42	100.0	4.31	100.0	4.54	100.0

Source: Author's calculations

⁹ This discussion is based on the analysis of the budget of the Ministry of Public Health and Population, which accounts for more than 90 percent of government health expenditures. Health expenditures carried out by other ministries are not necessarily captured in these figures, which may underestimate government's overall spending on health.

¹⁰ Net of donor-financed capital expenditures and debt service payments.

Wages and salaries have increasingly crowded out expenditures on goods and services. The share of personnel spending in health expenditures rose from 48.6 percent in 2008 to nearly 53 percent in 2009; and in 2010, it was at 51.5 percent. During this period spending on goods and services, which also includes operational spending and maintenance, fell continuously from 48.4 percent in 2008 to 32 percent in 2010. This trend is concerning as it suggests that the government is allocating lower amounts of resources to operational and maintenance expenditures to support the delivery of health services. This may explain the low level of satisfaction expressed by households on the quality of health services as well as the low utilization of health facilities found in the ECASEB survey.

Functional allocation of health expenditures

4.34 **In terms of the functional allocation of health expenditures the programs that constitute the majority of the budget are the “disease, epidemics, emergencies and disasters”, “primary health care,” and “tertiary care” programs.** These categories cover the government’s main health programs but the budget provides very limited information on what these programs entail and who are the intended beneficiaries. The ‘disease, epidemics, emergencies, and disasters’ program appears to focus mainly on combating communicable diseases, notably HIV/AIDS and tuberculosis; whereas the ‘primary health care’ program seems focused on providing basic health care services through health centers and health posts. In 2008, these two programs accounted for more than 60 percent of health expenditures on goods and services. The ‘tertiary health care’ program, which accounted for 17.6 percent of recurrent expenditures in 2008, seems to concentrate on the provision of hospital care provided by four hospitals located in Bangui. Other substantial functional categories include the secondary health care mission which focuses on prefecture or district hospitals and the logistical support program, which covers health infrastructure and clinical laboratory work.

Table 4.10: Functional distribution of health expenditures in 2008 (commitment basis)

	Recurrent expenditure (CFAF Billions)	% of total recurrent expenditures	Capital expenditures (CFAFBillions)	% of total capital expenditures
Central administration	0.04	1.2	0.02	5.8
Logistical support	0.29	7.4	0.04	9.0
Health infrastructure	0.01	0.1	0.00	0.9
Pharmaceutical services	0.00	0.1	0.00	0.0
National laboratory of clinical biology	0.13	3.3	0.03	6.0
Blood transfusion	0.15	3.9	0.01	2.1
Tertiary health care	0.68	17.6	0.09	20.2
University hospital of Bangui	0.06	1.5	0.06	14.5
Pediatric center of Bangui	0.17	4.3	0.02	5.7
Hopital l'Amitie	0.10	2.6	0.00	0.0
Hopital communautaire	0.36	9.2	0.00	0.0
Secondary health care	0.12	3.1	0.07	16.7
District hospitals (5)	0.12	3.1	0.07	16.7
Primary health care	0.77	20.0	0.16	36.8
Coordination and monitoring	0.00	0.1	0.00	0.0
Urban health centers and maternity hospital of Bangui	0.07	1.8	0.01	2.8
Nutrition center of Bossangoua	0.01	0.2	0.00	0.0
Health regions	0.21	5.4	0.04	10.1
Other health facilities	0.12	3.0	0.00	0.0
Project implementation units	0.37	9.5	0.10	23.9
Disease, Epidemics, Emergencies & Disasters	1.64	42.4	0.05	11.4
Expanded vaccination program	0.01	0.2	0.01	3.4
Disease prevention	0.01	0.3	0.01	2.3
Sexually transmitted infections/HIV	1.47	38.0	0.01	0.0
AIDS/Tuberculosis				
National referral center	0.13	3.3	0.02	4.5
Anti-vectorial interventions	0.01	0.3	0.00	0.0
Common charges	0.32	8.2	0.00	0.2
Total	3.86	100.0	0.43	100.0

Source: MoFB

4.35 **The functional allocation of health expenditures appears to reflect broadly government priorities.** However, disease prevention, vaccination and nutrition, which accounted for a smaller share of the recurrent budget in 2008, need more attention. Moreover, spending on the primary health care program, which is often classified as preventive medicine, appears to be driven by the overhead costs of project implementation units rather than by allocations to specific health interventions or activities in the program. In 2008, the allocation to project implementation units largely surpassed the allocation to health regions. The relatively large share of 'common charges' in the recurrent budget reinforces the need to better align spending with priorities in the sector.

4.36 **The government should strive to link its expenditure allocation to outcomes.** In order to facilitate this, health information systems should be improved to ensure adequate monitoring and evaluation. The budget also needs more information to allow analysis by health program. At present these programs are described in general terms which provide little insight into how to reallocate expenditure or change expenditure categories towards more efficient categories. For example it is

unclear why the 'common charges' category accounts for such a relatively large share of the recurrent budget and whether these expenditures could be re-allocated to priority health programs.

Budget execution and public financial management issues

4.37 The budget execution rate in health has been relatively low. The total budget execution rate in health averaged 71 percent over the period 2008-2010, significantly lower than the execution for the entire budget, estimated at 105.7 percent (Chapter 2). The execution rate for wages and salaries rose and remained steady at 97 percent on average. The execution rate for goods and services declined throughout the period, from 68 percent to 50 percent. The execution rate for domestically-financed capital expenditure was lowest, averaging just 32 percent.

Table 4.11: Health budget execution rate, 2008-2010 (Payments basis)

	Executed Budget CFAF Billions			Allocation in Budget Law CFAF Billions			Execution rate (%)			Average (%)
	2008	2009	2010	2008	2009	2010	2008	2009	2010	2008-10
Wages & salaries	2.82	3.09	3.22	2.98	3.16	3.31	94.7	97.7	97.3	96.6
Goods & services	2.81	2.60	2.44	4.15	4.11	4.90	67.8	63.3	49.9	60.3
Transfers & subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestically-financed capital expenditure	0.17	0.16	0.59	0.46	0.78	1.55	37.4	21.2	38.1	32.2
Total	5.81	5.86	6.26	7.59	8.05	9.76	76.5	72.8	64.1	71.1

Source: Author's calculations based on data from MoFB

4.38 The low budget execution rate reflects continued weaknesses in the budget process and inefficiencies in the expenditure chain. Budget implementation in CAR in general is severely constrained by the low level of domestic resources. A Treasury Committee, chaired by the Head of State, decides on the allocation of expenditures based on available resources. To some extent the budget execution rate reflects the decisions of the Treasury Committee to make resources available to the sector as well as inefficiencies in cash flow management. But the low budget execution rate is also the result of other factors including the long delay in starting budget execution, weaknesses in executing the new procurement procedures, and the difficulties encountered in the purchase of goods and materials due to inadequate capacity in procurement and the reluctance of private suppliers to participate in the procurement of goods and services because of unpaid government arrears.

4.39 As with most government ministries budget execution starts late in the year. Often budget execution starts in the second half of the year in June/July or later, which does not provide sufficient time to execute the capital budget. The main factors contributing to this delay are the delay in nominating the credit administrators who manage the budget line items and the delay in preparing procurement plans, which in turn delay the elaboration of their commitment plans.

4.40 Since adopting a new procurement code in 2008 the government has taken steps to make it operational. Procurement units have been set up in the priority sector ministries, including health, to enhance capacity to execute procurement procedures in these ministries in view of their importance for the government's poverty reduction strategy. To facilitate the implementation of the new code, a manual of procedures for executing agencies, standard bidding documents, and a description of the general conditions of contracts have been prepared, and a training program has been implemented.

4.41 Despite the establishment of a procurement unit in the ministry of health there are significant delays in the execution of procurement procedures. Weaknesses in procurement planning continue to delay the elaboration of procurement plans. During 2009, lack of familiarity with the new procurement law delayed considerably the execution of procurement procedures. In addition, as donors tend to follow their own procurement procedures, there is a lack of coordination with procurement for the domestically-financed projects. Addressing these weaknesses will be critical to improve the budget execution rate and ensure that services are delivered to the populations.

Household Expenditure

4.42 Household out-of-pocket expenses represent the majority of total health expenditures in CAR. Since the mid-1990s out-of-pocket health expenditures have accounted for 95 percent of private expenditure on health and for about 57 percent of total health expenditure on average. In comparison to other countries, out-of-pocket health expenditure in CAR is considerably higher than the average for Sub-Saharan Africa and low income countries, at 36.5 percent and 47.9 percent respectively in 2008. Households contribute to the financing of the health care system through the cost recovery mechanisms instituted in 1994 on the purchase of medicines, consultation fees, and payments for hospital care.

4.43 Analysis of a household survey conducted by an international NGO in seven prefectures in 2010 indicates that the poorest quintile spent more than 15 percent of its income on health expenditures, a level of spending that could be deemed catastrophic. For the sampled households the health expenditure of poorest quintile amounted to CFAF 4043 on average annually and represented 15.3 percent of their incomes. In comparison, the health expenditures of the richest quintile amounted to CFAF 22387, accounting for just 8.8 percent of their annual incomes. Moreover, the survey indicates that in four episodes of illness the poor households faced catastrophic health expenditures, that is, health expenditures during these episodes were more than 10 percent of their total consumption expenditures. According to the ECASEB survey the cost of health care is a major impediment to the utilization of health services in CAR.

Donor Financing

4.44 External funds are an important source of financing of health expenditure in CAR, financing primarily capital expenditures. Donor financing comes from a variety of sources including bilateral and multilateral aid, the United Nations system, and a number of non-governmental organizations. Donor financing is currently organized around a number of specific health projects supported by the World Bank, European Union, France, Germany, the Global Fund, UNDP and other UN organizations. Among others these projects aim to tackle HIV/AIDS and communicable diseases, improve primary health care, and strengthen the health system. In addition to project support the health sector also benefited from budget support operations from the World Bank through its development policy operations, the EU and African Development Bank which targeted poverty reduction more broadly.

4.45 The government is making an effort to record systematically donors' health expenditures in the Development Assistance Database. The database records the donor-financed projects and for each project it tracks the commitments, disbursements to the Project Implementation Unit (PIU) which is responsible for executing the project, and expenditures carried out by the PIU. However, DAD is not well integrated in CAR's public financial management system. The commitment figures for 2008 and 2009 in DAD, for example, are several times larger than the levels of donor funds projected in the budget laws for these years and their recording follows donors' procedures. There is need to ensure

consistency between the DAD figures and budget data recorded in Gesco, the computerized expenditure management system. In addition, it is not easy to establish from the database the share of the expenditures carried out by the PIUs that go to cover their overhead costs and those that are directed at priority health activities. With these shortcomings in mind, available data appears to suggest that donor-financed health expenditures generally reflect the government's priorities with the larger shares of resources allocated to basic health services, basic infrastructure, and endemic and sexually transmitted diseases, including HIV/AIDS (Table 4.12).

4.46 Data from the Development Assistance Database indicate that over the period 2008-2009 donors' commitments averaged 2.6 percent of GDP and actual expenditure averaged about 1.4 percent of GDP. These figures should be treated with caution for the reasons outlined above but they provide some indication about the magnitude of donors' expenditures on health in CAR.

Table 4.12: Donor Health Expenditures by Areas of Intervention, 2008-2009 (In CFAF billions)

Areas of Intervention	2008				2009			
	Commitment	Disbursement	Expenditure	Share of expenditure (%)	Commitment	Disbursement	Expenditure	Share of expenditure (%)
Multisector	2.50	2.65	0.40	3.1	2.85	0.03	1.26	10.2
Education and Personnel Training	1.05	1.11	0.26	2.0	0.50	0.12	0.35	2.9
Basic health care infrastructure	3.29	0.62	0.39	3.0	--	3.54	2.90	23.5
Tuberculosis	0.14	0.60	0.53	4.1	--	0.11	0.11	0.9
Malaria	2.99	1.22	1.25	9.8	0.13	0.20	0.46	3.7
Infectious diseases	2.42	1.71	0.63	4.9	0.73	1.44	0.21	1.7
Sexually transmitted diseases and HIV/AIDS	7.72	6.62	5.01	39.1	--	1.14	1.49	12.1
Nutrition	2.75	2.75	1.62	12.7	0.12	0.12	--	--
Policy and administration	1.07	1.11	0.53	4.1	0.34	1.88	0.74	6.0
Medical research	0.07	0.04	0.02	0.2	0.15	0.15	0.16	1.3
Medical services	0.51	0.45	0.34	2.6	0.22	0.48	0.27	2.2
Social services	1.27	2.16	0.69	5.3	0.06	0.06	1.32	10.7
Population services	0.47	0.19	0.12	1.0	--	0.32	0.06	0.5
Basic health services	3.90	1.82	1.03	8.0	3.23	6.00	3.02	24.5
Total	30.15	23.05	12.82	100.0	8.34	15.60	12.35	100.0

Source: Author's calculations based on data from DAD

4.47 The lack of a medium-term expenditure framework to underpin a programmatic sector-wide approach hampers donor coordination and a more effective monitoring of donors' spending in the health sector. The government is not fully informed about the activities of all donor organizations working in the various health regions in the country. In particular, while donor flows on bilateral and multilateral are becoming increasingly available, capturing the expenditures of NGOs on their assistance programs remains a challenge. In addition, the lack of coordination may reduce the effectiveness of donors' interventions while placing undue burden on the government's limited capacity. Furthermore an MTEF would help strengthen the basis for strategic planning. CAR has a number of strategic policy documents, including the PNDS, which set out its medium and long-term objectives and priorities; the government should now move to develop a medium-term expenditure framework to guide the allocation of resources in line with sector priorities such as progress toward the MDGs.

F. POLICY RECOMMENDATIONS

4.48 CAR is lagging considerably behind in health indicators which are, in most cases, below the rate of progress required by the Millennium Development Goals. There are three main reasons for this, all of them reflected in the findings of the ECASEB survey: low quality of basic health care, low utilization rates of health services by the poor and low levels of preventive care. The following recommendations should be considered.

4.49 In view of the fact CAR has one of the lowest health spending in the region; a case can be made that the government should consider allocating more resources to health expenditure. However this PER recommends that in the short run the government should first focus on improving allocation efficiency. Priority should be given to strengthening preventive care and intensifying programs that tackle communicable diseases. This could be achieved through a greater focus on results and by improving budget execution.

- Implementing innovative mechanisms in the health sector such as “Results Based Financing” will lower inefficiencies and inequities in public health spending by providing priority services in rural areas. The forthcoming World Bank operation under preparation for the health sector is built on this holistic approach which could address potentially the concerns highlighted and increase the coverage as well as quality of critical health services in CAR.
- Improving the budget execution rate will ensure that resources provided to the sector are fully utilized. Higher budget execution rate would also justify higher budget allocations. To improve budget execution it would be critical to appoint credit administrators as soon as the budget law has been adopted by Parliament. It would also be essential to strengthen the capacity of the main actors involved, clarify their roles, and ensure that the new procurement rules are adhered to. The categories of expenditures that need most attention are goods and services and domestically-financed capital expenditures.

4.50 The government should Increase access to and quality of health services for the poor by better targeting allocations to the poor and under-served regions. In many cases, the under-served regions are also the regions with a high incidence of poverty, such as Region 3 Ouham in the north-west. Increasing access and the quality of services in these regions would involve achieving a more equal distribution of doctors, nurses and midwives across regions.

4.51 Lack of cash is one of the main reasons for low utilization of health facilities. To address these concerns, demand side mechanisms should be identified to complement the results based financing approach which focuses on supply-side. In addition, extensive operations research is necessary on local health insurance schemes and on appropriate exemption procedures.

4.52 Going forward the government should strengthen the basis for strategic planning and resource allocation and assess the potential for public-private partnerships in health as an avenue for mobilizing resources for the sector.

- CAR has a number of strategic policy documents which set out its medium and long-term objectives and priorities. To strengthen the basis for strategic planning and budget management the government should move to develop a medium-term expenditure framework to guide the allocation of resources in line with sector priorities.

- The pilot public-private partnership in the management of the six urban health centers under the financing of the French Development Agency should be evaluated to draw appropriate lessons for private sector participation in the financing of health services in CAR.

EDUCATION

4.53 Although enrollment rates have risen in recent years, CAR still has relatively low proportions of its children in both primary and secondary education. In 2009, the average net primary enrollment was 75 percent of the relevant age group for Sub-Saharan Africa whereas it was about 63 percent in CAR (WDI, 2011). The PRSP emphasizes universal primary education, but it also recognizes the need to expand secondary education; and, in addition, it promotes technical and vocational education as well as the relevance of higher education. An overreaching objective is to improve the internal efficiency of the educational system so as to address the mismatch between the education system's performance and the needs of the national economy.

4.54 As part of efforts to improve the overall performance of the education system and make progress toward the Millennium Development Goals and the Education for All Initiative, the government has set five broad objectives that it intends to reach by 2015: (i) increase net primary enrollment by 6 percent; (ii) increase the completion rate by 6 percent; (iii) raise the gross enrollment in secondary education by 4 percentage points; (iv) create 10 technical and professional training centers; and (v) ensure the professionalization of 90 percent of higher education establishments.

4.55 This section examines the recent performance of the education sector at various levels. It begins with a review of progress and challenges in the sector, highlighting the issues that need attention. The trends and composition as well as the functional distribution of public expenditures on education are then analyzed. The questions of the level of resources available for education and their allocation are discussed in some detail and recommendations are provided.

G. PROGRESS AND CHALLENGES IN THE EDUCATION SECTOR

4.56 **In academic year 2009/10, public and private schools at all levels of education enrolled 748,991 pupils in over 2300 schools.** Formal education in Central African Republic begins with three years of pre-primary schooling followed by six years of primary education, and continuing with four years in junior secondary school and three years in upper secondary school. Successful completion of secondary education opens the doors to higher education, which comprises three years of undergraduate studies and graduate level education of varying duration. Technical education of three years and professional and vocational training provide an alternative to formal secondary education. In academic year 2009/10 the distribution of students across these levels of education was: 2.8 percent in pre-school, 85.0 percent in primary education, 11.5 percent in secondary education, 0.6 percent in technical education, and [] percent in higher education. Overall, education in CAR is provided largely by the public sector, which accounts for more than 80 percent of total enrollment in primary, secondary schools, and technical schools.

4.57 **CAR has made notable progress in increasing primary school enrollment in the post-conflict period.** Following the cessation of hostilities in 2003 gross primary school enrollment increased rapidly from an average of 65 percent in 2004-2006 to 75 percent in 2006/07 and to a peak of 94 percent in 2007/2008, boosted by improvements in the economy and progress in the construction of schools and the rehabilitation of classrooms across the country, including in conflict areas. This trend was

interrupted by a decrease in primary school enrollment to 84 percent in 2008/2009, reflecting in part the impact of the global economic slowdown on households in CAR. A rebound in enrollment to 91 percent is projected in 2009/10. By contrast, enrollment growth in secondary education has been weaker. Enrollment ratio at the junior secondary level increased slowly from 16 percent in 2007/08 to 19 percent in 2009/10, while the enrollment ratio at the senior secondary level remained around 7 percent.

Table 4.13: Gross and net enrollment rates for primary and secondary education, 2004/05-2009/10 (In Percent)

	2003	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Gross enrollment ratio							
Primary education	-	65	64	75	94	84	91
Secondary education							
Junior secondary	-	16	16	-	16	18	19
Senior secondary	-	7	-	-	7	8	6
Net enrollment ratio	-	-	-	-	-	-	-
Primary education	-	-	-	51.4	60.2	63	63
Secondary education							
Junior secondary	-	-	-	-	-	-	-
Senior secondary	-	-	-	-	-	-	-

Source: Ministry of Education

4.58 Despite recent progress in boosting primary school enrollment CAR is not on track to meet the Millennium Development Goals for universal primary education by 2015. To achieve the education MDGs the net primary enrollment and primary completion rates would have to rise to 100 percent by 2015, which seems unlikely on current trends. The net primary enrollment ratio was unchanged in 2009/10, at 63 percent; and, at 36 percent in 2008/2009, the primary completion rate lags even further behind the MDG target. Furthermore wide disparities in enrollments between boys and girls remain.

4.59 The national net primary enrollment ratio hides large variations among the country's eight academic regions. In 2009/10 the highest net enrollment ratio was 93 percent, which the Centre academic region had achieved, followed by Bangui at 82 percent. By contrast, the net enrollment rate was just 38 percent in the north-east academic inspectorate and 47 percent in the West academic region. Boosting the net enrollment ratio in these lagging regions, especially the north-east, will move CAR closer to the MDG target.

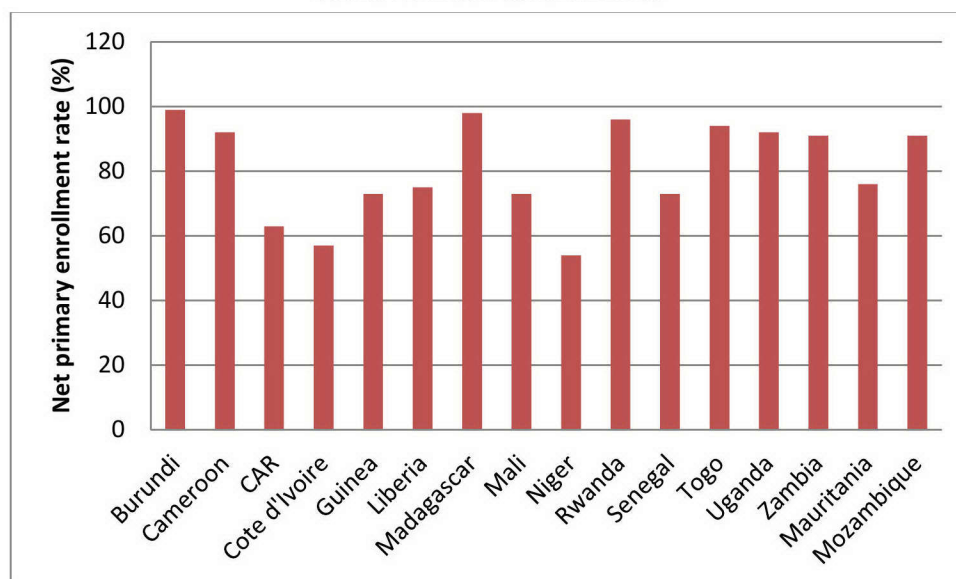
Table 4.14: Gross and net primary school enrollment ratios by academic inspectorates, 2009-2010

Academic Inspectorates	2008-09		2009-10	
	Gross enrollment	Net enrollment	Gross enrollment	Net enrollment
Bangui	101	77	113	82
Centre	110	86	120	93
Centre-east	72	55	84	62
Centre-South	82	58	91	62
North	87	67	96	66
North-East	90	67	96	38
West	64	49	67	47
South-East	78	57	79	52
CAR	84	63	91	63

Source: Ministry of Education

4.60 **CAR's enrollment indicators lag behind those of most other fragile countries.** CAR's net primary enrollment rate of 63 percent is one of the lowest among fragile countries. The low rate of net primary enrollment, coupled with the relatively slow pace of increase over the past two years, points to the need to strengthen the capacity of the education system to meet the demands of universal primary education.

