



CENTRAL AFRICAN ECONOMIC AND MONETARY COMMUNITY (CEMAC)

SELECTED ISSUES

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Approved By
African Department

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A REGIONAL APPROACH TO ENHANCING GOVERNANCE AND REDUCING THE POTENTIAL FOR CORRUPTION¹

A. Introduction

1. **Good governance, including the control of systemic corruption, is vital for macroeconomic stability as well as sustainable and inclusive economic growth.** IMF research shows that weak governance and systemic corruption is associated with lower growth and investment and higher inequality, (IMF, 2018). Investing in good governance and reducing corruption is a largely budgetary-neutral reform to empower the private sector and expand opportunities for all. It is a step of critical importance in the CEMAC, part of the overall objective to address the root cause of the crisis it has faced following the decline in commodity prices in 2014: a largely undiversified economy over-dependent on oil, and still untapped internal regional market.

2. **This note looks at some CEMAC specific regional dimensions of a possible strategy to enhance governance, which would support specific reforms in this area at the country level.** The next section provides background. The following section describes the specific dimensions of governance covered in the note. A section on defining and measuring governance comes next, followed by a discussion on the impact of governance and corruption on growth. Three sections then look at governance and corruption in the areas of public financial management, anti-money laundering, and the link between the oil sector and public resources. A final section concludes. In dealing with these prominent issues, it is recognized that CEMAC faces capacity constraints in many dimensions of its macro-economic management, including because of the presence of fragile countries. The recommendations therefore require a gradual and sustained approach to yield results overtime.

B. Background

3. **The CEMAC region was severely affected by a sharp decline in commodity prices after 2014, notably the reduction in oil prices.** Facing a continue and rapid decline in regional reserves, the authorities decided at end-2016 to embark on a coordinated and sizeable fiscal adjustment effort by member countries, supported by the IMF and other partners and backed by adequate policies at the regional level in the monetary and financial sectors. The short-term objective is to restore external and domestic stability. In the medium term, addressing the root cause of the crisis would require reducing excessive dependency on oil and lay the foundation for a broader economic base. To unlock this potential, it will be key to address the constraints that affect governance, in particular in the management of public resources, and which feed into a strong perception of corruption.

¹ Prepared by Sabrina Lando, Samuele Rosa, and Gwenaëlle Suc.

4. **This note assesses the link between governance and economic performance in the CEMAC.** It highlights areas where the CEMAC's governance is weak, based on available indicators over-time, and highlights areas for improvement. The focus of this note is on the regional dimensions of reform that can support better governance. It is recognized that the thrust of actions in this area are largely in the remit of national authorities. However, the very design of an economic and monetary union results in a set of policy and reform dimensions that have a distinct regional feature. For these, improvements require a coordinating or even steering role by regional institutions, to set a coherent framework for and maximize synergies of reforms at the country level.

5. **The note focuses on three key areas where governance has a specific regional dimension.** First, it examines gaps in the implementation of regional standards for public financial management. Second, it looks at standards to strengthen the framework underpinning efforts in the area of any-money laundering and combating the financing of terrorism. Finally, it assesses the framework for management and accountability of oil resources.

6. **This note relies mainly on IMF-led assessment, complemented by some third-party indicators.** Such assessment is complemented, where relevant, with the use of indicators of corruption (e.g.: Transparency International's Corruption Perception Index).

- In the area of public financial management, we rely on the Public Expenditure and Financial Accountability (PEFA)² indicators for CEMAC countries which have gone through such assessment. Additional indicators and assessment are obtained by measuring the gap between the CEMAC PFM Regulations for Public Financial Management, and actual practices at country level.
- In the area of AML/CFT, this note relies on indication of compliance with the international standards set by the Financial Action Task Force (FATF).
- Governance around management of oil resources is evaluated on the basis of compliance to the EITI standards, where relevant, and the implementation of CEMAC's own standards (mainly as derived from the CEMAC PFM regulations).

