THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 17, 1986

TO: Messrs. Stern, Qureshi, Shihata, Husain, Thalwitz, Mrs. Krueger

FROM: Y.H. for Basil Kavalsky, Acting Director, CPD

EXT.: 60115

SUBJECT: CENTRAL AFRICAN REPUBLIC - Proposed Structural Adjustment Credit

1. The Loan Committee will meet on Friday, June 20, 1986 at 2:30 p.m. in Room E-1208 to consider a proposed Structural Adjustment Credit to the Central African Republic of $14.0 million from IDA and $16.0 million from the Special Facility for Africa (of which up to $3 million -- 10 percent -- would be for retroactive financing). The Committee may wish to consider the following issues.

Implementation of the Structural Adjustment Credit

2. The proposed SAL would be the Bank's first adjustment operation in the Central African Republic. Our knowledge of the adjustment needs of the country is still at a relatively early stage, and for this reason much of the SAL's policy conditionality mandates studies which could establish the basis for future adjustment operations. In all some 30 studies or programs are to be prepared; many of them appear general or ambitious in scope. For example, the discussion of the civil service and public administration ends with the statement that the government will "review the educational system in the light of the nation's needs and redefine its policies on advanced and professional training" (para. 53). Similarly, in the discussion of agriculture (para. 34), the IM proposes that the Government will prepare "a program for the construction and maintenance of access roads and clarify institutional responsibilities for its implementation and coordination", and will "undertake a comprehensive study of export diversification possibilities". Para. 46 asks for "a study on the incentive structure affecting the efficiency of resource use in the small- and medium-scale enterprises".

3. Not only does the IM propose a large number of studies, but it also expects early completion dates for most of them. For example, six out of seven measures to be taken for food crops (para. 34) and five out of the six measures for coffee (para. 37) essentially require preparation of programs or studies, most of them to be completed this calendar year. The Region may wish to elaborate on the potential strains on the relatively weak administrative system of carrying out such an ambitious program of technical and institutional studies and the desirability of narrowing down the range and scope of the work to be done. To some extent these strains may be overcome by the use of at least nine outside consultants hired under the second IDA Technical Assistance project (para. 96). This extensive use of outside consultants does, however, raise a further issue of whether the Government's commitment to the reform process may be compromised by over-reliance on expatriate assistance.

4. There will be a need for the Bank to follow-up on these studies to ensure the implementation of their recommendations. The Initiating Memorandum mentions only one future adjustment operation, a sector adjustment loan in agriculture. Given the wide range of issues addressed in the studies, <u>does the Region plan to support a continuing reform process with a series of structural or sector adjustment loans</u>?

<u>Administrative Capacity</u>

5. During the period 1979-82 the country experienced an "almost complete .... disintegration of the public administration" (para. 8); civil service and parapublic wages have now been frozen (presumably in nominal terms) for five years, and the SAL proposes to further contain salary adjustments (para. 50-53). Real wages today appear to be about 55-60 percent of what they were in 1980. Experience from other Sub-Saharan African countries suggests that declining real wages in the civil service can have a seriously disrupting effect on government efficiency. In particular, low wages at senior levels can lead to a critical loss of management and technical personnel. <u>The Loan Committee may wish to discuss whether the envisaged civil service compensation policies are likely to weaken further the administrative capacity of the government to execute the SAL-supported reforms</u>. <u>What steps are being taken to motivate and retain essential personnel in the civil service while also reducing the numbers of redundant staff</u>?

<u>Monetary and Fiscal Policies</u>

6. Since the CAR, being a CFA Franc country, cannot influence its nominal exchange rate, monetary and fiscal policies are the principal means to ensure both macroeconomic stability and external competitiveness. Inflation appears to have averaged about 10 percent in recent years. <u>Has monetary and fiscal policy been satisfactory under the IMF program</u>? Under the terms of the Credit, the Government will undertake to increase public savings and budgetary receipts significantly (para. 25). The ways in which these goals will be achieved are not specified, and they will be made more difficult by the revenue-reducing aspects of the proposed liberalization program. The IM makes a number of proposals of an administrative nature for raising taxes, but there is no mention of increasing rates or broadening the tax base. Given the need to improve the government's budgetary position, <u>the meeting may wish to discuss whether the IM's revenue raising proposals are sufficient</u>.

7. Table 1 gives figures for the "Base Case" Scenario which show, over the period 1985-90, average annual real growth of public consumption of less than 1 percent, as against total investment growth of almost 9 percent. This breakdown suggests that current expenditures for rehabilitation and maintenance and for the conduct of economic services is satisfactory in relation to investment needs. <u>Is this balance between public consumption and investment in fact appropriate</u>?

Other Issues

8. Liberalization of the Trade Regime. Annex II (item D.2) indicates that first all quantitative restrictions on trade will be abolished and later import licences on all products subject to price controls will be eliminated and tariffs revised. This suggests that the quantitative restrictions are interpreted as excluding at least some import licences. What is the precise definition of import licences being used here? And does it make sense to remove quantitative restrictions independently of revising the tariff structure?

9. Agricultural Price Stabilization Fund. Paragraph 26 indicates that the second stage of the reform program for the Agricultural Price Stabilization Fund, CAISTAB, would be a "fundamental review of [its] role, organization and statutes". This stage would follow a number of specific reforms of the Stabilization Fund outlined in the first part of that paragraph. Would it not be more sensible for this fundamental review to establish the basis for reform? One of the specific reforms of CAISTAB would be a predetermined increase in the proportion of its revenues used for stabilization purposes. Such an allocation suggests that CAISTAB operates more on the lines of a price-support mechanism than of a stabilization fund. What are the objectives of CAISTAB's price interventions?

10. Cotton Sector. The IM notes (para. 38) that, to discourage cotton production, the government is both restricting the distribution of inputs, and lowering the subsidies on inputs from 55 to 45 percent of costs. Would it be preferable to reduce the subsidy by a larger amount rather than to restrict distribution of inputs?

11. Coffee Sector. An increase in the farmgate price of unprocessed coffee from CFAF 150 per kg to CFAF 190 per kg is proposed. This latter figure is equivalent, at current exchange rates, to about US 50 cents per kg. The current border price for processed coffee is $2 per kg, or four times the farmgate price. Are similarly large margins found in other African countries?

12. Parapublic Sector. It is proposed (para. 57) that subsidies and transfers to the parapublic sector be reduced by 10 percent in real terms in 1987. What specific policy changes are proposed to ensure that performance will improve to the extent consistent with a reduced budgetary transfer?

cc: Messrs. Serageldin, Fuchs, O'Brien, Bouhaouala, Westebbe, Palein, Knotter, Singh

Messrs. van der Tak, Rajagopalan, Michalopoulos, Roger, Jansen, Sigrist
Clements, Kopp, Ms. Donovan
Choksi, Huang, Nicholas, Ms. Brathwaite