Figure 4.8 : Net primary enrollment ratio in CAR in 2009 in comparison with other low-income countries in Sub-Saharan Africa



Source: World Development Indicators, 2011

4.61 **A major challenge for CAR is to raise significantly the primary completion rate.** While access in primary education has improved at the national level, both the completion rate (33 percent) and survival rate (30 percent) remain low due to high repetition and dropout rates. In 2009/10, the repetition rate remained high across the primary education cycle, especially in the first and third years, at 24 percent and 26 percent of enrollment at these levels, respectively. The drop-out rate is relatively high in the third, fourth and fifth years of primary education, at 16, 14 and 16 percent respectively, especially among girls.

4.62 **In 2008 the government developed a national strategy to address the education sector's systemic weaknesses.** In February 2008, the Council of Ministers adopted the National Education Strategy for the period 2008–20. The strategy was endorsed by the Education For All/Fast Track Initiative (EFA/FTI) partners in December 2008; and the EFA/FTI Catalytic Fund provided financing in the amount of US\$38 million to support the implementation of the first phase (2009–11). The main components of the EFA/FTI program are to improve access to education through school construction and rehabilitation, enhance the quality of education through teacher training and education materials, and increase the management capacity and internal efficiency of the education system.

4.63 **The 2008 household survey (ECASEB) carried out by the government points to a number of challenges that need to be addressed to achieve the Fast Track Initiative-Education for All (FTI/EFA) goals.** Key challenges include reducing inequality in enrollment ratios between urban and rural areas, closing the gender gap, and improving the quality of education. Inefficiencies in the system are reflected in the large dropout and repeater rates. Important determinants of education quality that need to be

addressed relate to the limited availability of textbooks, lack of teachers, teacher distribution and absenteeism, and class size. An emerging issue in terms of access to education concerns the very low enrollment levels in secondary education.

Reducing inequality in enrollment levels

4.64 The expansion in enrollment is narrowing the gap across income groups in primary education but strong inequalities remain. Access to primary education, which measures the proportion of pupils enrolled in the first grade relative to the number of 6-year old children, has risen nationwide, estimated at 91 percent in 2009/10 with net enrollment rates remaining stable at 63 percent. In 2007/08, 77 percent of the poorest households' children had access to primary education compared to 86 percent for the richest quintile. However, only 19 percent of 12 year olds from the poorest households completed 6 years of primary education compared to 46 percent for the richest quintile. The disparity is most striking at the junior secondary level where the gross enrollment ratio was at 14 percent for the poorest households against 42 percent for the richest households.

Table 4.15: Access and completion rates in primary and secondary education in 2008 by income quintiles

	Primary education			Secondary education			Gross enrollment	
	Access	Completion	Survival	Access	Completion	Survival	Primary	Secondary
Poorest quintile	77	19	15	36	19	7	82	14
2 nd quintile	98	31	30	48	31	15	89	22
3 rd quintile	100	35	35	44	35	15	97	26
4 th quintile	108	41	44	45	41	19	102	33
Richest quintile	86	46	40	39	46	18	107	42
CAR	94	33	31	42	33	14	94	27

Source: Author's calculations based on ECASEB survey data

4.65 The issues involve not only the supply but also the demand for education. While schools may be available for the poor, often the poor do not send their children to school; and the drop-out rate tends also to be higher for school children in poor households, especially in rural areas. In 2008 the drop-out rate was 19 percent nationally and 23 percent in rural areas. This is the product of many factors. One of the main factors highlighted in the ECASEB survey is that the poor see low value in educating their children, perhaps because they see the low quality of education in the schools. Financial costs of schooling are major obstacles for the poor as well. While public schools are free, they require that students purchase school books, materials, and uniforms which the poor cannot afford. Helping poor families meet these out-of pocket costs is often an effective way of increasing school attendance and helping to reduce poverty.

Addressing disparities between boys and girls and between regions

4.66 Disparities in enrollments in primary education remain large between boys and girls in most regions. In 2009/10 the gross enrollment ratio (GER) displayed a gender gap of 23 percentage points; for the net enrollment ratio (NER), the gender gap was 12 percentage points. The corresponding figures for 2008/09 are 25 and 16 percentage points, respectively, pointing to some gains for girls. These national averages hide large variations among regions, however. Overall, progress has been uneven across regions. The gender gap in gross primary school enrollment has been closed in Bangui; but while it declined in the Kagas (center), Fertit (North), Yade (North-East), and Oubangui (South-East) regions the size of the gender gap in these regions remains relatively large. In two regions, Equateur (West) and

Plateau (South west), the gender gap widened further in 2009/10 relative to 2008/09. The gender gap in net enrollment follows similar trends, remaining especially high in the Yade ad Equateur regions.

Table 4.16: Gross and net primary education ratios by region and gender, 2008-2010

Region	2008-09 (%)						2009-10 (%)					
	Boys		Girls		Total		Boys		Girls		Total	
	GER	NER	GER	NER	GER	NER	GER	NER	GER	NER	GER	NER
Bangui	100	77	102	77	101	77	115	83	109	80	112	81
Kagas	125	96	93	75	110	86	85	62	70	55	76	59
Fertit	111	81	68	53	90	67	99	65	72	52	86	58
Plateaux	91	63	73	53	82	58	98	65	71	50	84	57
Yadé	107	80	66	53	87	67	121	85	87	65	105	76
Oubangui	93	66	61	46	93	57	83	56	62	45	74	51
Equateur	77	58	52	40	64	49	90	62	61	44	76	53
CAR	96	71	71	55	84	63	100	69	77	57	88	63

Source: Ministry of Education and Author's calculations

4.67 Girls have considerably lower primary completion and survival rates, which suggest that in many regions CAR's public primary school system is still skewed heavily in favor of the education of boys. In the 2008/09 academic year the primary completion rate for girls averaged 58 percent in Bangui, greater than that of boys and significantly higher than the national average of 33 percent. In the other regions, the primary completion rate for girls remains very low, averaging just 13 percent in the Yadé region, 14 percent in Fertit, and 16 percent in the Oubangui. Yade and Oubangui are also among the regions with the highest incidence of poverty. This indicates that, as in many other low-income countries, it is in rural areas and poorest regions that girls' schooling mostly lags behind boys' schooling.

Table 4.17: Region and gender disparities in access, completion, and survival in primary education, 2008/09

Region	All students			Boys			Girls		
	Access	Completion	Survival	Access	Completion	Survival	Access	Completion	survival
Bangui	88	56	49	79	55	44	98	58	57
Equateur	73	23	17	81	27	22	64	18	13
Fertit	140	31	43	145	61	88	135	14	19
Kagas	73	31	23	90	39	35	82	21	17
Plateaux	70	31	22	80	53	42	61	26	16
Oubangui	60	23	14	59	27	16	62	16	10
Yade	134	24	32	140	51	71	127	13	17
CAR	94	33	31	95	39	37	85	25	21

Notes: Access rate: new entrants in grade 1 divided by the population of 6 year olds; completion rate = non repeaters in grade 6 divided by population of 12 year olds; survival rate is the product of access and completion rates. Source: Education Indicators Technical Guidelines, UNESCO Institute of Statistics, Nov. 2009

4.68 The ECASEB survey provides evidence that the gender gap in primary school enrollment is highest in the poorest income quintile. The gross enrollment ratio shows a gender gap of more than 30 percentage points in the poorest quintile; whereas it falls to just 10 percentage points in the richest quintile. Gender equity in enrollment rises with income, with gross enrollment approaching parity in the highest income quintile. These large disparities in gross primary enrollment across income groups suggests that the poorest households favor sending boys than girls to primary schools, whereas the wealthiest households appear to not differentiate between boys and girls.

Table 4.18Table 4.19: Gross and Net Primary enrollment ratios by Gender and Income Quintile in 2008

Quintile	GER				NER		
	Boys	Girls	Total	Equity GER	Boys	Girls	Total
Poorest quintile	97.2	64.3	81.5	66.1	54.8	41.3	48.4
Quintile 2	96.8	79.5	88.5	82.2	64.0	51.0	57.8
Quintile 3	108.0	84.5	96.8	78.2	65.8	56.1	61.2
Quintile 4	110.9	91.5	101.5	82.5	70.8	61.4	66.2
Richest quintile	111.8	101.8	106.7	91.0	75.2	69.5	72.2
CAR	104.1	83.1	94.0	79.8	65.2	54.9	60.2

Source: Author's calculations based on ECASEB data

4.69 The disparities in enrollment between boys and girls and between poor and rich households widen significantly as one moves to the next level of education. In secondary education, boys in the poorest quintile have a GER of 20 percent compared with 49 percent for boys in the richest quintile; and girls in the poorest households have a GER of 6 percent compared with 37 percent in the richest households. The equity ratio in gross enrollment shows a gap of 44 percentage points between the poorest and the richest households, which is considerably larger than in primary education. The average equity ratio, at 60 percent, indicates that for every 100 boys only 60 girls are enrolled in secondary education. As regards the net enrollment ratio the national average is around 15 percent, which highlights that while enrollment in secondary education is generally low in CAR it is significantly lower in the poorest quintile, at just 8 percent of the relevant age group. In 2008 about 11 percent of boys of secondary school age attended school in the poorest quintile while 30 percent in the richest households did. For girls the corresponding figures are 5 percent and 22 percent. The net enrollment ratios for boys and girls in the richest quintile are much higher than the national averages.

Table 4.20: Gross and Net Enrollment Ratios by gender and Income quintiles in Secondary Education

Quintile	GER				NER		
	Boys	Girls	Total	Equity GER	Boys	Girls	Total
Poorest quintile	20.4	6.4	13.9	31.2	11.4	4.5	8.2
Quintile 2	29.0	15.1	21.5	52.1	16.7	9.7	12.9
Quintile 3	32.7	18.5	25.5	56.5	16.3	10.7	13.5
Quintile 4	45.3	23.5	33.3	51.9	22.2	16.1	18.8
Richest quintile	49.3	37.0	42.0	74.9	29.5	21.7	24.8
CAR	33.8	20.2	26.6	59.9	18.3	12.6	15.3

Source: Author's calculations based on ECASEB data

4.70 In summary the data continue to show large disparities in access to education, the disparities increasing with the education level. The Education Country Status Report prepared in 2006 found that in primary education there were around twice as many children from the wealthiest households than from the poorest households and that these disparities are even more blatant in post-primary levels. The findings of the ECASEB survey presented above indicate that these disparities remain strong despite recent progress in increasing primary gross enrollment. These gains need to be sustained. In particular, the government needs to pay greater attention to girls' education, especially at the primary school level. It is now well established that the social benefits from educating girls can be substantial. Educated mothers give births to fewer children, raise healthier children, and educate them better than do uneducated mothers. Yet the primary school system remains heavily skewed in favor of the education of boys. Parents in the lowest income quintiles are more willing to pay for the education of boys than girls,

partly because of inherent bias and partly because they are more likely to capture a share of the benefits from the subsequent earnings of boys. Yet the social benefits of primary education accrue largely from the education of girls.

Improving the quality of education

4.71 The quality of education in CAR is low, affected by inadequate infrastructure and the low qualification of teachers. The low qualification of teachers is a serious problem that affects the quality of primary education. More than half (56 percent) of primary school teachers consist of the community recruited or parent-teachers with no formal training. In addition, textbooks and learning materials are in scarce supply. The students-mathematics textbook ratio for instance was estimated at 6 to 1 on average in 2009/10, and it was as high as 25 students to 1 in the academic inspectorate of Bangui. Average class size is very high in all regions but the situation is most critical in Bangui with 100 students per class; and in the Oubangui and the Plateau regions, with 97 and 96 pupils per class, respectively. Nationally there was a deficit of 280,727 seating places in primary schools in 2008/09. The national average of pupils per grade was at 91 in 2008/2009. The number of pupils in each individual classroom and grade is particularly high at the lower primary education levels (CI to CE1), while the numbers are reduced at the upper levels (from CE2 to CM2). There are 1,620 public primary schools in CAR with a total of 524,239 pupils, but only 4,144 teachers. This yields an average pupil-teacher ratio of 127, the highest in the SSA region, which is not consistent with the need for quality education. Although Bangui has the highest number of teachers (822) for its 79 public primary schools, its pupil-teacher ratio remains very high at 114, compared to the average of 54 pupils per teacher in private schools. The results of all these factors are high dropout rates and high repetition rates, especially among the poor.

4.72 In the ECASEB survey more than two-third of students attending a school establishment at all levels were not satisfied with the performance of their schools. The main reasons behind students' dissatisfaction are the lack of books (53 percent), the lack of teachers (43 percent), and the lack of seats in the classroom (42 percent). Other significant factors include the lack of qualified teachers (29 percent), the poor quality of school infrastructures (26 percent), and the prolonged absence of teachers (24 percent). Estimated at 76 percent, the percentage of students dissatisfied with of their schools is much higher in rural areas than in the urban areas (65 percent). The lack of teachers including absenteeism and their low qualifications rank highest among primary school students' concerns in rural areas; whereas in urban areas it is classroom overcrowding. The reasons for students' dissatisfaction at the secondary school level point also to the need to address the level of teacher qualifications, class size, inadequate supply of textbooks and teacher absence.

4.73 The low quality of primary and secondary education means that the CAR's education system is not producing enough students with the knowledge and skills that are needed to boost productivity and develop the economy. Basic literacy and numeracy are important for both the political development of a democratic country and for the more effective operation of the economy. In CAR, illiteracy is frequently cited as a factor holding back the development of entrepreneurship and financial markets in the country. Adult literacy was estimated at 55 percent over the period 2005-09, compared with the average of 62 percent for low-income countries and Sub-Saharan Africa. The results of the PASEC light survey, using standardized French and mathematics tests taken by grade 5 pupils in 2006 and in which CAR's scores were the lowest, highlighted the need to sharply improve literacy and numeracy skills. Since then, however, internationally or regionally comparable assessments have not been undertaken.

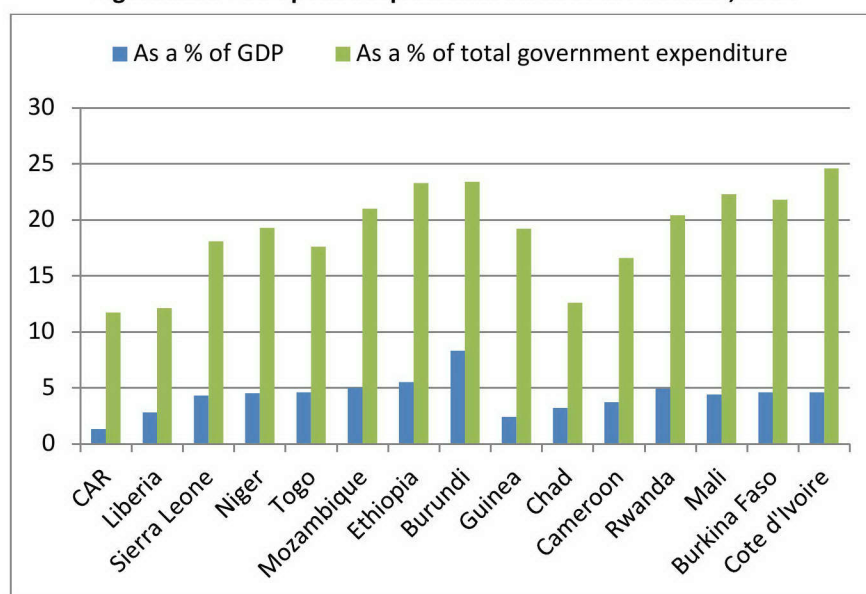
H. PUBLIC SPENDING IN EDUCATION

4.74 This sub-section examines public expenditures on education over the period 2008-2010. It analyzes the level and economic composition of government spending on education as well as its functional distribution. It also examines households' contributions to education financing and foreign-financed expenditures. The previous sub-section highlighted the need to reduce inequality in enrollment between income groups as well as the disparities between boys and girls and improve the quality of education. The analysis of funding and allocation of education expenditure in this sub-section aims to assess whether the current level of spending on education is adequate and whether public resources can be deployed in ways that would help to improve the quality, equity and efficiency of CAR's education system.

Total Public Expenditure on Education

4.75 Total public expenditure on education in CAR, the sum of current and capital expenditure on education by local, regional and national governments, represented 11.7 percent of total government expenditure in 2009. The available data show that education expenditure represents from 11 percent to 28 percent of total government spending in Sub-Saharan Africa (SSA), with an average of 18.3 percent (UNESCO, 2011). Compared to other regions, countries in the SSA region tend to invest a relatively large proportion of the government budget in the education sector. On average, however, the total amount of resources devoted to public education expenditure in CAR is lower than in most countries in the SSA region and considerably less than in most fragile countries with comparable national income levels such as Burundi and Mozambique.

Figure 4.9 : Total public expenditure on education in CAR, 2009



Source: UNESCO Institute for Statistics, 2011

4.76 Total public expenditure on education accounted for just 1.3 percent of GDP in 2009, largely below the average for Sub-Saharan Africa. As a region, Sub-Saharan Africa devotes about 4 percent of its GDP to public education expenditure (UNESCO, 2011). In general the share of education expenditure in total government expenditure provides a measure of the degree of commitment of a country to educational development; CAR's relatively low share highlights the need for greater efforts to increase

investment in the education sector. An analysis of CAR's natural wealth shows that CAR's greatest shortcomings lie in intangible capital, which encompasses human and social capital, including education and health.

Government Education Expenditure¹¹

4.77 Government education expenditures increased by about 4.3 percent in real terms between 2009 and 2010. Actual government spending on education rose by more than 9 percent in real terms in 2009 but declined slightly in 2010. As a result, the share of education in total government spending fell from 10.3 percent in 2009 to 9.1 percent in 2010, considerably less than the Education For All (EFA) Fast Track Initiative (FTI) benchmark of 20 percent. The decrease in the education share of government spending in 2010 was caused by a number of factors including low budget execution and a relative crowding-out effect due to an increase in military and administrative spending over the same period.

Table 4.21: Public expenditures in education (payments basis, CFAF Billions)¹²

	2008	2009	2010 Prel.	2011
	<i>Actual</i>			<i>Budget</i>
Nominal national education expenditure	9.37	10.61	10.70	16.35
Adjusted by CPI deflator	7.15	7.81	7.76	11.55
Growth real education expenditures		9.3	-0.7	48.8
Education expenditures (% of total expenditures)	9.6	10.3	9.1	13.7
Total education expenditures (% of GDP)	1.1	1.1	1.1	1.5
Total nominal national expenditures	97.74	103.07	117.56	119.35
Total real national expenditures	74.50	75.90	85.28	84.30

Source: Author's calculations

4.78 Over the period 2008-2010 government spending on education averaged just 1.1 percent of GDP, one of the lowest among low-income and fragile countries in Sub-Saharan Africa for which comparable data are available. Even though spending on education rose as a share of total government spending in 2009, as a share of GDP it was less than any other fragile country. The increase in education spending planned in the 2011 finance law will bring government education expenditures to a projected 1.5 percent of GDP. However, even if these projections are realized, total public education spending in CAR will still be considerably lower than the average for Sub-Saharan Africa and largely below the EFA FTI benchmark of 20 percent.

Donor Financing

4.79 The Central African Republic receives donor funding for education as a PRSP priority sector. External sources of funding include mainly grants but also concessional loans from multilateral organizations and bilateral agencies, international NGOs and international religious institutions. The support that is channeled through local and international NGOs working in CAR is much more difficult to quantify and some of it may not even be captured in the net ODA flows. Nevertheless, figures from the Development Assistance Database (DAD) permit an examination of commitment and disbursement trends of donor funding. The data show that education commitments reached a peak in 2009 due to EFA

¹¹ This analysis is based on the budget of the Ministry of Education, using data from the Ministry of Finance and Budget. In this case government education expenditure refers to current and capital expenditure of the central government and excludes foreign financing.

¹² Net of debt service payments and foreign-financed capital expenditure.

FTI financing. In 2008-2010 the largest multilateral donors to education in CAR were the World Bank, the European Union and African Development Fund. The largest bilateral donors have been France, Japan and China.