C. Scope of Governance Issues in CEMAC

7. **The choice of these themes reflects key features of the CEMAC economic structure.** Exports by the extractive sectors represent a dominant part of the regional economic basis and constitute the main source of foreign exchange. Consequently, good management in this sector,

² Public Expenditure and Financial Accountability (PEFA). Public Expenditure and Financial Accountability (PEFA) is a tool for assessing the status of public financial management. A PEFA assessment provides a thorough, consistent and evidence-based analysis of PFM performance at a specific point in time. For more information at <https://pefa.org/>.

where the state is present directly (through its state-owned enterprises) and indirectly (through related tax- collection), is key to ensure good governance at large. Second, the role of the public sector is still a dominant source of aggregate demand, and strong governance in managing public funds directly impacts governance in the CEMAC. Lastly, CEMAC banks play a crucial role in avoiding safe havens for the proceeds of corruption, thereby directly contributing to allocating financial resources to productive ends.

8. **These themes are also directly related to CEMAC’s own regional governance.**

- First, the CEMAC regulatory framework for public financial management (PFM) provides strong standards for transparency and accountability in the management of public resources. Weaknesses in this area can create the potential for resources not being collected and used according to the intended purposes. Work in this area is mainly led by the CEMAC Commission.
- Second, a strong AML/CFT regime is a crucial tool in addressing corruption. Because the proceeds of corruption are often concealed to avoid detection or confiscation, an effective AML/CFT framework can contribute to both prosecuting and deterring corruption. The diversion of resources away from economically and socially productive uses can also negatively undermine the stability of a country’s financial system or its broader economy. Work in this area is mainly led by the COBAC.
- Finally, the oil sector is central to the CEMAC, also given the strong presence of the state, through its SOEs, into profit sharing agreements signed with private entities. Such agreements, in turn, should be consistent with the regulatory framework set at the regional level in the area of foreign exchange. As such, the good management of these resources is essential to ensuring external stability to the monetary arrangement. Work in this area is a shared responsibility of member countries, primarily, the CEMAC Commission (in ensuring proper implementation of adequate tax codes and tracking funds which are to be covered by state’s budget), and the BEAC (in fully understanding the link between export commodity prices and volumes and accumulation of foreign exchange).

D. Background: Defining Governance and Corruption, and their Measurement

9. **The word governance, which may be subject to different definitions and interpretation, needs some clarity.** We rely on the recent IMF policy paper on Enhanced Framework for the Fund’s Engagement in Governance and Corruption. We define corruption as “the abuse of public office for private gain.” This definition is widely accepted in the literature and used by the Fund and other international organizations. (Box 1).

Box 1. Defining Governance and Corruption

Governance refers to the broad “framework for exercising authority” while “good” governance refers to the “quality” of governance and its impact on outcomes. Broadly speaking, governance relates to the “rules of the game”, while “good” and “weak” governance reflect how the game is played and its results. The Fund has defined governance as the set of “institutions, mechanisms, and practices through which governmental power is exercised in a country, including for the management of public resources and regulation of the economy.” Similarly, the Fund refers to “good” governance as a normative concept, according to which the “quality of governance can impact its effectiveness and efficiency in achieving desired outcomes.” (IMF, 2017a).

We define corruption as “the abuse of public office for private gain.” This definition is widely accepted in the literature and used by the Fund and other international organizations. It is also consistent with the provisions of the United Nations Convention Against Corruption. As the definition suggests, corruption is typically associated with the functions of the State and some of them—e.g., public finances and government regulation—may be particularly prone to creating opportunities for corruption (e.g., IMF, 2018; Tanzi, 1998).

10. **Weaknesses in the system of accountability and requirements for transparency can themselves create a fertile environment for corruption.** There may be potential for corruption stemming from lack of reliable reports on the source and use of public resources, which may render the public financial management process opaque and facilitate embezzlement of resources. From this standpoint, a key area of investigation is when standards in the area of accountability and transparency are mandated at the regional level but seldom implemented at the country level.

E. The Impact of Governance and Corruption on Economic Activity

11. **Many studies have shown that corruption and bad weak governance undermine economic growth, accentuate income inequality and persistent entrench poverty³.**

- These studies find that corruption and weak governance are significantly associated with low levels of economic growth. Weak governance may affect economic outcomes through several channels, including: reducing the attractiveness of an economic space and domestic and foreign investment; feeding into tax predatory behavior; resulting in poor infrastructure (through inefficient and untargeted spending); undermining human capital; generating political instability by fostering a sense of injustice.

³ Sanjeev Gupta and others-2003; and Aidt and others, 2008.