Table 4.22: Donor Funding in Education, 2008-2010 (In CFAF Billions)

	2008			2009			2010		
	Commitments	Expenditure	% of Total commitments	Commitments	Expenditure	% of total commitments	Commitments	Expenditure	% of total commitments
Multi-sector training	0.16	0.16	8.9	0.59	0.59	2.3	0.33	0.20	16.6
Vocational training	0.21	0.21	11.7	0.50	0.34	1.9	0.44	0.36	22.1
Primary education	0.43	0.00	23.9	17.01	0.62	66.7	--	4.63	--
Secondary education	0.03	0.03	1.7	0.42	0.45	1.6	0.45	0.39	22.6
School infrastructure	0.62	0.28	34.5	5.77	0.44	22.6	0.25	2.71	12.6
Teachers training	0.26	0.14	14.5	0.06	0.06	0.2	0.06	0.06	3.0
Vocational training			--	0.44	0.05	1.7	--	0.03	--
Education management	...	...	--	0.67	0.44	2.6	0.54	0.11	27.1
Education research	0.09	0.08	5.0	0.03	0.03	0.1	0.03	0.03	1.5
Total	1.80	0.90	100.	25.50	3.04	100.0	1.99	8.52	100.0

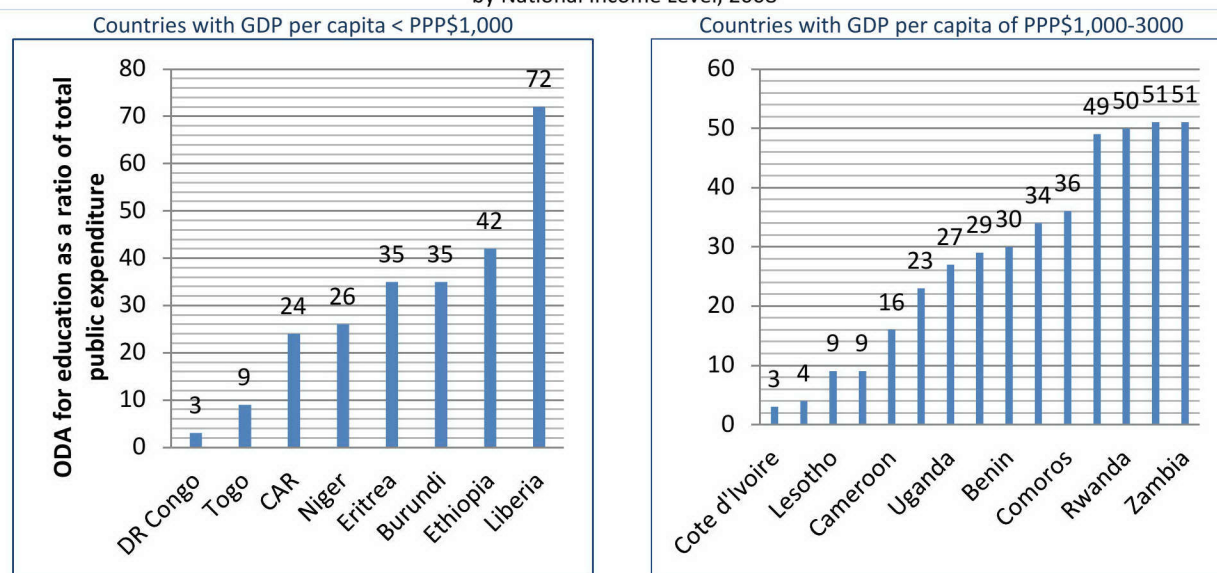
Source: Author's calculations based on data from DAD

4.80 Donor funding for education over the period 2008-2010 was directed at the priority areas identified in the PRSP with a growing emphasis on primary education. The data show that commitments for primary education increased from 24 percent in 2008 to 67 percent in 2009 (table 4.22). Commitments for school infrastructure were the second largest in 2009; they are linked in part to projects financed by Japan and China for the construction and rehabilitation of primary schools. Commitments for secondary education increased strongly in 2009 but, compared to primary education, they have been relatively modest. United Nations agencies such as UNESCO and UNICEF have focused part of their assistance on vocational training and capacity building interventions at the central and local levels. UNICEF provided also emergency assistance to improve access to and the quality of education, including in support of girls' education.

4.81 According to OECD-DAC the amount of official development assistance for education that CAR received in 2008 accounted for 24 percent of total public education expenditure. This compares with 72 percent for Liberia, 35 percent for Burundi and 9 percent for Togo. More generally, compared to countries with comparable level of national income, CAR has received far less aid to finance its education expenditures than most¹³.

¹³ In 2008, total ODA disbursement to CAR amounted to US\$255 million, ODA for education was US\$6.1 million, and ODA for education as a share of total ODA was 2.4 percent.

Figure 4.10: Official Development Assistance for Education as a Ratio of total Public Education Expenditure
by National Income Level, 2008



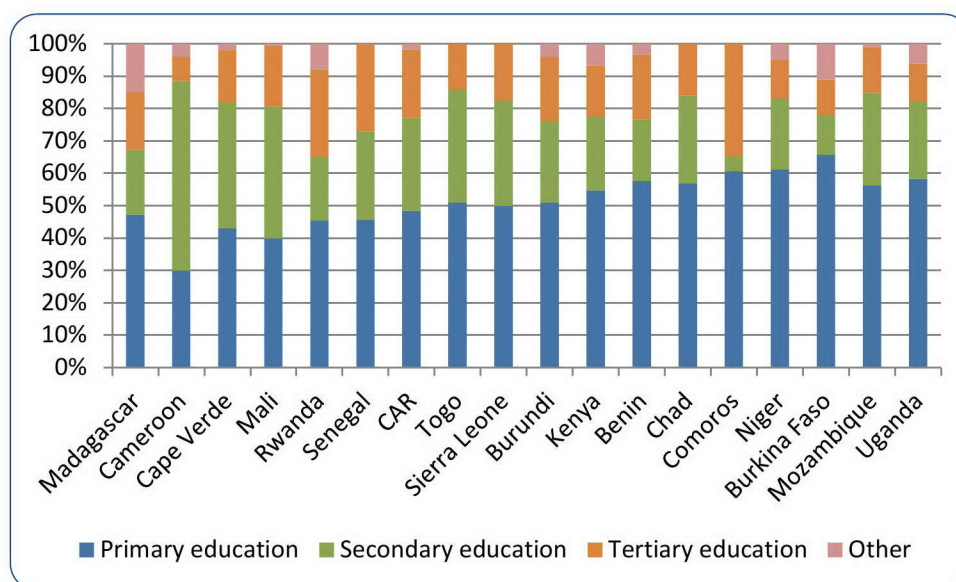
Source: UNESCO Institute for Statistics

Public Expenditure by level of Education

4.82 In 2008, public expenditure on primary education accounted for about 48.4 percent of total public expenditure on education, secondary education accounted for about 29 percent and tertiary education for 21 percent. In comparison the Education Country Status Report, which provides figures up to 2005, found that in 2005 spending on primary education accounted for 49.5 percent of total public expenditures, secondary education accounted for about 27.5 percent and tertiary education for about 23 percent. Thus the data show that over the past years the share of total public education expenditure allocated to primary education has declined further below the 50 percent mark, the benchmark set by the EFA FTI as a measure of the strength of government commitment to primary education. Given CAR's relatively low primary education indicators, especially its low net enrollment ratio and completion rate, primary education should remain a priority in the budget.

4.83 Figure 4.11 shows the allocation of public education expenditure by level of education in CAR and across a range of countries in the Sub-Saharan Africa (SSA) region. Primary education occupies the largest share of public education expenditure in most SSA countries, but this share ranges from nearly 66 percent in Burkina Faso to about 30 percent in Cameroon. Among the countries with comparable indicators several (e.g., Niger and Burkina Faso) allocate a larger share of total public education to primary education than CAR currently does.

**Figure 4.11: Public education expenditure by level of education
as of % of Total Education Expenditure in 2008**



Source: UNESCO Institute for Statistics

Economic Composition of Government Education Expenditures

4.84 Over the period 2008-2010 the majority of government education expenditures were allocated for wages and salaries followed by expenditures on goods and services. Personnel spending accounted for 81 percent on average of government expenditures in the sector. Expenditures on goods and services were the second largest item although they were far below personnel spending, averaging 13 percent of government expenditures over the period. This period was characterized by a rapid rise in expenditures on transfers and subsidies, which rose from 2.9 percent of spending in 2008 to 8.3 percent in 2010 in real terms, consisting mostly of scholarships for university students and temporary contracts for replacement teachers.

Table 4.23: Economic composition of education expenditures

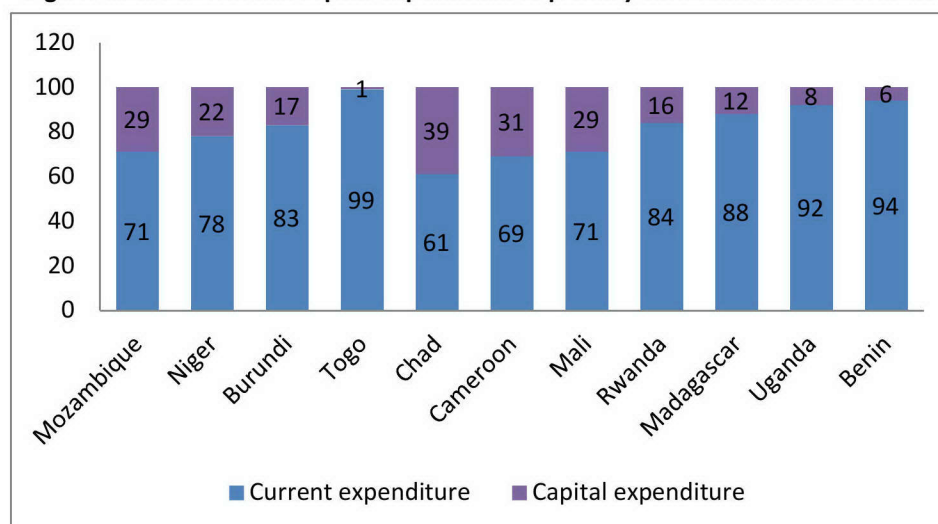
	Executed Education Budget (payment basis), CFAF billions					
	2008	% of Total	2009	% of Total	2010 Prel.	% of Total
Current expenditure	7.14	100.0	7.80	100.0	7.75	99.9
Salary	6.06	84.8	6.23	79.9	6.16	79.4
Non-salary	1.08	15.2	1.57	20.1	1.59	20.5
Goods & services	0.88	12.3	1.15	14.8	0.94	12.2
Transfers & subsidies	0.20	2.9	0.42	5.4	0.65	8.3
Domestically-financed capital expenditures	0.00	0.0	0.00	0.0	0.01	0.1
Total	7.14	100.0	7.80	100.0	7.76	100.0

Source: Author's calculations

4.85 The government budget for education in terms of actual spending has been heavily geared toward current expenditure. Almost no space was made for capital expenditures, reflecting the excessive reliance of the government on donors to finance investments in the education sector. In many SSA countries current spending accounts for the largest share in primary education compared to capital

expenditure but there are large variations among countries in the share taken up by each category of expenditure. In Togo, for instance, current expenditure accounts for all primary education; whereas Chad allocates more than one-third of primary education spending to capital spending (figure 4.12).

Figure 4.12: Current and capital expenditure in primary education in SSA countries



Source: UNESCO Institute for Statistics

Nature of Spending by level of Education

4.86 The share of current spending dedicated to salary or non-salary expenditure varies by level of education. CAR allocates a large portion of current expenditure to salaries, especially at the primary level, but this portion falls as the levels of education rise to secondary and tertiary.

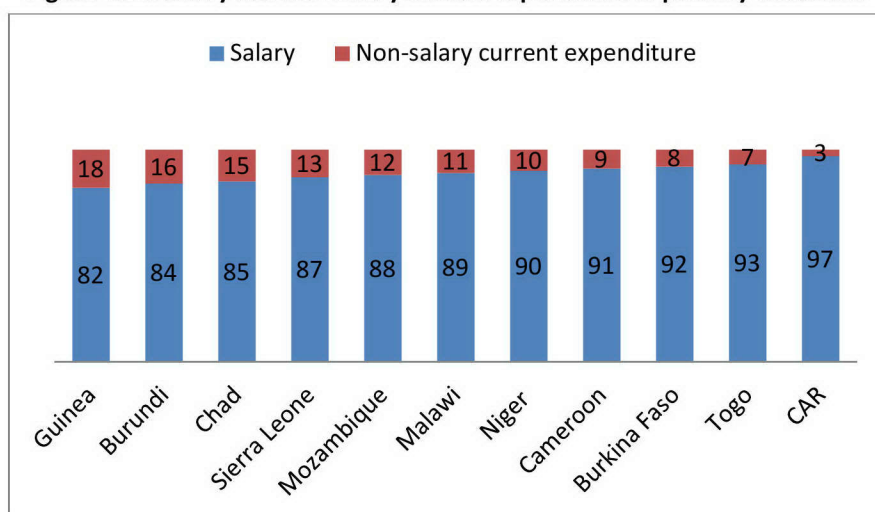
Table 4.24: Public expenditure by level of education in CAR in 2008, commitment basis (In CFAF Billions)

	Total Salary	Goods & services	Transfers	Total current expenditure	As a % of all education levels	Domestically financed capital expenditure
Primary education	5.22	0.41	0.14	5.77	49.5%	0.12
Secondary education	2.22	0.30	0.20	2.72	23.3%	0.13
Junior level	1.26	0.30	0.20	1.76	15.1%	..
Upper level	0.96	..	..	-	..	..
Technical & Professional education	0.70	0.16	..	0.86	7.4%	0.00
Tertiary education	1.12	0.49	0.70	2.31	19.8%	0.16
All levels	9.26	1.36	1.04	11.66	100.0%	0.41

Source: Author's calculations

4.87 A recent study by UNESCO found that salary accounted for 97 percent of current expenditure on primary education in CAR, the highest among countries with comparable national income. Maintaining higher teacher salaries may be very effective in improving the quality of instruction by enhancing the motivation of teachers but focusing mostly on teachers is not enough to improve the quality of education. CAR needs to invest in the other determinants of education quality, which include adequate supplies of books and learning materials, and maintenance and operation expenditures.

Figure 4.13: Salary and non-salary current expenditure in primary education



Source: UNESCO Institute for Statistics

4.88 **The share of non-salary spending in current expenditure is often regarded as an indication of the quality of education because it is associated with textbooks and other learning materials.** Table 4.25 below shows the main categories of non-salary current expenditures in CAR in 2009. The level of non-salary current expenditure was not only low but it consisted mainly of expenditures for student's scholarships, payments for teachers under temporary contract in secondary schools and at the university, food and tuition subsidies. There was some allocation for office supplies and building maintenance but expenditures for learning materials were limited

Table 4.25: Non-Salary current expenditure in education in CAR in 2008 (Payments order basis)

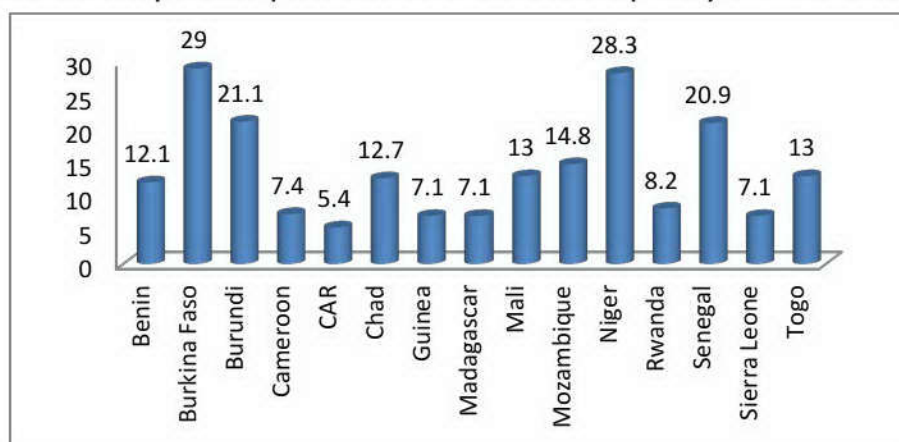
	Central Administration		Primary education		Secondary education		Technical & vocational training		Tertiary education	
	CFAF million	% of Total	CFAF million	% of Total	CFAF million	% of Total	CFAF million	% of Total	CFAF million	% of Total
Office supplies & maintenance	28.57	21.0	64.77	13.9	82.22	25.1	30.77	33.5	44.57	4.8
Technical materials	1.51	1.1	19.50	4.2	32.99	8.9	25.77	28.1	15.35	1.7
Building maintenance	2.25	1.7	102.72	22.2	19.89	5.3	..	..	13.52	1.5
Exams & tests preparation	..	..	35.34	7.6	35.34	9.5	35.34	38.5	..	..
Scholarships	..	..	169.38	36.5	..	..	..	..	214.08	23.2
Temporary contracts	..	..	..	..	201.89	54.2	..	..	389.92	42.2
Student & teacher transportation	..	..	..	..	..	..	..	..	24.59	2.7
Food	..	..	..	..	..	..	..	..	..	..
Registration fees	..	..	..	..	..	..	..	..	200.79	21.7
Other	103.57	..	72.00	15.5	..	..	..	..	20.77	2.2
Total, all levels	135.92		463.71		372.33		91.88		923.59	

Source: Author's calculations

Analysis of Education Expenditure per Student

4.89 In 2009 public expenditure per student as a share of GDP per capita was estimated at 4.5 percent for primary education, 16.1 percent for secondary education and 124.1 percent for tertiary education. While the unit costs for secondary education and tertiary education are broadly comparable to those of other low income countries, the unit costs for primary education are exceptionally low in CAR. Public expenditure per tertiary student exceeds 27 times the expenditure per primary pupil. An explanation for the tertiary education costs in CAR may be the large scholarships awarded to tertiary students.

Figure 4.14: Public expenditure per student as a share of GDP in primary education in CAR in 2009



Source: UNESCO Institute for Statistics

Budget Execution and Public Financial Management Issues

4.90 The education budget has been largely under-executed over the period 2008-2010. The education budget execution rate averaged just 74.4 percent over this period, significantly below the execution rate of the total budget, at 105.7 percent on average but higher than the execution rate for health, at 71.1 percent. This low budget execution rate reflects operational inefficiencies. As in most sectors, the execution rate is highest on wage and salary expenditures. The execution rate for goods and service expenditures, which concern the purchase of materials and supplies and operation and maintenance expenses, has been less than 50 percent on average. This suggests that schools are far from operating efficiently. The execution rate on transfers and subsidies has increased rapidly from 20.2 percent in 2008 to 66.4 percent in 2010. This rapid increase in spending on transfers and subsidies may have crowded out spending on goods and services.

Table 4.26: Education budget execution rate, 2008-2010 (Payments basis)

	Executed Budget CFAF Billions			Allocation in Budget Law / CFAF Billions			Execution rate (%)			Average (%)
	2008	2009	2010	2008	2009	2010	2008	2009	2010	
Wages & salaries	6.06	6.23	6.16	6.16	6.11	6.63	98.4	102.0	92.8	97.8
Goods & services	0.88	1.15	0.94	1.97	2.12	2.28	44.6	54.4	41.5	46.9
Transfers & subsidies	0.20	0.42	0.65	1.02	0.98	0.97	20.2	43.3	66.4	43.3
Domestically-financed capital expenditure	0.00	0.00	0.01	0.47	1.16	0.66	0.0	0.0	1.6	0.5
Total	7.14	7.81	7.76	9.61	10.37	10.55	74.3	75.4	73.6	74.4

Source: Ministry of Finance and Budget

4.91 Improving the performance of the education sector will require major improvements in budget planning and execution procedures and practices. Budget planning should be based on a coherent sector strategy and on an operational medium term expenditure framework to guide the sectoral allocation of expenditures across programs and projects according to PRSP priorities, based on adequate costing from sectoral analysis. While a national strategy for education exists a sectoral MTEF is currently lacking. As in other ministries, budget preparation starts when the Prime Minister sends to line ministries the Budget Framework Letter about the next budget. Central directorates and local government officials submit budget proposals, which are received by the Minister's office and discussed with the Ministry of Finance. Final budget allocations, including decisions on intra-sectoral priorities, are made by the Ministry of Finance and usually reproduce previous budget allocations, with adjustment for price increases. The selection and design of donor-financed investment projects follow a separate process which does not fully involve the staff of the Ministry of Education. Budget execution is marked by long delays in the preparation of procurement and commitment plans. As in the case of the Ministry of Health these delays are due to delays in appointing credit managers and to the high turnover among the managers. Weak procurement capacity and the reluctance of domestic suppliers to participate in the bidding process due to government arrears are also important contributing factors to the low execution rate of the education budget.

Household Expenditures on Education and Private Sector provision of Education

4.92 Parents in CAR devote considerable resources to the education of their children. Parents who send their children to private school cover the full cost of education, including higher tuitions. Parents with children in public schools also report spending on registration fees, even though fees have been officially abolished in primary and secondary education. In public schools registration fees are officially set at FCFA 600 per pupil and per year for primary schools and at about FCFA 1,500 for secondary schools. The ECASEB survey shows that households in CAR pay tuition and other education-related costs such as uniforms, books, school materials, transportation, and food. In Table 4.27 below data from the ECASEB survey are used to gauge the magnitude of household spending in education. The estimates suggest that education-related costs are out of the reach of poor households.

4.93 Payments for tuition, school materials and transportation constitute a large financial burden on parents in CAR. Tuitions account for more than 80 percent of households' expenditures on education. Parents pay tuition for pre-school, primary and secondary education, higher education and vocational and professional training. On average parents spend CFAF28403 on registration cost for primary schools (including pre-primary schools). This represents about 7 percent of the average household spending on education and 8.5 percent of average household spending on tuitions. For secondary education, parents spend on average CFAF36437 and CFAF43870 on registration costs for general secondary education and technical secondary education, respectively which, together, account for 24 percent average household spending on tuition. The highest mean household spending on tuitions is for professional training, at CFAF97500. Besides tuitions, books and school materials and transportation cost account for relatively large shares of household spending on education. The category "other" consists mainly of contributions to the Parent Teachers Association (APE), and parts of these contributions are used to pay community teachers in primary schools. In the ECASEB survey, parents pointed to high cost of education as one of the reasons for abandoning schools in primary and secondary education.

Table 4.27: Distribution of Aggregate Household Spending by Category, 2008

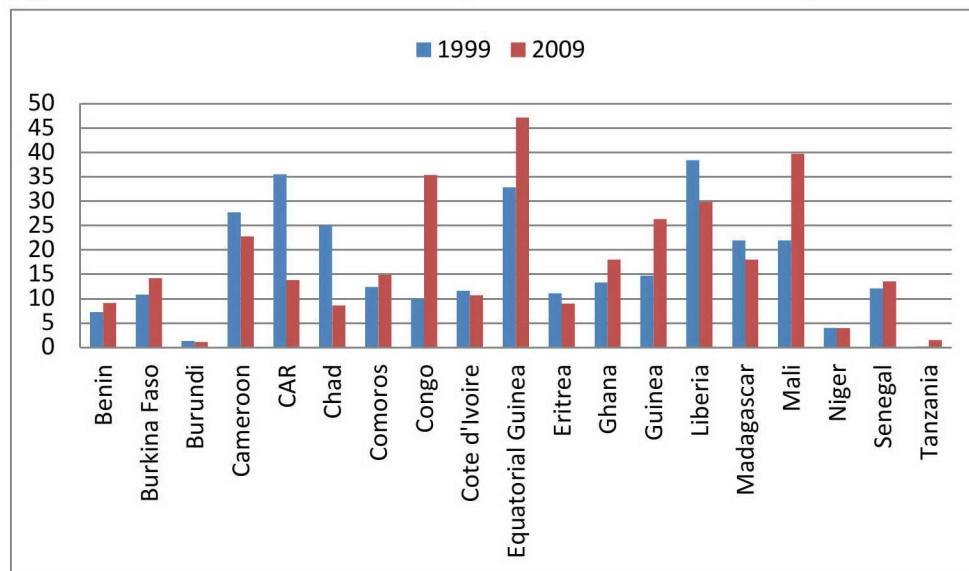
Indicator	Tuition	Uniforms	School materials	Transport	Food	Other	Total
Mean household spending (CFAF)	334811	9243	31699	27979	3070	3464	410266
Percentage of total	82	2.3	7.7	6.8	0.7	0.8	100.0

Source: Author's calculations based on ECASEB data

4.94 Private and public sectors' primary and secondary education in CAR offer the same curriculum and language of instruction, complementing the efforts of the government through the public school system. However, the size of the private sector is relatively small at the primary level, with a total enrollment of about 14 percent compared to public schools. Enrollment in private secondary schools was at 9.7 percent in 2009. Private schools are often associated with the perception that they are better organized and provide better quality teaching and fewer disruptions during the school year. This perception leads higher income families, especially in urban areas, to enroll their children in private schools as an alternative to public schools.

4.95 Enrollment in private primary schools has declined significantly over the past decade. In 1999 enrollment in primary private schools was relatively high, at 35.5 percent; in 2009, it was reported at 13.8 percent, a 61 percent decline. The proportion of children attending private schools varies considerably among SSA countries. The decline in private primary school enrollment in CAR over the past decade has been one the steepest (figure 4.15). This may be the product of several factors including lack of security, deficiencies in the quality of education as perceived by families, financial hardships in households, or an increase in tuition costs.

Figure 4.15: Enrollment in Private Primary Schools in Sub-Saharan Africa, 1999 and 2009



Source: UNESCO Institute for Statistics

4.96 Data indicate that enrollment in private primary schools continues to fall across regions with the exception of major urban centers, most notably Bangui. If the decline in enrollment in private primary schools continues there is the risk that large structural inequalities will become entrenched, with on one side poorly funded and overcrowded public schools that focus on rural areas and families

with modest means in urban areas; and on the other side, private schools operating in major urban centers and servicing the needs of families that are seeking a better quality education for their children.

Table 4.28: Primary school enrollment in Private schools in CAR

Region	2008-09				2009-10			
	Boys	Girls	Total	% Girls	Boys	Girls	Total	% Girls
Bangui	15,513	15,239	30,752	49.6	16,121	16,470	32,591	50.5
Equateur	9,435	6,023	15,585	38.7	9,678	6,499	16,177	40.2
Fertit	975	568	1,543	36.8	493	369	862	42.8
Kagas	1,472	905	2,377	38.1	1,613	1,248	2,861	43.6
Plateau	5,909	5,089	10,998	46.3	5,394	4,947	10,341	47.8
Oubangui	3,669	2,930	6,599	44.4	2,926	2,143	5,069	42.3
Yade	9,835	6,274	16,109	38.9	8,507	6,030	14,537	41.5
CAR	46,808	37,028	83,936	44.1	44,732	37,706	82,438	45.7

Source: Ministry of Education

Policy Recommendations

4.97 The Central African Republic has made notable progress in increasing the gross primary enrollment ratio but faces significant challenges to achieve universal primary education. The low rate of net primary enrollment, coupled with the relatively slow pace of increase over the past two years, points to the need to strengthen the capacity of the education system to meet the demands of universal primary education. The following recommendations should be considered.

4.98 On average, the total amount of resources devoted to public education expenditure in CAR is lower than in most countries in the SSA region and considerably less than in most fragile countries with comparable national income levels. More resources will be needed to achieve the EFA objectives and improve the quality of education and equity. However, in the short run the focus should be on prioritizing resources by levels of education and ensuring that committed resources are effectively utilized.

- Resources should be reallocated within the education sector toward primary education. Given the low primary completion rate as well as the low net enrollment rate, it would be critical to increase the share of the budget allocated to primary education.
- The low budget execution rate also means that fiscal space can be created within the sector by improving the allocation of resources. The execution rate for goods and service expenditures, which concerns the purchase of materials and supplies and operation and maintenance expenses, has been less than 50 percent on average and needs particular attention.

4.99 The spending mix in primary education should be improved. Currently government spending in primary education is heavily geared toward salaries. While higher teacher salaries may be very effective in enhancing the motivation of teachers, focusing mostly on teachers is not sufficient to improve the quality of education. The emphasis on teacher salaries has been at the expense of expenditures on learning materials.

- The distribution of expenditure in primary education should be improved by increasing the share allocated to non-salary expenditure, especially learning materials and operation and maintenance. The share of resources allocated to non-salary expenditure is not only small but it

has consisted mainly of expenditures for student's scholarships and payments for teachers under temporary contract in secondary schools and at the university.

- Over the medium-term, efforts should be made to develop a medium term expenditure framework to guide the sectoral allocation of expenditures across programs and projects according to PRSP priorities, based on adequate costing from sectoral analysis.

4.100 The expansion in enrollment is narrowing the gap across income groups in primary education but strong inequalities remain, including in secondary education. Wide disparities in enrollment between boys and girls also remain. Efforts to ensure an equitable access to education should be increased. The government should focus on improving the enrollment of children of households in the poorest income quintile where the drop-out rate is highest. The issues involve not only the supply but also the demand for education.

- While schools may be available for the poor, often the poor do not send their children to school, especially in rural areas. According to the ECASEB survey one reason is that the poor see low value in educating their children, perhaps because they see the low quality of education in the schools. Education-related costs are also major obstacles for the poor. While public schools are free, they require that students purchase school books, materials, and uniforms which the poor cannot afford. Helping poor families meet these out-of pocket costs would be an effective way of increasing school attendance.
- The ratio of girls to boys in primary education has improved in recent years and should be increased further, approaching equality as soon as possible. There are a number of strategies to enhance female education, including building more schools, training more female teachers, promoting the benefits of female education, and providing stipends and scholarships for girls rather than for boys at the primary education level.

INFRASTRUCTURE

4.101 This section identifies the key infrastructure issues hampering economic performance in CAR as well as the reforms needed to improve services. It analyzes existing patterns of infrastructure spending; assesses the infrastructure funding gap based on the cost of development targets; and identifies sources of financing, including the scope for creating space through efficiency gains. The focus is on four key economic infrastructure sectors: power, transport, information and communication technology (ICT), and water and sanitation. This section is based on a country study conducted as part of the continent-wide Africa Infrastructure Country Diagnostic (AICD)¹⁴. It uses the standardized AICD methodology to benchmark CAR's infrastructure performance against that of comparable African countries –primarily other low-income fragile countries–, with particular emphasis on CAR's immediate regional neighbors in Central Africa.¹⁵

¹⁴The Africa Infrastructure Country Diagnostic (AICD) has conducted extensive data collection and analysis of the infrastructure situation in Sub-Saharan countries. In its first phase, the AICD covered 24 countries and recently the work is being extended to the rest of the continent.

¹⁵ Some methodological issues need to be borne in mind. First, due to the cross-country nature of the data collection, there was inevitably a time lag involved. The period covered by the AICD runs from 2001 to 2006. For the purpose of benchmarking, most technical data are presented for 2006 (or the most recent year available), while financial data are typically averaged over the available period to smooth out the effect of short-term fluctuations.

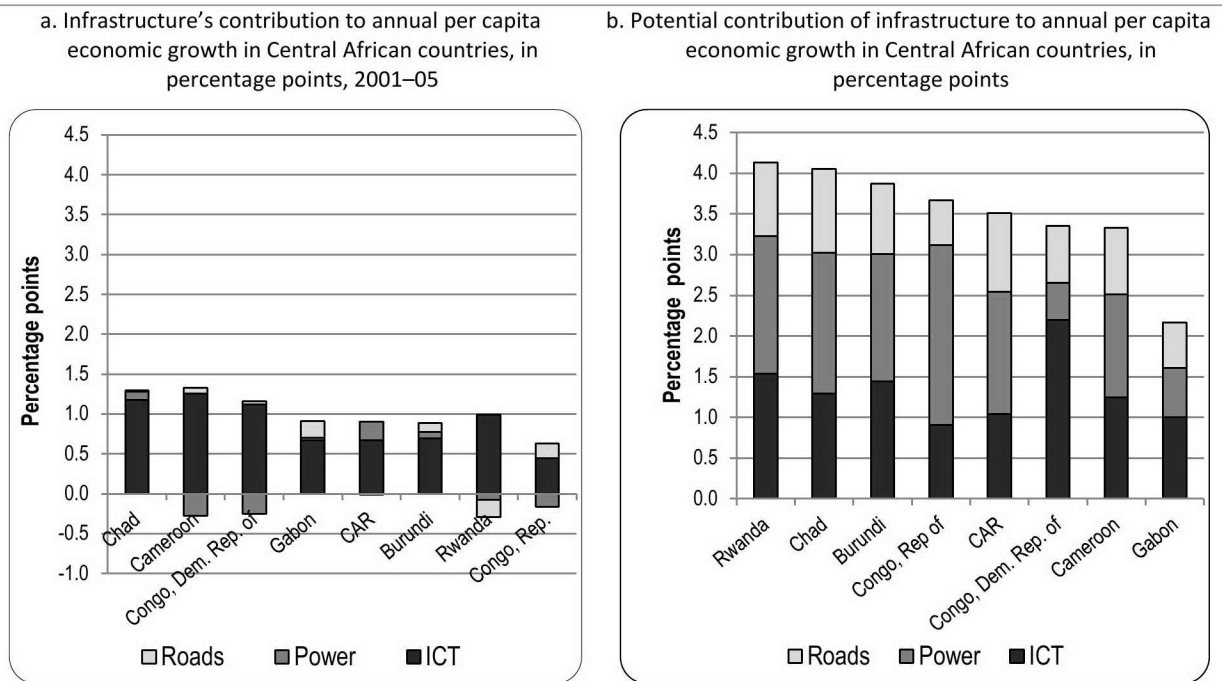
4.102 The section is organized as follows. The first sub-section quantifies the contribution that economic infrastructure can make to per-capita GDP growth in CAR; it finds that if CAR can improve the reach as well as quality of its infrastructure to the level seen in the leading country, namely Mauritius, this will add up to 3.5 percentage points annually to per-capita GDP growth. Most of this growth will come from the power sector with significant contributions from the ICT and transport sectors. The second sub-section reviews the performance of the main infrastructure sectors and highlights the key challenges that are impeding progress; the third sub-section presents targets for infrastructure upgrading in the four sectors, estimates the costs of meeting these targets, and calculates funding gaps by comparing the costs to available resources. The fourth sub-section presents the main conclusions and recommendations.

I. THE POTENTIAL CONTRIBUTION OF ECONOMIC INFRASTRUCTURE ON CAR'S OUTPUT GROWTH

4.103 **The potential for infrastructure to contribute to accelerating economic growth in CAR is substantial.** Analysis of cross-country data suggests that if CAR improves the supply and quality of its infrastructure to the level of the best performing African country—Mauritius- growth performance could be enhanced by as much as 3.5 percentage points on a per capita basis (figure 1b). In comparison, over the period 2000-2005, economic infrastructure- telecommunication, power and transport- contributed just 0.9 percentage points to per-capita GDP growth, considerably less than in many other Central African countries, reflecting the effects of the conflict as well as continued low investment in the infrastructure sectors. The ICT sector made the strongest contribution, adding 0.67 percentage points to the per capita growth rate, while the contribution of the road sector was negative, reducing per capita growth by -0.01 percentage points.

4.104 **Most of the potential growth contribution would come from the power sector, particularly from increases in electricity generation capacity.** ICT would be an additional source of growth through further expansion of mobile and Internet markets. Improving the conditions of road corridors would be particularly important; this would reduce costs and facilitate as well as increase trade with neighbors, boosting economic growth.

Figure 4.16: Infrastructure has contributed much to economic growth—but could contribute more



Source: Calderón 2009.

J. CURRENT STATUS AND MAIN CHALLENGES IN CAR'S INFRASTRUCTURE SECTORS

4.105 The main achievements and challenges in each of the CAR's major infrastructure sectors are summarized in table 4.29. The table outlines the need for upgrading infrastructure in all subsectors, the obstacles to enhancing the coverage and quality of infrastructure services, and the ambitious reform efforts in this area. The following section discusses these achievements and challenges in more detail, by sector.

Table 4.29: Achievements and challenges in various infrastructure sectors

	Achievements	Challenges
Surface transport	Relatively good or fair condition of road network and selection of surface treatment appropriate to traffic levels	Improving the condition of road corridors Diversifying access to sea ports by facilitating river transportation Reducing transportation costs to further reduce price of diesel
Water and sanitation	Sectoral reform, including of national water agency	Improving the quality of water supply and sanitation infrastructure to expand access to improved water supply and sanitation services, increase consumption per capita, and reduce distributional losses Strengthening the operation and financial performance of SODECA
Power	Sectoral reform, providing for market liberalization	Improving the quality of energy infrastructure to expand access to power and reduce power outages and transmission and distribution losses Strengthening the operation and financial performance of ENERCA
Information and Communication Technology	Sectoral reform, providing for market liberalization Rapid expansion of the mobile market via entry of private operators	Expanding the Internet market and connecting to the submarine cable landing in Cameroon Liberalizing the fixed-line market

Note: SODECA = National water utility; ENERCA = National electricity utility

Surface Transport

4.106 The transportation of goods from and to CAR is extremely costly and slow, which contributes to higher prices of basic goods. CAR's costs of trading across borders are above the average of Central African countries, which are higher than in other regions in Sub-Saharan Africa. The cost associated with exporting or importing a container, at about \$5,500 per container, is the second-highest in Central Africa after Chad. The average time to export and import is 54 and 62 days, respectively. The result is that basic goods are considerably more expensive in CAR than in non-landlocked neighboring countries.

4.107 CAR's road network is in relatively poor condition except for its strategic corridors. The condition of the classified paved road network is below the level of comparable peer countries: 62 percent is in good or fair condition versus 80 percent in fragile states. Meanwhile, only about 2 percent of the unpaved network is in good or fair condition. This divergence in the quality of paved and unpaved roads can be partially explained by the fact that 75 percent of the resources of the Road Fund—mostly for routine maintenance—are directed to the primary network, which is almost totally paved.

Table 4.30: Road indicators, benchmarked against Sub-Saharan African fragile and low-income countries

Indicator	Unit	Fragile states	CAR	Low-income countries
Road network density [1]	km/1000 km ² of land area	145	41	132
GIS rural accessibility	% of rural pop within 2 km from all-season road	30	58	23
Classified paved road network condition [2]	% in good or fair condition	80	62	86
Classified unpaved road network condition	% in good or fair condition	72	2	56
Classified paved road traffic	AADT	843	200	1,288
Classified unpaved road traffic	AADT	31	14	39
Primary network overengineering	% of primary network asphalted with 300 AADT or less	47	61	30

Source: AICD Road Sector Database.

Notes:

[1] Total network includes the primary, secondary, and tertiary networks.

[2] Classified roads are those that have been included in the roads legislation as public roads.

GIS = geographic information system; AADT = average annual daily traffic

4.108 CAR needs to develop an effective road fund to enhance spending on maintenance and rehabilitation. At 10 cents per liter, the fuel levy is among the highest in Sub-Saharan Africa, covering routine maintenance needs and 25 percent of the total maintenance requirements. Existing fuel levy represents around 7 percent of the retail diesel and super gasoline prices. AICD estimations suggest that CAR's spending on maintenance and rehabilitation is about 55 percent and 10 percent less than required, respectively, which is inadequate for routine maintenance and rehabilitation needs.

Water supply and sanitation

4.109 About 70 percent of the population relies on wells and boreholes as the main source of water, which is above the average in comparable fragile states. In many cases the condition of the CAR's wells and boreholes does not guarantee the provision of safe water. The challenge of improving the quality of water is more pressing when one considers that around one-fourth of the boreholes are out of service and that on average they provide water to 1,500 to 2,000 people—more than the government's norm of 300 people.

Table 4.31: Benchmarking water and sanitation indicators

		Unit	Fragile states		Central African Republic		Low-income countries
			Mid-2000s	1994	2000	2006	Mid-2000s
Access to piped water	% pop		17.9	2	3	2	9.3
Access to standposts	% pop		9.4	15	19	23	17.1
Access to wells/boreholes	% pop		54.5	73	68	70	39.3
Access to surface water	% pop		18.1	10	9	5	34.2
Access to septic tanks	% pop		11.2	1	1	2	4.7
Access to improved latrines	% pop		29.0	24	24	76	18.3
Access to traditional latrines	% pop		36.8	42	51		38.5
Open defecation	% pop		23.1	33	24	23	38.3
				2000	2005	2009	
Domestic water consumption	liter/capita/day		29.6	—	6.3	6.5	50.9
Revenue collection	% sales		94.6	61	61	86	94.1
Distribution losses	% production		31.5	39	53	51	34.8
Cost recovery	% total costs		57.2	—	46	—	89.5
Operating cost recovery	% operating costs		80.1	—	64	—	125.2
Labor costs	connections per employee		168.8	63	49	62	175.9
Total hidden costs as % of revenue	%		169	185	187	148	67
			Central African Republic		Non-scarce water resources	Other developing regions	
<i>U.S. cents per m³</i>			2004	2009			
Average effective tariff			57	57	80		3.0–60.0

Source: AICD water supply and sanitation database (<http://www.infrastructureafrica.org/aicd/tools/data>).

Access figures calculated by the AICD using data from Demographic and Health Survey (1994) and Multiple Indicators Cluster Surveys (2000 and 2006), as published by the WHO/Joint Monitoring Program (JMP) in March 2010.

4.110 There is a wide disparity in access to safe water between rural and urban populations. At 52 percent of the population, urban access to standposts is 10 times higher than rural access; and, at 43 percent, urban reliance on wells and boreholes is half the level in rural areas. In rural areas, 95 percent of the water comes from boreholes with hand pumps. If one considers that only 10 percent of the water coming from wells and boreholes is safe, only 14 percent of the rural population has access to safe water versus 61 percent in urban areas. In addition, 43 percent of rural households spend between 30 minutes and 1 hour walking to fetch water versus 25 percent of their urban peers.

4.111 More than three-fourths of the population rely on latrines as of 2006, but due to data constraints and the difficulty of tracking investments made by nongovernmental organizations (NGOs), it is not possible to make a clear separation between improved and traditional latrines. In rural areas, it is mainly VIP latrines or septic sanplat or double-vented types that are installed by NGOs. Devices for hand washing have been installed in community centers by the Department of Health and NGOs working in

the sector. After 2006 a substantial number of households had access to shared latrines constructed by humanitarian agencies.¹⁶

4.112 CAR's provision of utility water is critically affected by SODECA's inefficiencies. Distributional losses are more than twice as high as those of a well-performing utility and rank among the highest in Sub-Saharan Africa. Despite some improvements in collection ratios, SODECA recovered only 86 percent of the total billing in 2009, which compares unfavorably with utilities in fragile states. At 62 connections per employee, labor productivity is less than half the average productivity of a utility in fragile states and below the benchmark of 200 connections per employee calculated for a well-run utility in Africa. With an average cost-recovery ratio of 43, revenues are not enough to cover total costs. The relatively low average effective tariff (at 57 cents/m³)—below the average total cost (at 119 cents/m³)—calls for the introduction of mechanisms to get consumers to contribute more to the utilities' financial sustainability.

Table 4.32: Evolution of operational indicators associated with SODECA, Central African Republic

Year	Water delivered (million m ³ /year)	System losses (%)	Collection ratio (%)	Average total cost (\$/m ³)	Average effective tariff (\$/m ³)	Total hidden costs (\$ million/year)	Total hidden costs (% revenues)
2000	8.2	39	61	0.87	0.44	4	185
2001	8.3	40	61	0.88	0.42	4	199
2002	9.0	45	61	0.85	0.45	4	185
2003	8.9	44	61	0.91	0.45	5	203
2004	9.3	53	61	1.09	0.64	5	214
2005	9.3	53	61	1.09	0.57	5	187
2006	10.0	48	61	1.01	0.57	5	177
2007	9.9	52	67	1.11	0.57	6	164
2008	9.9	51	83	1.11	0.57	5	166
2009	9.3	51	86	1.11	0.57	5	148

Source: Derived from Briceño-Garmendia, Smits, and Foster (2009).