- The link between governance and inequality is also widely explored in the literature. With respect to income inequality and poverty, empirical evidence suggests that weak governance and corruption create distortions in resource allocation, adds to inefficient and predatory bureaucracy, and favor private interests. These studies conclude that this poor institutional quality compromises economic efficiency by misallocating scarce resources and is correlated with an elevated level of poverty.

12. **These links have been confirmed by a meta-study conducted by IMF staff** (IMF 2017, 2018). A meta-analysis of the impact of corruption and weak governance on growth was conducted for some of the 26 most-quoted studies (providing 149 estimates of the impact of corruption) and 17 other studies (providing 125 estimates on the impact of governance). The analysis suggests that improving governance and reducing corruption are significantly related to stronger and more inclusive growth. These results are particularly important for countries starting with relatively weak governance and corruption. The correlation between corruption/weak governance and growth is also significantly higher for low-income countries. They suggest that improvements in this area should continue to have a significant impact over time (Box 2).

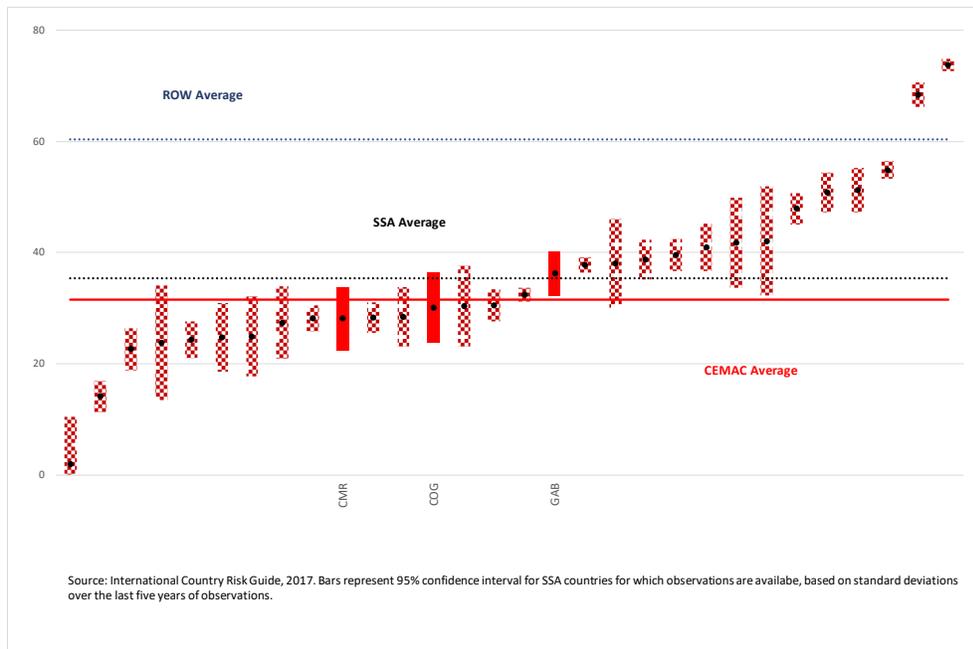
Box 2. The Growth Dividend of Governance—Evidence from a Meta-Analysis Conducted by IMF Staff

- Most estimates of the impact on per capita growth from improving corruption perceptions by a quartile along the corruption index range between -0.3 and -1.1 percentage point.
- About 90 percent of the estimates point to a negative correlation, as expected, and 80 percent of them are statistically significant.
- Similarly, the distribution of growth impact estimates resulting from a deterioration of the governance index by a quartile is mainly distributed between -0.2 and -1.5 percentage point.
- This finding is strong for different measures of corruption perceptions and quality of governance, estimation techniques and institutional quality controls.