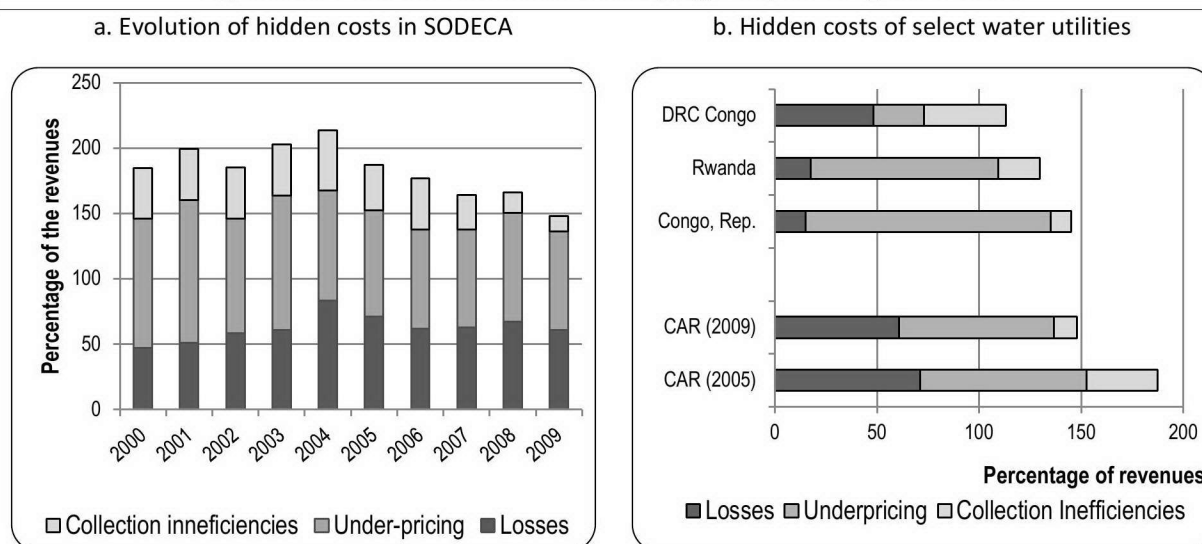
4.113 The persistence of a flat-rate tariff regime has rendered cost recovery ineffective. Water from kiosks is priced at 207 CFA francs/m³ (or 44 cents) and this price has not been adjusted since 1998. Moreover, revenue collection from private taps represents less than a tenth of the customer base. Also, while the government represents around 35 percent of the total consumption it is unlikely to pay its bills for months or years. On average, between 2002 and 2008 government arrears totaled about \$7 million, more than twice the utility's revenue for 2008.

4.114 Comparing CAR's key performance indicators against those of a well-performing utility makes it possible to quantify the monetary value of the major inefficiencies affecting the sector in terms of hidden costs. Three types of hidden costs are considered: the losses on the water distributional network above the norm of 20 percent of production (losses); the inability to collect 100 percent of bills (collection inefficiencies); and, an average effective tariff that is not high enough to cover the cost of producing a cubic meter of water (underpricing).

¹⁶ Shared latrines have expanded dramatically in recent years: 27 new shared latrines were built in 2007, 5,352 in 2008, and 1,527 in 2009 (World Bank 2010).

4.115 The AICD calculations estimated SODECA's hidden costs at 185 percent of its revenues in 2000, with underpricing accounting for half of the total. Hidden costs reached a maximum of 214 percent of the revenues in 2004, when distributional losses were at their highest level in the decade, at 53 percent of the production. Since 2005, estimated hidden costs have decreased owing to improvements in the collection ratio and a decrease in nonrevenue water. But as the average effective tariffs have remained at 57 cents/m³, the hidden costs have been driven by under-pricing. Whereas in 2005 SODECA's hidden costs were above the average level for utilities in the Central African region (below 150 percent of revenues), as of 2009 SODECA's hidden costs were at the same level of other utilities in Central Africa.

Figure 4.17: The hidden costs of water supply, as a percentage of revenue



Source: Derived from Briceño-Garmendia, Smits, and Foster (2009).

Electricity

4.116 **Years of sociopolitical crisis in the CAR have left the power infrastructure in an embryonic state.** Total installed capacity is 39 MW, one of the lowest in Sub-Saharan Africa. Moreover, the limited infrastructure that is available is decaying due to poor maintenance and needs to be completely refurbished. The installed capacity, at 10 MW per million people, is half the average of low-income countries in Sub-Saharan Africa. The limited generation capacity consists of Boali 1 and Boali 2—the two main hydropower plants—with a capacity of 14.9 MW each, a diesel plant in Bangui with a capacity of 6 MW, an interconnected grid between Boali and Bangui that carries 34 MW of generated power, and a small distribution network. In 2007 the government started construction of Boali 3, an additional 10 MW hydropower plant that is not yet operational.

Table 4.33: Power indicators, benchmarked against select groups of countries

		CAR	Low income fragile	Low income, non-fragile	Middle income
Access (national)	% of population	1	15	33	50
Access (urban)	% of population	10*	58	86	101
Access (rural)	% of population	0	4	4	32
Installed generation capacity	MW per million people	10	46	20	799
Electricity consumption	kWh/capita	27	165	107	4,479
Power outages	Days/year	40	11	10	6
Collection rate	% of billing	69	34	92	91
Cost-recovery ratio	% of total costs	75	100	89	85
Revenue per unit	U.S. cents per kWh	13	3	14	13
System losses	% generation	48	40	24	20
Total hidden costs	% revenue	167	443	69	0.1
U.S. cents		CAR	Predominantly hydro	Other developing regions	
Effective power tariff	Residential at 100 kWh	15	10.27		
Effective power tariff	Commercial at 100 kWh		11.73	5.0–10.0	
Effective power tariff	Industrial at 50,000 kWh		11.39		

Sources: Fragile and non-fragile countries' figures as of 2005, calculated using the AICD power database (<http://www.infrastructureafrica.org/aicd/tools/data>), which contains household data. For the CAR, national access is for 2009 (World Bank 2009), electricity consumption is for 2007 (CIA World Fact Book 20010); power outages are for 2005 (Rosnes and Vennemo 2009); collection ratio is for 2010 (World Bank 2010); cost-recovery ratio is for 2009 (World Bank 2009); system losses are for 2009 (ENERCA 2010); effective tariff is for 2008 (World Bank 2009).

Note: Urban access for the CAR represents access to electricity in Bangui.

kWh = kilowatt-hour; MW = megawatts.

4.117 The limited availability of power has translated into poor access to electricity. As of 2009 only 1 percent of the CAR's population had access to electricity compared to 33 percent in low-income countries. Urban access, at 10 percent and mainly concentrated in Bangui, is just one-ninth of the average access in urban areas found in other low-income countries. No one in rural areas benefits from electrification. Households rely on firewood or fuel oil as the main source of energy for domestic consumption (EIU 2007). The very low population densities impose a substantial challenge to expanding access to power.

4.118 CAR will need to develop 143 MW of additional capacity to fully meet growing demand over the next 10 years.¹⁷ But after the development of Boali 3 (10 MW), the next available plant at Palambo is a full 300 MW site that would require huge investment (\$450 million) to develop. The development of this power plant could be linked to the expansion of mining activities in the country.

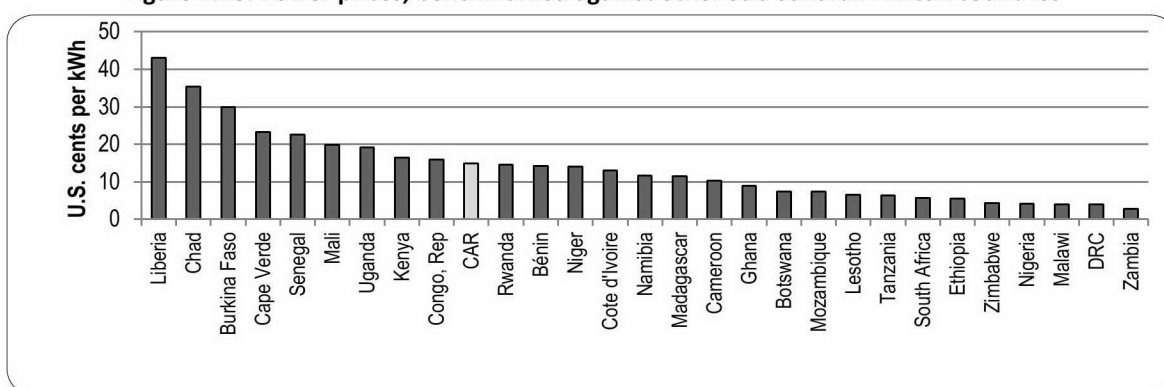
4.119 CAR's power sector is critically affected by ENERCA's poor performance, a public utility characterized by enormous system losses, an inability to recover operational and capital costs, and low revenue collection rates. On average a staggering 50 percent of the generated power in the system

¹⁷ These represent investments in the Palambo and Boali 3 plants.

has been lost every year since 2006. Around 35 percent of the power is lost due to nontechnical factors such as theft; the remaining 15 percent of the system losses are due to technical issues. Distribution cables in Bangui are over 40 years old and are made of bare copper. The copper is a rather attractive commodity for looters, and aging cables have been an easy target for illegal connections.

4.120 Despite relatively high tariffs, ENERCA has not been able to recover its total cost of production. At 15 cents per kilowatt-hour (kWh), the CAR's consumers pay higher prices than consumers in other African countries that generate power from hydro resources. High prices are driven up further by the high costs often associated with the small scale of production, escalation of fuel prices, and regular breakdowns of the power infrastructure. Historically, ENERCA has only recovered 75 percent of its total cost of around 20 cents/kWh. Underpricing has hindered ENERCA's ability to undertake new investment and refurbish its dilapidated infrastructure. But in the medium term, as the structural problems facing the sector are addressed and new generation capacity comes on stream, long-run marginal costs would likely be on the order of 11 cents/kWh, or within range of existing tariffs.

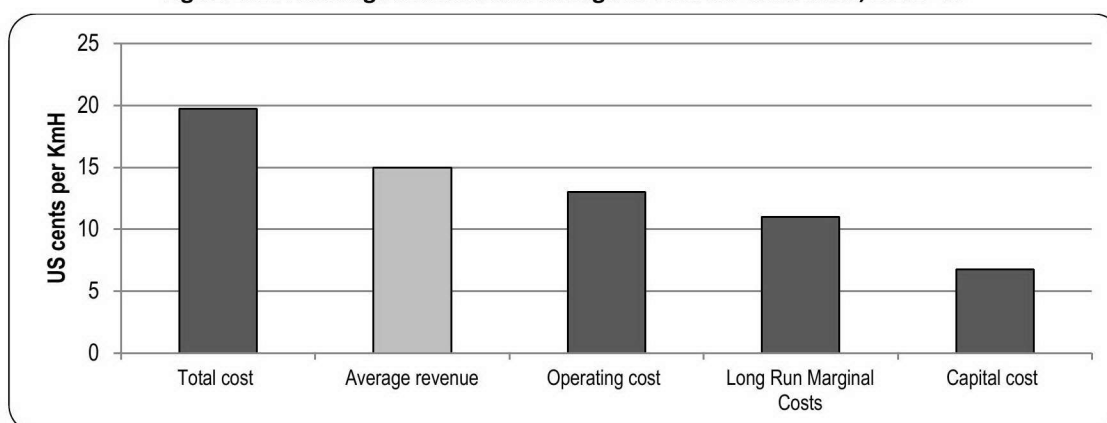
Figure 4.18: Power prices, benchmarked against other Sub-Saharan African countries



Source: World Bank 2009, AICD estimates.

Note: Average effective tariff estimates are based on prices paid by domestic and nondomestic customers, weighted by their contributions to total consumption.

Figure 4.19: Average revenue not enough to recover total costs, 2002–09



Source: Based on Briceño-Garmendia, Smits, and Foster (2009).

Note: Historical cost (both total and operational) is a simple average of ENERCA's cost between 2002 and 2009.

4.121 ENERCA's revenue collection ratio has worsened over time, decreasing from 88 percent to 62 percent between 2006 and 2010. About 50 percent of the unpaid bills concerns public sector entities

and administrations. The municipality of Bangui accumulated arrears of almost CFAF 7 billion (\$7 million) to ENERCA. As of 2009, the government needed to repay its arrears and assume the domestic commercial bank debts of ENERCA. These payments were valued at CFAF 1.7 billion or almost \$4 million (IMF 2009). Paying off this balance will allow ENERCA to strengthen its finances. The large system leakages—compounded by ENERCA’s inability to recover power production costs and its under-collection of revenues—have led to vast hidden costs, which have worsened over time both in absolute and relative terms. The increase in operating costs from 2008 to 2009 was largely circumstantial due to the breakdown of the Boali power plant.

Table 4.34: Large inefficiencies drain significant potential revenues from ENERCA

Year	Power delivered	System losses	Collection ratio	Average total costs	Average effective tariff	Total hidden costs	Total hidden costs
	(GWh/year)	(% of production)	(% of billings)	(\$/kWh)	(\$/kWh)	(\$ million/year)	(% revenues)
2004	64	50	88	0.14	0.14	5	48
2005	77	57	88	0.16	0.14	8	84
2006	65	55	88	0.15	0.14	7	90
2007	66	53	83	0.12	0.15	6	63
2008	64	57	74	0.15	0.15	7	76
2009	72	48	64	0.20	0.15	14	117

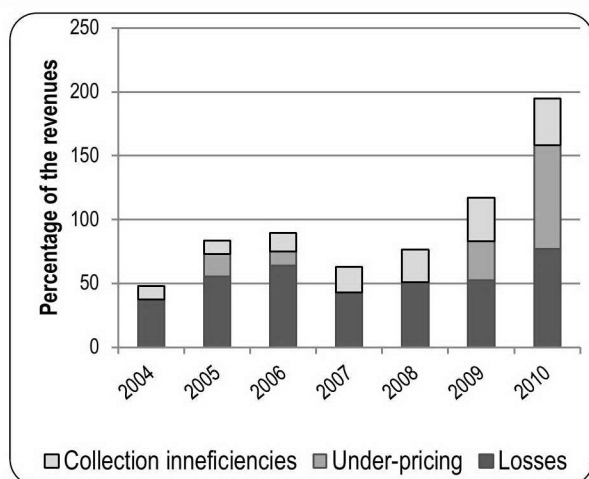
Source: ENERCA 2005, 2006, 2007, 2007, 2008, 2011; World Bank 2009.

Notes: Collection ratios for 2004–05 were not available, so the 2006 ratio was used.

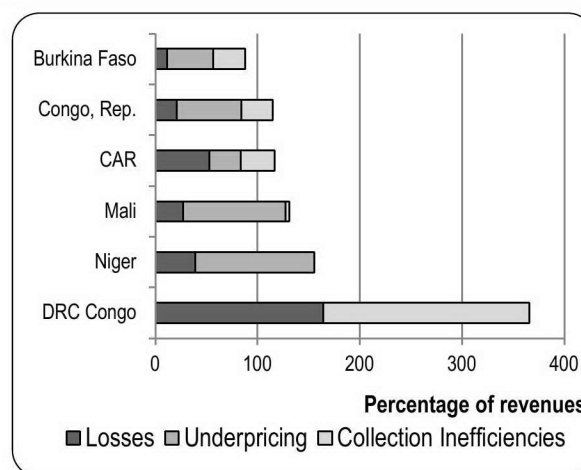
4.122 Unaccounted losses (mostly nontechnical) constitute the most obvious challenge, followed by collection inefficiencies. Inadequate bill collection has been an increasing burden for ENERCA in recent years. Relative to other low-income countries in Central and West Africa, however, ENERCA’s hidden costs in 2009 were better than several other countries.

Figure 4.20: Hidden costs, as percentage of revenues

a. ENERCA has massive hidden costs largely due to unaccounted losses



b. Hidden costs are large compared to several countries in Central and West Africa



Source: Derived from Briceño-Garmendia, Smits, and Foster (2009).

Information and communications technologies

4.123 The country has benefited from a huge expansion in the coverage and access of mobile communications. Mobile penetration rose from 0.3 subscriptions per 100 people in 2000 to 15.2 in 2009, but is still below the rates of fragile states. With only around half the population covered by a mobile signal,¹⁸ penetration remains behind the levels of comparable Sub-Saharan peers. The intensification of competition since 2004 and the actions of strategic investors from the Middle East and Europe in mobile operations¹⁹ should help to boost access. But this may be difficult without universal service support, since it is estimated that only around half the population can afford to pay for service.

¹⁸ Figure refers to the largest mobile operator by subscriptions (Orascom Telecom 2010).

¹⁹ Bintel (a Dubai-registered company) purchased Nationlink, an existing mobile operator in 2007. Likewise, Orascom Telecom of Egypt purchased Telecel, another existing mobile operator, in 2008. France Telecom entered as the fourth mobile operator in 2007 through its Orange subsidiary.

Table 4.35: ICT indicators, benchmarked against Sub-Saharan African fragile and low- income countries

Indicator	Unit	Fragile states		CAR	Low-income countries
		2008	2000	2008/2009	2008
GSM coverage	% population under signal	68	19	50	63
Mobile phone	subscribers/100 people	20.0	0.3	15.2	24.4
International bandwidth	bits/capita	47.2	0.06	3.5 ^[1]	24.8
Internet	users/100 people	2.7	0.06	1.4	3.5
Landline	subscribers/100 people	0.7	0.3	0.2	0.8

<i>US dollars</i>	Fragile states		CAR	Low-income countries
	2008	2002	2009	2008
Price of monthly mobile basket	12.0	—	12.4	11.0
Price of monthly fixed-line basket	16.0	—	13.9	10.4
Price of monthly fixed broadband	72	—	671 ^[2]	287
Price of a call to the United States per minute	0.62	4.53	0.62	0.69
Price of an inter-Africa call per minute	0.74	—	0.62	0.94

Source: Adapted from AICD, OTH, ART, SOCATEL, Orange, and World Bank ICT At-a-Glance.

[1] = 2007.

[2] = 2010, WiMAX.

— = Data not available.

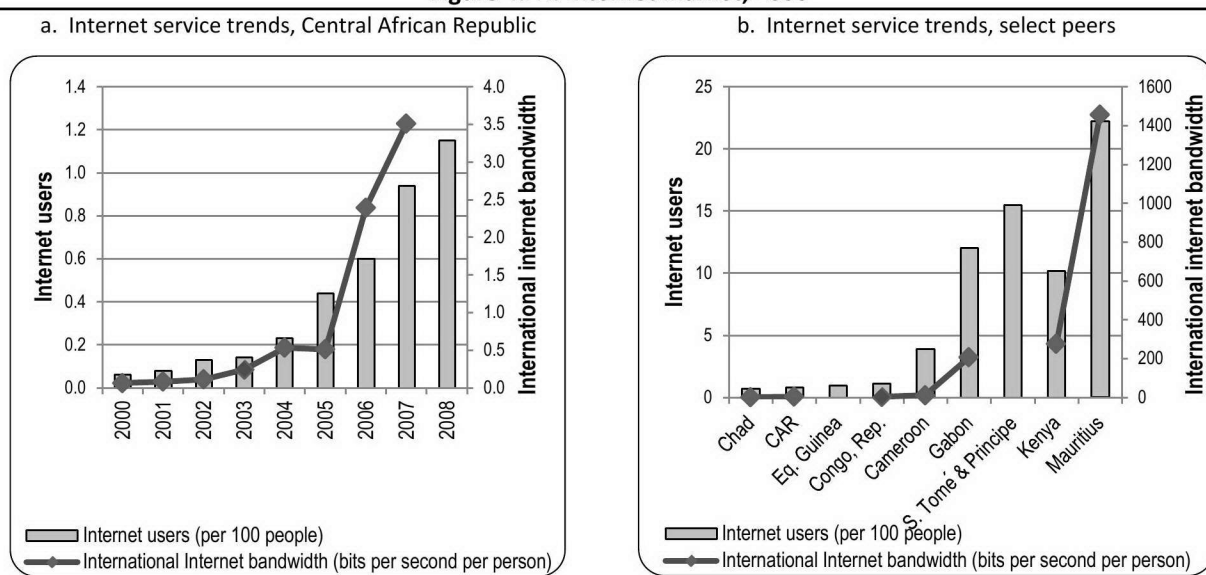
4.124 A number of factors external to the ICT sector have hindered CAR's access to and use of modern electronic communications, resulting in relatively high Internet prices and low access. Among other factors, CAR's poor electricity infrastructure and fiber-optic links are major barriers to the expansion of the ICT sector. The low level of access to electricity is a major factor constraining telecommunications in CAR. Internet costs remain high, pending completion of fiber-optic links to submarine cables. Being landlocked, CAR is reliant on costly satellite VSAT²⁰ connectivity for international Internet access. While there has been significant growth in the Internet market as well as international Internet connectivity and the number of Internet users (around 3.5 bits per person,²¹ or 1.4 users per 100 people), the CAR's Internet market is one of the least developed in the CEMAC region. The poor condition of SOCATEL's network makes the launch of DSL²² Internet services unlikely.

²⁰ Very Small Aperture Terminal.

²¹ International bandwidth was estimated at between 14 to 16 megabits per second (Mbps) in 2007 (World Bank 2009e).

²² Digital subscriber line.

Figure 4.21: Internet market, 2008



Source: World Bank, including AICD analysis.

4.125 Efforts are under way to establish a regional fiber-optic network that connects CAR and Chad to networks in Sudan,²³ which would help lower prices provided that there is competition in the international gateway. The creation of a Central African Backbone (CAB) across CAR, Cameroon, and Chad could provide much of the needed capacity. Estimations suggest that the opportunity cost of providing bandwidth that relies on satellite connection as opposed to the CAB network is \$117 million until 2021.²⁴ In addition, the economic impact on CAR and Chad is estimated at \$94 million, out of which \$76 million is consumer surplus and \$18 million is producer surplus. Despite these potential gains, there are problems surrounding the institutional arrangements and governance of international cable access, which, for instance, impede Chad from using its existing fiber-optic links laid along the Chad-Cameroon oil pipeline. Another identified risk for the CAB is low private sector interest in financing, installing, managing, and maintaining the regional network infrastructure.

Table 4.36: Submarine cables and competition, ICT prices, 2008

\$	Price per minute during peak time		Monthly Internet ADSL ^[1]
	Region	United States	
Without submarine cable	0.97	0.96	266
With submarine cable	1.07	0.63	89
• Monopoly on international gateway	1.65	1.11	109
• Competitive international gateway	0.45	0.28	65

Source: AICD analysis

Note: [1] 256 kilobyte per second (kbps) connection.

ADSL = asymmetric digital subscriber line

²³ The Central African Republic is one of the first three countries selected for the World Bank's Central African Backbone project which will "support the countries of the Central African region in developing their high-speed telecommunications backbone infrastructure to increase the availability of high-speed Internet and reduce end-user prices" (see <http://go.worldbank.org/D1V9Y4SYS0>).

²⁴ Using a discount rate of 13 percent and average annual decrease of satellite connection of 8 percent.

4.126 **Incomplete liberalization and poor infrastructure led to the stagnation of the landline market under state monopoly control.** SOCATEL, once partly owned by France Telecom, is now fully state owned²⁵ and the only player in the fixed-line market. SOCATEL suffers chronic operating losses given its low market share in a competitive sector (about 1 percent of the overall subscribers for the telecommunications fixed and mobile segments). Fixed-line subscriptions have been stagnant for several years, at about 0.2 subscribers per 100 people, and 97 percent of the 9,000 existing lines are in Bangui. On average, only 20 new lines per month are connected to the network. Given the shortage of traditional fixed lines, higher levels of ICT access will come through wireless technologies. Recently, Orange launched a wireless broadband service using WiMAX technology, but prices are still high at \$671 per month for a 256 kilobyte per second (kbps) connection.

K. FINANCING AN UPGRADE OF CAR'S INFRASTRUCTURE

4.127 **This sub-section develops a financial framework in which the cost of meeting infrastructure development targets is compared to existing spending levels and patterns to quantify sector-specific funding gaps and possible financing sources.** The analysis proceeds as follows. The level and composition of spending needed to redress the infrastructure backlog is first defined. An overview of infrastructure spending over the period 2002–07 is then provided, which highlights the main sources of financing (public sector, private sector, official development assistance, ODA from non-OECD states), the economic uses of funds (capital, operations and maintenance (O&M)), and the relative importance of each sector against the existing budget envelope. In analyzing public spending pattern, inefficiencies are identified and quantified. The funding gaps in each sector are then evaluated, followed by a discussion of how these gaps might be covered through existing budgetary resources and possible re-allocations.

Infrastructure development needs and their costs

4.128 **To assess the adequacy of CAR's current level of spending in the economic infrastructure sectors it is useful to first estimate the cost of achieving indicative targets.** The cost of achieving the CAR's infrastructure targets was estimated using sector-specific models developed within the AICD framework. In this framework, the infrastructure deficit for each country is calculated using microeconomic models that take into account both growth-related and social demands for infrastructure, and incorporate costs of maintenance, rehabilitation, and expansion. The physical infrastructure targets are the basis for the set of spending estimates. Starting in 2005, a 10-year horizon was used for most sectors as a timeline for attaining a number of key social targets for broader infrastructure access. Methodologies for estimating spending needs vary according to the characteristics of each sector, as follows:

- **Transport.** This model is based on a spatial analysis that assesses the costs of linking economic and demographic nodes through transport infrastructures with the objective of achieving regional, national, urban, and rural connectivity. The model identified key geographic and demographic features of each country, using geographic information system (GIS) data to measure the necessary distances. Costs are based on condition, type and standard of investment, and maintenance needs.
- **Water and sanitation.** This model builds on the methodology developed by the Joint Monitoring Program of the United Nations to estimate the cost of meeting the Millennium Development

²⁵ SOCATEL is allegedly facing serious difficulties due to unpaid government bills and disputes over the international gateway (Balancing Act 2010).

Goals (MDGs) for water and sanitation. Estimates were based on minimum acceptable asset standards. It was assumed that relative prevalence of water and sanitation modalities remain broadly the same between 2006 and 2015, and services are upgraded for only a small segment of customers.

- **Power.** This is a dynamic model that combines economic growth and electrification targets to estimate power spending needs. The model simulated optimal (least-cost) strategies for generating, transmitting, and distributing electricity in response to demand increases. It also estimates the cost of meeting power demand under a range of alternative scenarios that take into account access targets, fuel prices, unit costs of investment, and the feasibility of cross-border trade. Spending needs are estimated by identifying potential generation projects and their rank according to cost effectiveness. Investments include refurbishment of existing capacity for electricity generation and construction of new capacity for cross-border electricity transmission. The model takes into account the O&M requirements of existing, refurbished, and new assets.
- **ICT.** The model considered the cost of network rollout based on topographical factors and local availability of power. It also estimated local revenue potential based on demographic densities, per capita incomes, and estimated subscriber rates. Based on commercial viability, the model calculated the amount of investment and recurrent spending required to achieve universal population coverage, meet market-driven demand through 2015, and improve cross-border connectivity.

4.129 The infrastructure targets and costs for CAR are based on a diagnostic of the quantity and quality of the existing infrastructure in each of the four sectors. According to these targets CAR needs to achieve transport connectivity with good-quality, one-lane paved roads in fair condition; halve the number of people without sustainable access to safe drinking water and basic sanitation by 2015 to meet the MDG for water supply and sanitation; install 143 MW of new capacity for hydropower generation²⁶ to increase electrification from 1 percent to 34 percent of the population, which implies increasing the number of connections by a factor of 50—from 6,000 to more than 300,000; and establish a fiber-optic link to Chad to subsequently connect to the submarine cable landing in Cameroon

²⁶ As discussed in the power section, for the CAR to achieve this capacity the country would need to build the Boali 3 (10 MW) and Palambo (300MW), and the country would then produce an excess capacity of around 157 MW.

Table 4.37: Indicative infrastructure targets for CAR, 2005-2015

	Economic target	Social target
Transport	To connect Bangui, cities with more than 250,000 inhabitants, and border crossings with one-lane paved roads in fair condition [1]	Providing rural road access to the highest-value agricultural land, and urban road access within 500 meters
WSS	Not applicable	Achieving Millennium Development Goals of halving the population without access to improved water and improved sanitation by 2015
Power	Develop 143 MW of new generation capacity to meet national access rate of 34 percent	Increasing national electrification to 34 percent (84 percent urban and 1 percent rural)
ICT	Install fiber-optic links from Bangui (the CAR) to N'Djamena (the CAR) to allow for connectivity to the broadband facilities submarine cable landing in Cameroon	Providing universal access to GSM signal and public

Sources: Mayer and others 2009; Rosnes and Vennemo 2009; Carruthers, Krishnamani, and Murray 2009; You and others 2009.

Note:

[1] Regional connectivity is defined as the road network that links national capitals to each other, to all other cities with a population greater than 250,000, to international land borders, and to deep-water ports.

[2] Assuming an internal rate of return of 12 percent.

GSM = global system for mobile communications.

— = Not available.

4.130 Given these targets the models estimate that it would cost about \$349 million per year over a decade to meet CAR's infrastructure needs.²⁷ Capital expenditure would account for about 60 percent of this requirement. Transport is the sector with the highest spending needs, requiring \$160 million per year. ICT is the sector with the second-highest needs, requiring \$86 million per year for the next decade to meet various connectivity targets. Around \$55 million per year is needed to meet demand in the power sector; and about \$47 million will be needed each year to meet the MDGs in the water supply and sanitation sectors. The CAR's infrastructure spending needs, at 17.5 percent of GDP (using 2009 GDP), are at the average level for Central African countries but lower than comparable fragile states. Capital investment in meeting these needs would absorb around 10 percent of GDP, while O&M spending would take up about 7 percent of GDP.

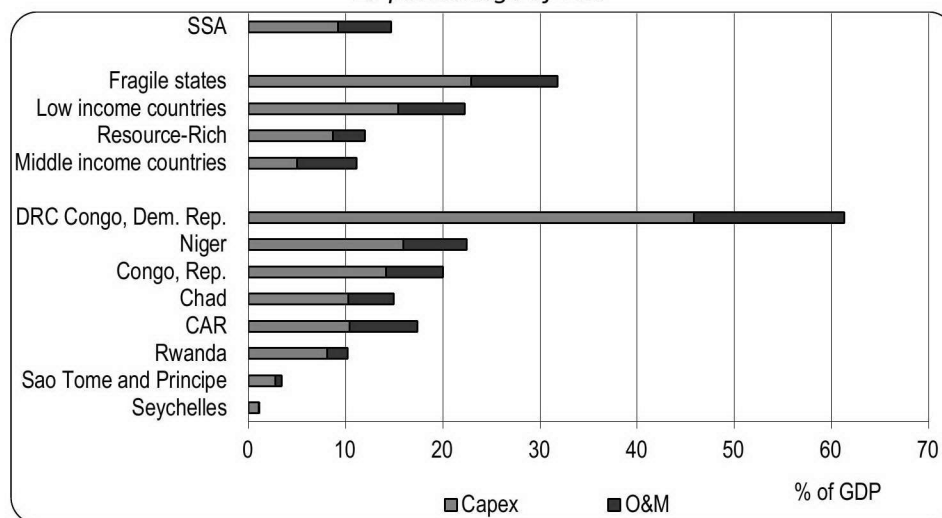
Table 4.38: Indicative infrastructure spending needs for 2006–15

<i>\$ million per year</i>			
Sector	Capital expenditure	Operations and maintenance	Total needs
Transport	91	69	160
ICT	30	56	86
Power	50	5	55
WSS	37	10	47
Irrigation	1	—	1
Total	208	141	349

Sources: Mayer and others 2009; Rosnes and Vennemo 2009; Carruthers, Krishnamani, and Murray 2009; You and others 2009. Derived from models that are available at <http://www.infrastructureafrica.org/aicd/tools/models>.

²⁷ These estimates do not include the river transport subsector.

Figure 4.22: Infrastructure spending needs in the regional context
As percentage of GDP



Funding from existing budgetary resources

4.131 When all traceable financing sources—public sector, private sector, ODA, and non-ODA—are put together, existing spending in infrastructure amounts to \$134 million per year. The public sector, including state-owned enterprises, accounts for about two-thirds of total infrastructure spending (\$87 million), with 29 percent of the spending directed to operation and maintenance and 35.7 percent to capital expenditure. The remaining third is sourced externally, mainly by ODA (\$43 million), and to a smaller extent, by the private sector (\$4.5 million). There are no data on spending by non-OECD financiers in the CAR.

Table 4.39: Financial flows to infrastructure
\$ millions per year

Operation and maintenance		Capital expenditure					Total spending
	Public sector	Public sector	ODA	Non-OECD financiers	PPI	Total capital expenditure	
Power	10.1	11.3	4.0	0.0	0.0	15.3	25.5
ICT	2.5	0.1	2.7	0.0	4.5	7.3	9.8
Transport	23.1	35.3	29.2	0.0	0.0	64.6	87.6
WSS	3.2	0.9	6.7	0.0	0.0	7.6	10.8
Total	38.9	47.7	42.6	0.0	4.5	94.8	133.7

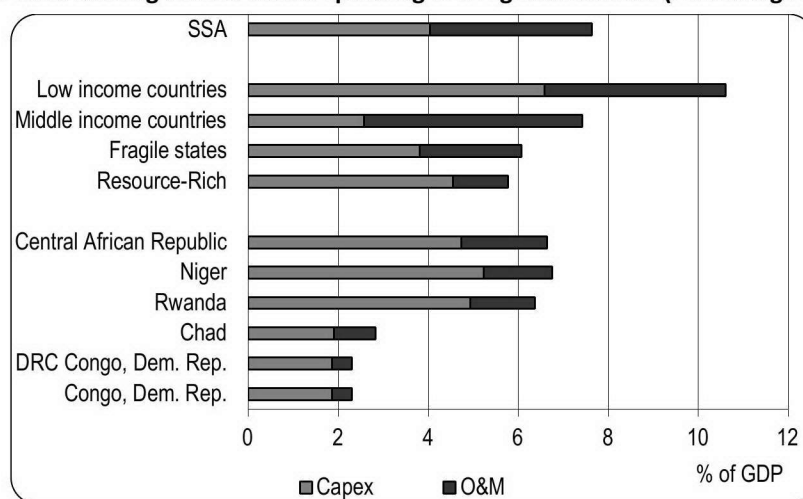
Source: Derived from Foster and Briceño-Garmendia (2009).

Note: Public sector spending includes central government spending (on-budget) and state-owned enterprise (SOE) spending. Non-OECD financiers include China, India, and the Arab countries.

4.132 As a share of GDP, CAR's existing infrastructure spending is already quite substantial. It devotes around 7 percent of GDP to spending on economic infrastructure. While this is the most among countries in Central Africa and higher than the average for fragile states, it is only half of the 14 percent of GDP that China has systematically invested in infrastructure over the past two decades. That said, the

CAR's spending level represents an important effort relative to the size of its economy and a still-precarious revenue base as the country emerges from conflict.

Figure 4.23: Existing infrastructure spending in a regional context (Percentage of GDP)



Source: Derived from Foster and Briceño-Garmendia 2009

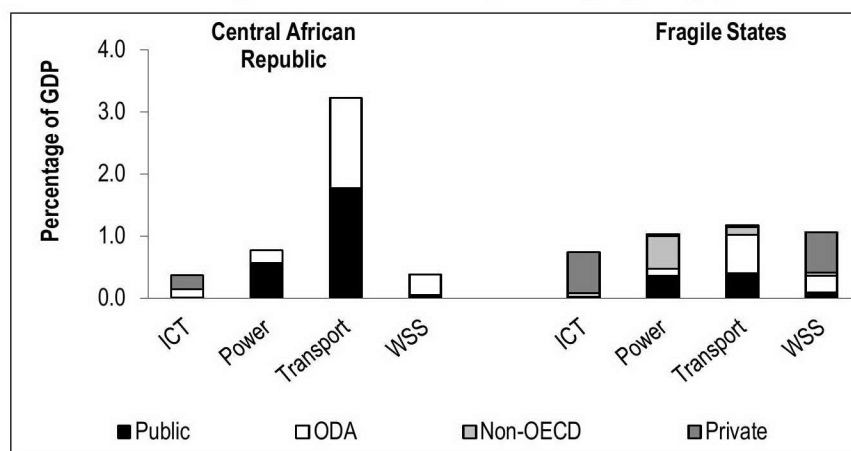
4.133 Infrastructure spending is skewed to capital investments. Expenditure on the rehabilitation and expansion of the existing network absorbs about three-fourths (or \$95 million) of the total financial flows to infrastructure in the CAR. Operating expenditures account for the remaining one-fourth (or \$39 million). Operating expenditure in the CAR is entirely covered by budgetary resources and payments from users recovered by the stated-owned enterprises. The transport sector receives around half of the total O&M financing flows, mainly channeled to the road subsector.

4.134 Close to 50 percent of capital expenditure funding comes from the public sector, from central and state governments, and public enterprises. ODA accounts for 44 percent of total capital flows to infrastructure. Private sector flows account for just 5 percent of total capital investment, suggesting that the potential for public-private partnerships, even in the ICT sector, is hardly tapped in the CAR. It is worth noticing that these figures do not capture the amounts invested by NGOs, which might be particularly important in some sectors, such as sanitation.

4.135 CAR's investment patterns differ significantly from those of comparable countries. Relative to comparable peer states, the CAR is more reliant on public investment in the power and transport sectors. Most of the capital flows to the ICT sector in the CAR come from the private sector, followed by ODA.

Figure 4.24: Patterns of capital investment in infrastructure benchmarked against comparator countries

Investment in infrastructure sectors as percentage of GDP, by source



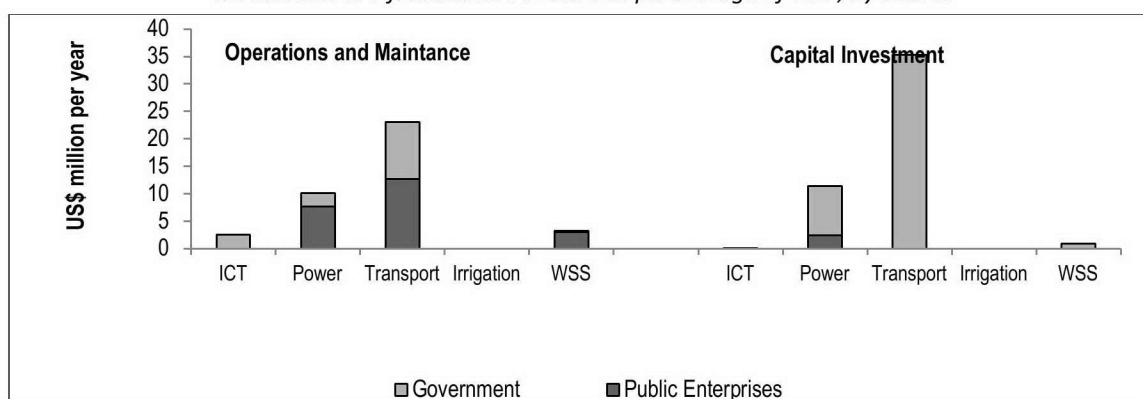
Source: Derived from Briceño-Garmendia, Smits, and Foster (2009).

Note: Private investment includes self-financing by households. Non-OECD financiers include China, India, and the Arab countries.

4.136 **Public spending is mostly channeled through the central government**, in particular capital investment. It is particularly striking that the transport and water supply and sanitation sectors do not report any significant capital investments financed from own sources. Operating expenditure, on the other hand, is largely channeled through public enterprises. SODECA finances around 85 percent of the total O&M spending in the water supply and sanitation sectors. Spending by ENERCA represents 75 percent of the O&M funds allocated by the public sector in power. The road fund finances around 50 percent of the total O&M made by the public sector in transport.

Figure 4.25: Patterns of public spending on infrastructure

Investment in infrastructure sectors as percentage of GDP, by source



Source: Derived from Briceño-Garmendia, Smits, and Foster (2009).

4.137 **The transport sector accounts for the largest share of total annual financial flows to infrastructure in the CAR (60 percent) but spending on maintenance and rehabilitation in the transport sector is only one-fourth of total financial flows to the sector.** Evidence suggests that countries that spend too little on maintenance will end up with larger rehabilitation liabilities, often resulting in the need for emergency works to restore the functionality of critical infrastructure. On the

other hand, countries with large investment programs may have fewer resources left over to address road maintenance needs. This is a worrisome finding because if high capital spending comes at the expense of lower maintenance expenditure, then the condition of the network will only deteriorate over time. The transport sector is significantly reliant on ODA funds, which are mostly allocated to this sector. On average around 45 percent of financial flows to transport come from ODA. The high volatility of ODA flows has contributed to the volatility of public investment in the sector. ODA commitments were reduced during the conflict and reached their peak in 2006, when the peace agreements were signed. After 2006 ODA commitments to the sector were severely reduced and have been stagnant.

Potential gains from increased spending efficiency

4.138 The analysis suggests that an additional [US\$37] million per year could be found within the existing envelope to meet CAR's infrastructure needs by improving spending efficiency. Potential efficiency gains could be achieved by:

- *Improving budget execution rate (US\$14 million).*
- *Reducing distributional losses (US\$8 million)*
- *Improving collection of bills (US\$4 million)*
- *Pricing infrastructure services to cost-recovery levels (US\$6)*
- *Re-allocating existing infrastructure spending toward subsectors with the highest funding (US\$5).*

4.139 Looking across sectors, power offers the greatest savings—up to \$22 million per year—by tackling the inefficiencies of ENERCA and reallocating resources within the sector.

Table 4.40: Potential gains from greater operational efficiency

	<i>\$ million per year</i>					
	ICT	Irrigation	Power	Transport	WSS	Total
Low budget execution	0	—	3	10	—	14
Distribution losses	n.a.	n.a.	6	n.a.	2	8
Undercollection	n.a.	—	4	—	0	4
Underrecovery of costs	n.a.	—	4	—	2	6
Reallocation potential within sector	0	0	5	0	0	5
Total	0	0	22	10	5	37

Source: Derived from Foster and Briceño-Garmendia (2009).

— = Not available; n.a. = Not applicable.

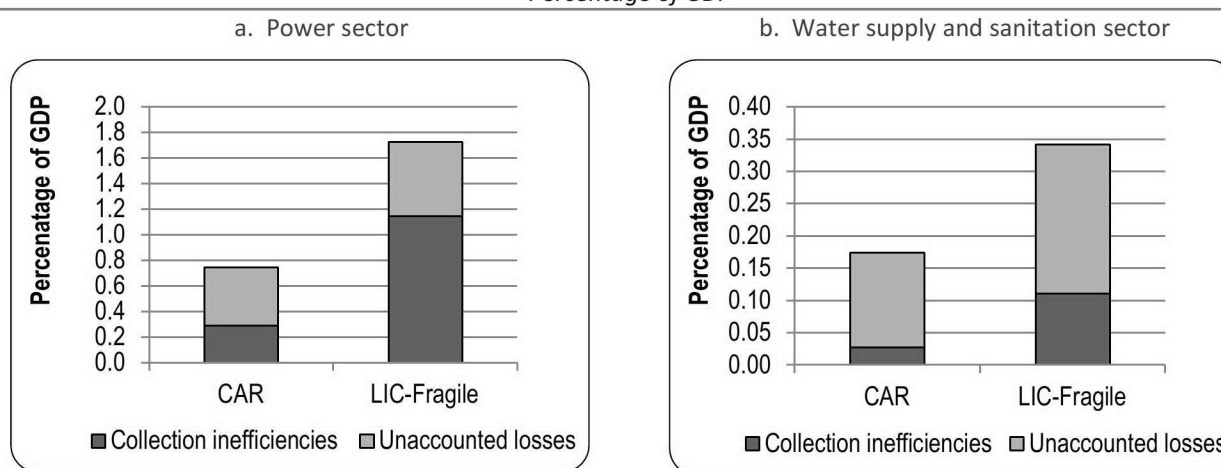
4.140 Raising the budget execution rate on the capital budget could generate US\$ 14 million in savings. Much of the savings would come from the transport sector. As shown in chapter 2 domestically-financed capital expenditures have a low budget execution rate; and the budget execution rate for the roads sub-sector is among the lowest, ranging from 68 percent in 2008 to 88.3 percent in 2010 with an average of just 80 percent over the period 2008-2010 (table 2.11).