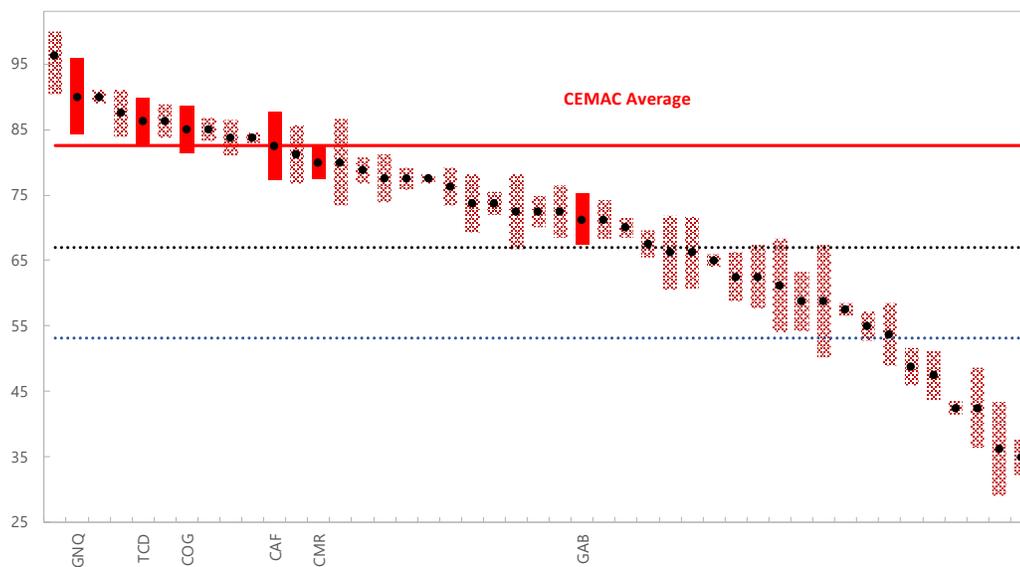
13. **Third party indicators on governance and corruption suggest that CEMAC countries lag their sub-Saharan African (SSA) peers.** The averages of such indicators for available CEMAC countries are below averages for the full set of countries belonging to the SSA region. The latter is also below the average for the rest of the world countries covered by the survey (Figure 1).

Figure 1. CEMAC, SSA, and Rest of the World: Governance and Corruption Indicators

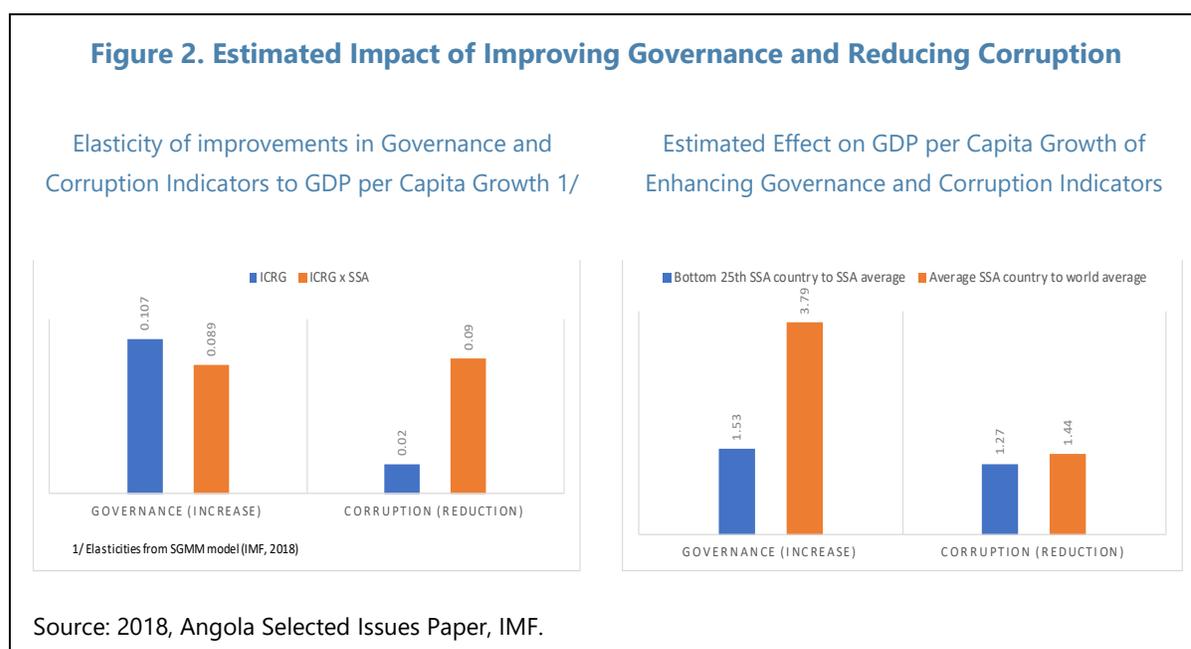
ICRG Governance Indicator, 2017
Index from 0 (worst) to 100 (best)