4.141 Increasing operating efficiencies of utilities could add US\$ 12 million a year. ENERCA suffers from high power losses and low bill-collection efficiency. In 2009 ENERCA's distributional losses, at 48.3

percent of production, were almost five times the best-practice 10 percent benchmark. If transmission and distributional losses were tackled, it could result in \$6 million savings (0.19 percent of GDP). Another \$4 million (or 0.3 percent of GDP) per year could be saved by raising bill-collection efficiency from 64 to 100 percent. Operational inefficiencies are also present in the water supply sector and cost CAR about \$2 million a year, equivalent to 0.12 percent of GDP, with distributional losses responsible for about 85 percent of the hidden costs and collection inefficiencies for about 15 percent. CAR could avoid this cost by reducing nonrevenue water from 51 percent to the 20 percent benchmark of a well-functioning utility. If CAR tackles the operational inefficiencies in the power and sanitation sector it could expand the budget envelope by 0.62 percent of GDP, which is equivalent to almost 70 percent of the contribution of infrastructure to the CAR's economies during the earlier 2000s. The burden of operational utility inefficiencies in the CAR is lower than for the benchmark countries.

Figure 4.26: Uncollected bills and unaccounted losses in power and water utilities, 2009

Percentage of GDP



Source: Derived from Briceño-Garmendia, Smits, and Foster (2009).

4.142 Improving cost recovery from user charges could provide another US\$6 million. Under-pricing of power costs CAR about \$4 million each year, or around 0.3 percent of the country's GDP. Compared with the rest of Africa, where under-pricing of power is commonplace, CAR's power utility ENERCA is doing better than other fragile, low-income countries. It is estimated that the average total cost of producing electricity has been \$0.20 per kWh in CAR, while the average effective tariff stood at \$0.15, as of 2009. In the water sector, average tariffs charged by SODECA, CAR's water utility serving Bangui and seven urban centers, stand at \$0.57/m³ versus an estimated \$1.1/m³ average cost-recovery tariff. The consequent macroeconomic burden of undercharging for water services—at 0.12 percent of GDP—is somewhat lower than that for power (0.18 percent of GDP) and is comparatively lower than in other fragile states. Underpricing is the major inefficiency driving up SODECA's hidden costs.

4.143 **Because of inequitable access to power and water services in the CAR, subsidized tariffs are highly regressive.** Close to 100 percent of people with electricity or piped water connections belong to the top 20 percent of the expenditure distribution; such connections are nonexistent for poorer households. Only the richest quintile has access to piped water. Most of the poorest quintiles rely on surface water. This inequitable distribution of connections virtually guarantees that any price subsidy to these services will be extremely regressive.

Figure 4.27: Underpricing of power and water in the Central African Republic and comparator countries

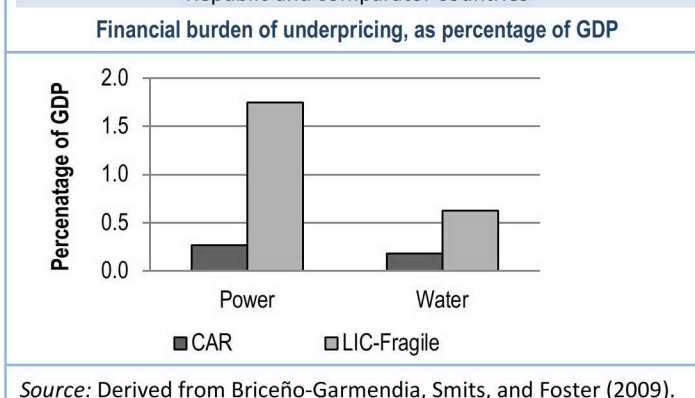
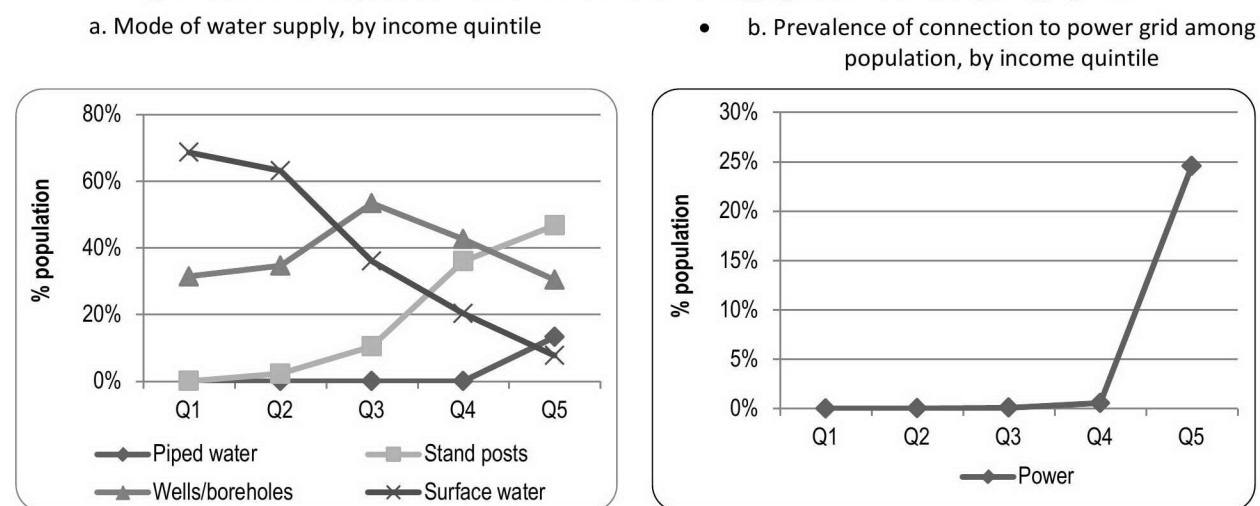


Figure 4.28: Consumption of infrastructure services is highly differentiated by budget, 2006



Source: Banerjee and others 2009.

Note: Q1 – first budget quintile, Q2 – second budget quintile, and so on.

4.144 **By re-allocating resources within the power sector CAR could gain US\$5 million toward financing its infrastructure needs.** About \$5 million more than the estimated O&M requirements in the power sector is spent each year. This could be better allocated toward the expansion and rehabilitation of the existing network. According to estimates, the CAR needs to spend around \$5 million per year on power O&M but in fact is spending about \$10 million. This finding reinforces the review of expenditures on transfers and subsidies in chapter 2, which pointed to the need for close monitoring of spending by the regulatory agencies including in the power sector.

L. COVERING THE FINANCING GAP

4.145 **The CAR's infrastructure funding gap amounts to \$183 million per year, or about 9 percent of GDP, once efficiencies are captured.** While much of this gap is found in the transport and ICT sectors,

accounting for about 75 percent, the water supply and sanitation sectors account for 17 percent of the funding gap and the power sector for the remaining 8 percent.

Table 4.41: Funding gaps by sector (\$ million per year)

	ICT	Irrigation	Power	Transport	WSS	Total
Spending needs	(86)	(1)	(55)	(160)	(47)	(349)
Existing spending*	10	0	20	88	11	129
Efficiency gains	0	0	22	10	5	37
Funding gap	(76)	(1)	(13)	(62)	(31)	(183)
Reallocation potential across sectors	0	—	0	0	0	0

Source: Derived from Foster and Briceño-Garmendia (2009).

Note: Potential overspending across sectors is not included in the calculation of the funding gap, because it cannot be assumed that it will be applied toward other infrastructure sectors.

— = Not available.

*traced to needs.

**Assuming complete fungibility across sectors.

4.146 **The infrastructure funding gap is almost equally divided between capital investment and O&M but the O&M funding gap is higher.** The water supply and sanitation sector, ICT, and the transport sector have important gaps in funding capital expenditure, followed by the power sector. The largest funding gap for O&M is found in the ICT sector in the amount of about US\$50 million per year, followed by the transport sector at about US\$39 million. The relatively large funding gap for O&M suggests that actual spending on O&M is inadequate, a finding that was highlighted in chapter 2 which pointed to the need to enhance the budgeting of these expenditures.

Table 4.42: The size and the composition of the funding gap by sector, O&M and capital (\$ million per year)

	Capital expenditure gap	Operation and maintenance gap	Total funding gap
ICT	23	50	73
Irrigation	—	—	0
Power	18	0	18
Transport	22	39	62
WSS	25	6	31
Total	88	96	183

Source: Derived from Foster and Briceño-Garmendia (2009).

4.147 **The size of the efficiency gains are equivalent to only about 17 percent of the total funding gap, suggesting that to meet its infrastructure targets CAR would also need to scale up the size of its infrastructure.** This finding is consistent with the earlier discussion of the potential contributions of infrastructure to annual per capita growth in CAR, where it was established that most of the gains in growth would be due to faster accumulation of infrastructure assets. This point also coincides with one of the pillars of the CAR's poverty reduction strategy, which places the emphasis on building new assets.

M. CONCLUSIONS AND RECOMMENDATIONS

4.148 **The analysis in this section shows that there is scope to create fiscal space in the budget through efficiency gains in the infrastructure sector.** Efficiency gains could be achieved through intra-sectoral reallocation of resources and through greater operational efficiency in public utilities and the Roads Fund in the current use of resources. By taking appropriate steps CAR could realize about US\$37 million in savings, about 1.8 percent of GDP, that it could use toward financing its infrastructure needs.

4.149 However, the analysis also shows that even if these gains are fully realized a substantial financing gap for infrastructure development would remain. This suggests that there is a need for CAR to not only prioritize its infrastructure spending but also that additional resources would have to be found from outside the budget to finance CAR's infrastructure needs. The following recommendations should be considered.

4.150 In the short to medium run, the government should take steps to strengthen management capacity in public utilities and in the Roads Fund to ensure the delivery and quality of basic infrastructure services. In particular:

- The financial and operational capacity of SODECA and ENERCA should be strengthened by eliminating distributional losses in the power and water supply and sanitation sectors; improving the collection of electricity bills; and pricing infrastructure services to full recovery costs. With the enhanced capacity, the existing power and water supply and sanitation infrastructure should be refurbished to functioning order.
- The financial and technical capacity of the Roads Fund should be reinforced to improve spending on maintenance and rehabilitation of the road network.

4.151 Over the medium-term, efforts should be made to tap financing sources outside the budget. Finding additional resources from outside the budget would also bring other benefits. Opportunities to explore could include:

- Developing creative cross-border financing mechanisms. Such mechanism for power generation and transmission investments, as well as joint transport projects would help develop regional infrastructure corridors.
- Attracting greater private sector investment into the infrastructure sectors. This would help bring critical technical and managerial know-how to infrastructure development and service delivery. Involving the private sector more strongly in the economy would require important reforms in the legal and regulatory framework, however.

CHAPTER 5: AN ASSESSMENT OF CAR'S PUBLIC INVESTMENT MANAGEMENT SYSTEM

A. INTRODUCTION

5.1 **The previous chapters have focused on two broad policy options that could create more fiscal space in the budget for priority spending in the Central African Republic.** The scope for raising more domestic revenue by broadening the tax base, improving tax administration and curtailing tax expenditures was analyzed in chapter 3; and the scope for creating fiscal space through changes in the composition and efficiency of spending was examined in chapter 4. This chapter complements the discussion in the previous two chapters by focusing on the third and critical aspect of CAR's fiscal space, which centers on improving the quality of public investment.

5.2 **To grow rapidly and sustainably CAR must not only invest a substantial fraction of its output in public infrastructure and health and education, it must also do so productively.** Chapter 2 argued for the need to scale up investment spending to meet the demand for basic public services and drive growth, but experience has demonstrated that public investment may fail to boost economic growth and improve living conditions because of low efficiency. This could be due to factors such as poor project selection, weak enforcement of procurement procedures, and failure to complete projects. It is therefore important, in considering the case for creating additional fiscal space in the budget for investment, to undertake an assessment of the efficiency of public investment.

5.3 **The government recognizes the need to improve the quality of public expenditures in order to achieve its PRSP objectives and has launched a series of initiatives aimed at strengthening the effectiveness of public investments.** The public investment program (PIP) is the government's key instrument for the implementation of its development strategies and policies through its contributions to fixed capital formation. Actions taken by the government to strengthen the viability of the PIP have included: (i) the compilation of a manual of procedures for the elaboration of the PIP; (ii) the establishment of a programming system aimed at improving the quality of public expenditure; and (iii) the development of appropriate instruments to ensure the coherence between the PIP and national and sectoral priorities.

5.4 **These actions build on broader public financial management reforms that aim to strengthen the preparation, approval, execution and monitoring of the budget in order to improve the efficiency and effectiveness of public expenditure.** Launched in 2005 the PFM reforms have advanced in a number of areas including the modernization of the legal framework for public finance with the adoption in 2006 of the Organic Law relating to finance laws, the harmonization of the budget and accounting nomenclature, the computerization of the expenditure chain, the compilation of government accounts and preparation of the budget execution law for 2008, and the adoption of a new procurement code. Many challenges remain, however, as noted in the latest public expenditure and financial assessment (PEFA) conducted in 2010.

5.5 **This chapter aims to provide an institutional assessment of the public investment management system in CAR.** It follows the diagnostic methodology developed by Rajaram et al (2010)²⁸,

²⁸ Anand Rajaram, Tuan Minh Le, Nataliya Biletska and Jim Brumby (2010). A Diagnostic Framework for Assessing Public Investment Management. World Bank: Policy Research Working Paper 5397

which identified eight desirable features of an effective public investment management system. The diagnostic approach is a ‘gap-analysis’ of the actual public management (PIM) system in place in CAR relative to these desirable features so as to identify those aspects of the PIM system that are weak and need attention. The assessment finds that CAR’s public investment management system has many significant weaknesses, ranging from planning to project execution, including procurement and reporting. Important gaps remain in areas such as environmental screening, project selection, appraisal, and monitoring and evaluation.

5.6 The rest of the chapter is organized as follows. Section B discusses recent trends in capital expenditures in CAR. Section C reviews the institutional framework for PIM and describes the roles and responsibilities of the main actors involved in the public investment management system. Section D analyzes the performance of CAR’s public investment management system in relation to the must-have features in Rajaram *et al* (2010) and highlights its weaknesses and strengths. Section E outlines the main recommendations, and section F concludes.

B. CAPITAL EXPENDITURE TRENDS IN CAR

5.7 Capital expenditure has rebounded in response to CAR’s large reconstruction needs following the cessation of hostilities. In particular, since 2008 capital expenditure has increased steadily, averaging 5.4 percent of GDP over the period 2008-2010. This trend was driven mainly by foreign financing which has been high, especially during the donor re-engagement phase in 2005-2006 and in response to the global slowdown in 2010 to mitigate its economic and poverty impact on CAR.

5.8 Domestically-financed capital expenditure, by contrast, has remained very low, averaging just above 1 percent of GDP. A relatively large proportion of domestically-financed capital expenditure has been allocated to economic services including agriculture and infrastructure, while smaller amounts were allocated to health and education. Moreover, compared to other categories of expenditures domestically-financed capital expenditures have consistently posted low budget execution rates.

Figure 5.1 : Capital expenditure
(Share of GDP, payments basis)

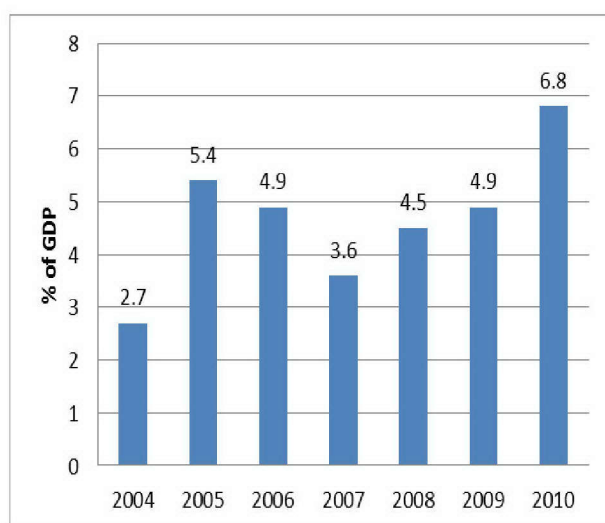
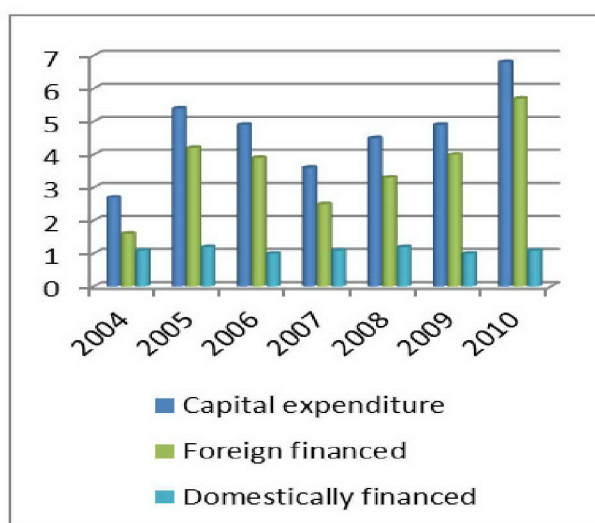


Figure 5.2 : Foreign and domestically financed capital expenditure
(Share of GDP, payments basis)



Source: Author’s calculations

5.9 **Fixed investments in CAR are largely below their pre-crisis level.** Over the period 1990-1999 gross fixed public capital formation averaged 6.2 percent of GDP, higher than the average for Sub-Saharan Africa (table 5.1). Since 2000 this ratio has declined, averaging just 3.5 percent of GDP during 2000-2008 compared with the average of 4.7 percent of GDP for the SSA region. This reflects in part the effects of the conflict, which destroyed installed capital, but also the relatively low levels of capital expenditures since conflict ended despite a recovery in recent years. Given the country's large needs and the deteriorated state of the capital stock, capital spending in CAR should be expected to be higher than its current level. As discussed in the previous chapters CAR needs significant productive investments in infrastructure and human capital to accelerate economic growth, improve the living conditions of the population, and reduce poverty.

Table 5.1 : Table Gross Government fixed capital formation, Share of GDP (%)

	1980-89	1990-99	2000-08
Burundi	13.8	9.3	6.9
CAR	5.5	6.2	3.5
Chad	3.8	7.4	9.0
Comoros	18.7	7.0	5.3
Congo, Republic	11.1	6.4	8.0
Congo, Dem. Republic	4.4	1.7	3.2
Eritrea	..	17.6	17.5
Gambia	10.4	7.8	7.6
Guinea	7.5	6.1	3.9
Guinea Bissau	33.3	20.2	13.0
Liberia	..	..	..
Sao-Tome & Principe	..	..	..
Sierra Leone	4.0	3.8	5.2
Togo	11.2	3.7	3.2
Sub-Saharan Africa	5.4	4.5	4.7

Source: Africa Development Indicators, World Bank, 2010

5.10 **In striving to expand capital spending, CAR needs to take into account absorption constraints.** Weak administrative capacity remains a major impediment to higher growth and sustained implementation of reforms. Strengthening administrative capacity and institutions in all areas of public sector management is critical for enhancing resource absorption, sustaining growth, and improving program implementation.

5.11 **Accelerating economic growth will require not only raising public infrastructure investments to appropriate levels but also increasing the quality of these investments.** Higher public investment spending should remain consistent with the need to main macroeconomic stability and fiscal sustainability and provide the basis for private sector development, not crowd it out. In addition, once built, new infrastructure will have to be maintained. All this will require that public investment projects are appropriately selected, well designed and effectively executed so that they can help overcome the infrastructure constraints that CAR faces and contribute to growth and development in the country. The next sections examine whether CAR's public investment management system can allow high and productive public investments, beginning with a review of the institutional framework for PIM.

C. INSTITUTIONAL FRAMEWORK AND MAIN ACTORS

Institutional framework

5.12 **Decree No. 06-247 dated 31 July 2006 sets out the institutional framework for public investment management in CAR.** It assigns to the Ministry of Economy, Planning and International Cooperation (MEPCI), which is responsible for the formulation and execution of the government's economic policy, the central role for managing the public investment process.

5.13 **The responsibilities of the MEPCI cover the whole spectrum of the public investment process from identification to execution, including budgeting and monitoring evaluation.** Specifically, the responsibilities of the MEPCI are to: (i) identify development projects that are consistent with government policies; (ii) undertake the financial programming of investment project costs; (iii) elaborate the government triennial investment program; (iv) monitor and evaluate the financial execution of the investment budget; (v) coordinate the demand for investments from all government departments to ensure optimal results; (vi) ensure that monitoring and evaluation is undertaken at the sectoral level to guarantee the effectiveness of investment projects; and (viii) contribute to the annual budgeting of investment projects and their components. The MEPCI is expected to carry out these functions in collaboration with other government agencies and departments.

Main actors in the investment management process

5.14 **Several institutions within government are involved in investment management.** These are: the Ministry of Finance and Budget, sector ministries, the Ministry in charge of decentralization and the Ministry in charge of the Environment; each assigned a specific role in coordination with the Ministry of Economy, Planning and International Cooperation as follows.

5.15 **Within the Ministry of Economy, Planning and International Cooperation**

- *The Directorate General of Economic Programming (DGPE)* is the critical link in the investment management process. It identifies the key development projects, coordinates their implementation, leads the financial programming of projects and manages the public investment program. It fulfills the "gatekeeper" function. Within the DGPE, the *Directorate for the multi-year Programming of Investments (DPIP)* is responsible for preparing the government three-year investment program, elaborating the priority investment program, coordinating all the demands for public investments from government ministries for optimal results, and coordinating the monitoring and evaluation of investment projects.
- *The Directorate General for Policy and Strategy* is charged with coordinating and providing information on sectoral strategies, and their implementation.
- *The Directorate General for Development Partnership* is responsible for the mobilization of development resources, and negotiations for the financing of development projects and programs.
- *Departmental technical Directorates* are charged with assisting local governments in the arbitrage of investments pertaining to regions.

5.16 Within the Ministry of Finance and Budget

- *The Budget Directorate General (DGB)* is responsible for the preparation and execution of the national budget. It develops the medium-term expenditure framework for the preparation of the budget and leads the process of estimating and allocating envelopes to sectoral ministries.

5.17 Within sectoral ministries

- *The Directorates of Studies and Programming* coordinate the planning of public investment projects and programs at the sectoral level and submit to the DPIIP the three-year public investment proposals of line ministries. They represent government ministries and institutions during consultations with the DPIIP.

5.18 **The Ministry in charge of Decentralization and Local Governance and the Ministry in charge of Environmental Protection are designated to contribute to the spatial planning and environmental impact assessment of public investments, respectively.** Thus, in its overall set up the PIM system in CAR brings together agencies and departments that can address critical aspects of the public investment process, including planning, budgeting, resource mobilization, monitoring and evaluation, and environmental protection. In practice, however, there is a large gap between *de jure* legal framework and the *de facto* application of the decree. Coordination is inadequate and the effectiveness of these institutions in carrying out their duties is hampered by numerous institutional weaknesses.

D. PERFORMANCE OF THE PIM SYSTEM

Strategic Focus, Project Development and Preliminary Screening

5.19 **An important criterion in the selection process for investment proposals in CAR is that they are consistent with the government medium term objectives as laid out in the poverty reduction strategy.** Since conflict ended in 2003 CAR has prepared and implemented a full PRSP. This PRSP, adopted in June 2007, covered the period 2008-2010 and was prepared through a large consultative process to identify its strategic priorities. A second PRSP, covering the period 2011-2013, is currently under preparation drawing on the lessons learned from the first PRSP.

5.20 **CAR has, through its PRSP, a strategic framework for the allocation of public resources but this document needs to be supplemented with sector strategies.** The PRSP outlines the government's vision and priority actions for reducing poverty in line with the Millennium Development Goals, and provides broad orientations for the allocation of resources. A monitoring and evaluation (M&E) framework accompanies the PRSP and the government is striving to develop the statistical base to quantify performance indicators and monitor implementation of its poverty reduction strategy. However, although sector ministries are expected to develop their sector strategies to guide the allocation of resources at the sectoral level, only a few sector strategies are available. In turn, the lack of sector strategies is hampering the development of sector medium-term expenditure frameworks (MTEFs) which would translate the sector priorities into investment plans with realistic cost estimates.

5.21 **The public investment program (PIP) is evolving. It aims to integrate consistent investment projects that meet a set of predetermined criteria and are geared toward promoting the social and economic development of CAR.** Preparation of the PIP resumed in earnest after conflict ended; and, over the past few years, the government has been striving to develop a moving three-year investment plan that is compatible with the macroeconomic framework. However, this exercise remains incomplete

and the quality of the PIP has not been consistent with the need to strengthen capital formation and generate sustainable benefits for the population.

5.22 A formal process for project development is in place to ensure basic consistency with government policies and priorities but its effectiveness is hampered by weak coordination among the investment management institutions. At the beginning of the budget preparation cycle line ministries are required to prepare project profiles, which provides basic information on planned projects and programs, including relevant strategic priority and sub-program or program, specific problems to be addressed, project objectives, main activities, expected results and estimated budget. The Directorate of Public Investment (DPIP) within the DGPE conducts the initial review of the project profiles submitted by line ministries and the first level screening takes place at this stage. It consists mainly of ensuring that line ministries prepare their project profiles and that these profiles provide relevant information for the elaboration of the PIP. In addition, the DPIP takes stock of the investment portfolio in the PIP as at end-December of the previous year, assesses the situation as at end-June of the current year, and evaluates the prospects for the following year. This is followed by a second-stage screening during which the coherence of projects with national and sectoral priorities is established. Government priorities are outlined in the budget circular issued by the Prime Minister.

5.23 The process for screening project proposals needs to be strengthened to enhance its effectiveness. At the end of the second-stage screening projects are selected for inclusion in the PIP. Projects are rarely rejected at this stage even though they may not be well defined because sector ministries are not always able to provide timely information and data for the project profiles. Key instruments such as sector medium term expenditure frameworks, which would help link the budget with the PRSP, are lacking and need to be developed. At the moment, the decisive factor for including a project in the PIP is resource availability. This means that the link between projects and sector priorities is not always thoroughly assessed.

Box 5.1 : The Essential Features of a Good Public Investment Management (PIM) System

These elements would minimize major risks and provide an effective process for managing public investments:

- **Investment Guidance and Preliminary Screening.** A first level screening of all project proposals should be undertaken to ensure that they meet the minimum criteria of consistency with the strategic goals of government.
- **Formal Project Appraisal.** Projects or programs that meet the first screening test should undergo more rigorous scrutiny of their cost-benefit or cost effectiveness. The project selection process needs to ensure that projects proposed for financing have been evaluated for their social and economic value. The quality of ex ante project evaluation depends very much on the quality of the analysis, which, in turn, depends on the capacity of staff with project evaluation skills, their underlying incentives and motivation. The experience of advanced PIM systems, including Chile, indicates that consistent investment in training in project evaluation techniques is an important aspect of an effective public investment system.
- **Independent Review of Appraisal.** Where departments and ministries (rather than a central unit) undertake the appraisal, an independent peer review might be necessary in order to check any subjective, self-serving bias in the evaluation.
- **Project Selection and Budgeting.** It is important that the process of appraising and selecting public investment projects is linked in an appropriate way to the budget cycle even though the project evaluation cycle may run along a different timetable.
- **Project Implementation.** Project design should include clear organizational arrangements and a realistic timetable to ensure the capacity to implement the project.
- **Project Adjustment.** The funding review process should have some flexibility to allow changes in the disbursement profile to take account of changes in project circumstances. Each funding request should be accompanied by an updated cost-benefit analysis and a reminder to project sponsors of their accountability for the delivery of the benefits.
- **Facility Operation.** Asset registers need to be maintained and asset values recorded. Ideally, countries should require their operating agencies to compile balance sheets, on which the value of assets created through new fixed capital expenditure would be maintained.
- **Ex-post Project Evaluation.** Ex post project evaluation of completed projects should focus on the comparison of the project's outputs and outcomes with the established objectives in the project design. Good practice suggests that the project design should build in the evaluation criteria and that learning from such ex post evaluations is used to improve future project design and implementation.

Source: Rajaram et al. (2010).

Formal Project Appraisal

5.24 Criteria for the programming of investment projects recognize the need for pre-feasibility and feasibility studies, preliminary project design, and social and poverty as well as environmental impact analysis. However these criteria are not rigorously implemented. In practice, CAR lacks a formal appraisal process for a detailed evaluation of public investment project proposals. The project benefits listed in the project profiles are defined in broad terms and the costs are estimates based on needs. The systematic use of cost benefit analysis to assess the net benefits of project proposals is not mandatory; and pre-feasibility and feasibility studies are rarely carried out to support any cost-benefit analysis that is undertaken. There is no formal guidance on the technical aspects of project appraisal and to the

extent such guidance exists it is not well publicized and the extent to which sector ministries adhere to it is unclear.

5.25 Donor-financed and domestically-financed investment project proposals follow different procedures for the appraisal of their viability. Donor financed investment proposals follow the donor specific procedures for project identification, preparation, appraisal, and implementation. These projects are generally subject to a formal and fairly rigorous economic and social analysis. Domestically-financed investment project proposals, by contrast, follow internal procedures and are not subject to a rigorous evaluation process. The government may participate in the appraisal of donor-financed projects but does not generally undertake a re-appraisal of these projects.

5.26 Limited staff capacity with project evaluation skills is a major impediment to the establishment of a formal project appraisal process. In general, the capacity of sector ministries to collect and analyze either project-specific data or the general statistics required to calculate economic benefits is very limited across government. This capacity is also critically lacking at the level of the Ministry of Finance and the Ministry of Economy and Planning. Some government officials have received training in aspects of the economic and financial analysis of projects; however their skills are not effectively utilized.

5.27 Given the lack of a systematic process for appraising project proposals investment in training in project evaluation techniques would be a critical step towards establishing an effective public investment system. The training program should be calibrated to address most critical needs. Initially emphasis could be placed on developing competencies around the basic elements of formal project appraisal so as to ensure that:

- Projects are well justified and their objectives clearly specified;
- Alternative options to meet the project's objectives are identified and assessed comparatively;
- The most promising option is subject to a detailed analysis; and
- Project costs and benefits are thoroughly and accurately estimated.

5.28 The development of a detailed project design is also important to ensure the selected investment project is properly costed and can be tendered and implemented. The design of donor-financed investment projects generally includes a full risk assessment, performance indicators to measure results, and an implementation strategy. Donor-financed projects are typically managed and executed through projects implementation units (PIUs). PIUs are usually created within recipient agencies to execute the investment projects, and are stand-alone units established with the objective of fulfilling the fiduciary requirement of donors. They tend to follow special procedures with regards to procurement, payments, and financial reporting.

Independent Review of Appraisal

5.29 Subjecting project appraisals to an independent review is an important aspect of an effective public investment management system. Such an independent review helps to protect the integrity of the project appraisal process and to strengthen the cost-benefit analysis by searching for any bias that may lead to an under-estimation of costs and/or an over-estimation of benefits. Its value resides in providing a thorough and objective review of appraisals thereby contributing to strengthen check and balances in the investment system.

5.30 This independent review function, which is currently not being performed, would be very valuable in the context of CAR. However the Ministry of Finance and the Ministry of Economy and Planning currently lack the capacity to perform this function. No external or specialized agency undertakes an independent review of project proposals developed by line ministries for quality and objectivity of the appraisal. Perhaps more importantly, there is no regulation requiring that investment proposals be subjected to independent reviews.

Project Selection and Budgeting

5.31 The government recognizes the need to link the process of appraising and selecting public investment projects with the budget cycle. Every year the DGPE is required to propose to the government a triennial public investment plan. To this end, preparation of the investment budget which is the first tranche of the triennial plan starts in the second semester of the calendar year to ensure consistency with the macroeconomic framework.

5.32 Integrating the project appraisal and selection process with the overall budget cycle remains a critical challenge, however. The PIP is almost entirely financed by donors. As discussed above the process of including project proposals in the PIP begins with the preparation of project profiles by line ministries and their review by the DPIP. The donor-financed projects are not subjected to the same rules as the domestically financed projects for appraisal and inclusion in the PIP, they follow their own evaluation methodology; and the government does not review project appraisals undertaken by donors, in part because government teams participate in the appraisal of these projects. Projects appraised for inclusion in the PIP are not screened by an external agency or department for quality and objectivity of appraisal. A peer review process has not been established. Thus, while efforts are made to base the choice of investments on government priorities the selection process remains largely driven by resource availability; it is also critically hampered by the lack of sector strategies.

5.33 Investment planning, which is centered on the PIP, and the formulation of the recurrent budget are prepared through two parallel processes. The coordination consists of bringing these two parallel processes together. The recurrent budget is coordinated by the Budget Directorate at the Ministry of Finance. The investment budget process is coordinated by the Public Investment Directorate at the Ministry of Economy and Planning. For most of the time during preparation of the budget these two processes operate separately. They are brought together in the last phase of budget preparation before the draft budget law is submitted to Parliament for approval. The Prime Minister approves the final PIP following a review by the cabinet of ministers. This process does not ensure that the implications of current budgetary decisions for government finances in the medium-term are fully taken into account. One consequence has been that resources budgeted for operation and maintenance have been inadequate at the preparation stage, constraining line ministries during budget implementation. Over the past several years the budget has been marked by a growing imbalance between recurrent and capital expenditures, including in the priority sectors. For example, as pointed out in chapter 2, CAR is spending around 55 percent and 10 percent less than required on maintenance and rehabilitation of infrastructure, respectively, which is inadequate. In the absence of improved budgeting for recurrent spending, the widening imbalance will reduce the productivity of new and ongoing investment.

5.34 The development of an MTEF, including at the sector level, will be essential to efforts to fully integrate the investment and the recurrent budget. A macro-level MTEF exists at the Budget Directorate and is used to develop revenue and expenditure projections and generate ceilings that are consistent with key macroeconomic variables and fiscal targets. However, the annual budget is not

firmly anchored in the medium-term projections. Multi-year ceilings are not included in the budget documents submitted to Parliament. Medium-term expenditure frameworks will help limit the inefficiencies that arise from annual budget allocations for multi-year investment projects. The advantage of medium-term frameworks is that they help anchor annual expenditure allocations in medium term projections. In addition, they help allocate sectoral spending across different programs and projects, based on the country's development priorities. Their use will help focus attention on priorities and ensure that essential expenditures such as O&M are adequately budgeted for.

5.35 The process to control the gates to the budgeted PIP needs to become more effective. In principle the DGPE performs the function of gatekeeper but there are no clearly established procedures for dealing with submission of project proposals after the selection process has been completed. Limited information is available on the PIP during its review by the cabinet and approval by the Prime Minister. Line ministries frequently complain about their limited participation in the budgeting process and the lack of transparency in the decision-making process. They point out that sectoral allocations in the budget approved by Parliament are frequently different from the allocations agreed upon during the budgetary conferences.

Project Implementation

5.36 CAR faces serious challenges in the execution of the public investment program. The execution rate on the investment budget has been consistently low and, as chapter 2 shows, this has particularly been the case in several priority sectors. For example, over the period 2008-2010 the total execution rate on domestically-financed capital expenditures averaged just 75 percent; it was 32.2 percent for health and 31.8 percent for roads. The low execution rate on the domestically-financed capital expenditures is the result of many factors, including inefficiencies in cash flow management, deficiencies in the expenditure chain, and weaknesses in procurement. In general line ministries prepare procurement plans with considerable delays. This, in turn, delays the elaboration of their commitment plans. These delays as well as the lack of coherence between planned activities and availability of cash to finance them contribute to the low execution rates on the investment budget. The new procurement code promotes competitive bidding; however, enforcement of the new procurement rules and regulations has been weak and a large volume of contracts continues to be awarded on a sole source basis.

5.37 CAR is progressively developing the institutional framework to improve project implementation. This includes the development of a medium-term approach to budgeting, adoption of a new procurement code, the computerization of the expenditure chain, the development of a manual of procedures to guide the management of public investments, and the establishment of the development assistance database (DAD).

- With the adoption of a medium-term approach the authorities aim to anchor the annual budget in medium-term projections. The 2010 budget was prepared in the context of a medium-term framework. A basic medium-term fiscal framework was developed to set the overall spending limit based on revenue projections. This approach is intended to help ensure that the implications of current budgetary decisions for government finances in the medium-term are properly taken into account as well as to limit inefficiencies that arise from annual allocations for multi-year investment projects included in the PIP.

- The new procurement code promotes competitive bidding. Cabinet has adopted the key legal texts that are needed to render the new code fully operational. In addition, the government created a general public procurement directorate (DGMP), charged with the overall responsibility for public procurement policy, a regulatory authority (ARMP) to oversee the procurement function, and a bidders complaint unit to ensure that effective procedures are implemented for resolving disputes or any other complaints that may arise during the procurement process. Procurement units have been set up in the ministries of Education, Health, Agriculture, and Infrastructure and are being equipped, staffed and trained. A manual of procedures for executing agencies and standard bidding documents have been prepared to facilitate the implementation of the new procurement code.
- A computerized expenditure management system (GESCO) has been set up since 2008. GESCO is designed to permit the recording and tracking of resource flows through the budget expenditure chain from commitment to payments. It supports the preparation of quarterly budget execution reports, and is expected to enhance transparency in public expenditure management and strengthen cash flow management.
- In 2008, the government set up the development assistance database to record donor flows. The database aims to provide information on donors' project, their total costs and the use of funds in terms of commitments, disbursements, and expenditures.
- A manual of procedures developed in 2009 provides a set of guidelines for the management and monitoring of project implementation.

5.38 However these reforms are not fully effective and outcomes have not met expectations, especially in public financial management. In the case of procurement there is need to enforce the rules and procedures in line with the regulations of the new procurement code. There is a tendency among contractors to attempt to circumvent the procurement procedures or to get permission for single source selection, which raises costs. In the case of GESCO, as noted in chapters 1 and 2 there is need for the authorities to adhere to budget procedures and limit the recourse to exceptional procedures for the payment of government expenditures as well as the need to train more staff in the operation and use of the system. Regarding DAD, there is need to ensure that donor flows are systematically recorded, the database is frequently updated, and the information is disseminated. Finally in the case of the budget, there is need to develop multi-year ceilings for expenditure in order to limit inefficiencies arising from annual budgeting for multi-year investment projects.

Project Adjustment

5.39 The government is currently involved in efforts to revamp the PIP to make it the principal instrument for the planning and execution of public investments. With the support of the African Development Bank the government has developed a manual of procedures for the management and programming of public investments. The manual describes key concepts, the scope of the PIP, project cycles, the roles and responsibilities of the different actors involved in the management cycle of public investment at the central and local government levels, and the basic principles for programming public investments. It also outlines the key steps in project selection, implementation and monitoring and evaluation. The objective of these efforts is to turn the PIP into an effective instrument that can support an active management of the asset portfolio. A successfully revamped PIP will help improve the prioritization of investments as well as project implementation by providing updated information on the financial and execution status of investment projects.

5.40 The funding review process needs to clearly specify the steps that have to be taken to take account of changes in project circumstances. The guidelines for monitoring and evaluation provide a description of the steps that should be followed to record the data and information needed to carry out an assessment of a project's achievements and problems. Properly gathered, the data will provide information on the nature of problems and difficulties encountered in the execution of the project and solutions proposed to address the problems. The guidelines do not, however, outline problems that may arise during implementation and steps that should be taken to correct these problems. Moreover, the database of public investment projects is not widely available, and the monitoring of the PIP is not systematic. As noted above a development assistance database has been set up at the Ministry of Economy and Planning to record donor's aid and investment projects. However, up to date information on ongoing and completed projects is not regularly available.

5.41 Most of the projects in the PIP are donor-financed and are executed outside the normal budget process by project implementation units. The project implementation units (PIUs) set up in the beneficiary agencies to execute the investment projects are required to prepare quarterly project implementation reports. But there is no systematic monitoring of the activities undertaken by the PIUs. Significant cost overruns and delayed delivery of projects occur; but no independent evaluation of the revised benefits and costs is conducted by the government.

Facility Operation

5.42 Once a project is completed there is a process for handing over the assets to the public entity that is to operate the asset. However, asset registrars are not maintained and asset values are not systematically recorded. In addition, no routine inspection takes place to ensure that the assets build are in accordance with the agreed specifications. As in many other countries in Sub-Saharan Africa an asset register exists for land but few titles are registered, and no valuation is undertaken for most of the other assets build through the PIP. Operation and maintenance expenditures are under- budgeted and, in most cases, are under-executed in most sectors.

Project Evaluation

5.43 Most project evaluations take place in the context of portfolio reviews conducted by donors such IDA. These portfolio reviews provide the authorities with the opportunity to discuss the performance of projects and results. They constitute the main framework for assessing project outcomes and for examining whether the project was implemented in accordance with the original or amended time frame and whether the outputs were delivered as expected. However, periodic compliance audits of samples of investment projects are lacking. The Court of Account, the supreme audit institution, is under-funded and lacks the capacity to undertake periodic compliance audits. Ex-post evaluations during which a deeper analysis of what has worked and what has not is carried out are less frequent. The DGPE undertakes an annual review of the implementation of the PIP, which reports on project costs, deliveries and expenditures against budget appropriations. However, this review is not disseminated and the impact of its recommendations on the PIP seems limited.

E. POLICY RECOMMENDATIONS

5.44 CAR has recognized the vital importance of improving public investment efficiency especially in view of its plans to raise the level of public investment significantly in order to stimulate higher economic growth. Over the past few years CAR has endeavored to put in place a system to strengthen

the PIP process to enhance the selection, budgeting, implementation, and monitoring of public investments so as to maximize their impact on growth and the living conditions of the population. The public investment management system faces major challenges, however. Most notably, inadequate project selection and budgeting lead to the under-budgeting of O&M expenditures; a formal project appraisal process is lacking; monitoring of the execution of public investment projects is not systematic, and the process for screening project proposals needs significant strengthening. Addressing these and related challenges will be critical to ensuring that scarce resources are not wasted.

5.45 The diagnostic analysis of the PIM suggests priority reforms in two broad areas. First, in the short to medium run efforts should be geared towards strengthening project appraisal, selection, and monitoring of project execution. Progress in these areas will help prioritize investment spending and enhance the impact of the investment budget on growth and poverty reduction.

- The manual of procedures provides a set of consistent guidelines for the appraisal and selection process of investment project. These guidelines should be followed and appropriate capacity should be progressively developed to ensure that the guidelines are adequately implemented and updated.
- The development assistance database (DAD) should be strengthened to permit a more active monitoring of the execution of investment assets. It would be critical to ensure that donor flows are systematically recorded, the database is frequently updated and the information is regularly published.

5.46 Second, over the medium-term, the government should place emphasis on strengthening the medium-term framework of budget policy. The development of an MTEF will be essential to efforts to fully integrate the investment and the recurrent budget and improve the allocation of resources. Two areas deserve particular attention.

- The macro-level MTEF should be strengthened by developing multi-year ceilings for the investment budget and including these ceilings in the Finance Law submitted to Parliament for approval.
- Medium-term budget frameworks should be progressively developed to help allocate sectoral spending across different programs and projects, based on the country's development priorities as set out in the PRSP.

F. CONCLUSIONS

5.47 The analysis presented in this chapter shows that CAR's public investment management system is generally weak and most aspects of the system need attention. The system cannot be fixed at once, however, and priorities would need to be set. The analysis suggests that in the short run, the government should intensify its efforts to strengthen the PIP process by ensuring that the guidelines for investment programming and management are followed by sector ministries. To enhance the efficiency of public investments efforts should be devoted to strengthening capacity in project selection, appraisal and monitoring. Over the medium-term, efforts should also continue to strengthen the medium-term focus of the budget by linking the budget to the PRSP through a medium-term expenditure framework that provides multi-year ceilings for capital expenditures, takes into account evolving fiscal developments, and ensures adequate budgeting of operation and maintenance (O&M).

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