Corruption Perception Index, 2017
Index from 0 (best) to 100 (worst)



14. **Improvements in the governance and corruption indicators are related with higher growth** (Figure 2). Based on an SGMM model developed by staff (IMF, 2017) the elasticity of growth on improvement in the area of governance and corruption is significant, with the impact of reducing corruption in SSA much higher than the average for the rest of the countries covered in the surveys. This largely reflects the fact that the corruption index shows higher variation for the SSA, with the countries in this group with better governance posting higher growth. A simulated improvement in the governance or corruption index also shows that the estimated impact on growth would be significant for SSA. Given that governance and corruption indices are generally worst in CEMAC compared to the average of SSA, it is likely that the growth response could be higher in the case of CEMAC.



F. The CEMAC Framework for Public Financial Management

A strong and transparent framework for the management of public resources is the first line of defense against poor governance and potential corruption. The CEMAC has designed and adopted at the regional level the relevant regulations to build this framework and improve the efficiency in managing public resources. The challenge is to ensure proper and full implementation of these principles at the national level. This is best done by ensuring regular assessments, reporting on the implementation status, and supporting member countries in their efforts in this area.

Assessment

15. **The CEMAC PFM framework provides sound basis to manage public resources in a transparent and efficient manner, and address PFM vulnerabilities to corruption.**

The architecture underpinning the regional framework in the area of public financial

management (PFM) is rooted in six CEMAC directives. Taken together, these directives form a coherent framework to direct the role and responsibilities, the processes, the reporting, and internal and external controls and audits related to the collection of taxes and management of public resources. They also provide clear guidance in the area of consultation with civil society, dissemination of data, and, importantly, the interaction between executive and legislative bodies in the budget preparation, execution, and reporting. Principles included in these directives reflect international standards and best practices to promote fiscal transparency and effective management of public funds (Table 1).

16. **Because CEMAC standards are defined with the legal instrument of a “directive”, their provisions need to be transposed into national laws to become applicable to member states.** This transposition requires that member countries submit their draft law to the CEMAC Commission for the latter’s assessment of conformity. Recommendations of the CEMAC Commission are then embedded in the finalized law which can be approved. This process is meant to ensure coherence between the regional framework and the national level. There are a set of administrative acts which then follow the approval of national legislations to ensure that processes and procedures, as well as specific obligations in the area of data reports and audits, are well defined and guide work practices in the public administration.

Table 1. CEMAC: Key Directives on Public Financial Management: Scope and Issues Covered

CEMAC Directive #	Adoption	Scope	Issues Covered
06/2011	12/11/2001	Code of Good Governance and Transparency in the Management of Public Resources.	Key principles to ensure transparency, good governance, and participation of civil society in the area of fiscal policy, and budget formulation and execution.
01/2011	12/19/2001	The framework for budget law preparation and implementation.	General rules on the nature, coverage, presentation, preparation, and adoption the budget law.
02/2011		General rules in the area of public accounting.	Operational an procedural framework underpinning budget execution and controls.
03/2011		Structure of State’s accounting – the balance sheet.	General rules defining the object of state’s public accounting plan, and the rules of its production so as to track status/evolution of the state’s assets and liabilities.
04/2011		The nomenclature and presentation of budget operation.	Key principles related to the presentation of operations of the general budget, of annexed budgets, and special accounts of the Treasury.
05/2011		Table/presentation of the financial operation of the state.	Defines principles (concepts and methodologies) for the production of statistics on budget executions (follows international statistical standards – e.g. GFM).

17. **The transposition of these PFM directives is uneven, providing a potential for lack of standardization and adherence to key standards in this area.** CEMAC central directives on Governance and Transparency (06/2011) and on the budget law (01/2011) have been transposed into national legislation by all CEMAC countries, except Equatorial Guinea. Implementation on all

other directives is also partial, as three countries (Cameroon, Central African Republic, and Equatorial Guinea) have not transposed these into national legislations.

CEMAC: Status of Transposition of Directives on Public Financial Management

(November 2018)



Note: Degree of transposition of the six PFM Directives into national legislation is reflected. "Not implemented indicates" that no initiative was taken so far by the authority to provide the CEMAC Commission with a draft national law to transpose a given CEMAC Directive. "In progress" means that a draft law was prepared by the national authorities and sent to the CEMAC Commission, but the comments of the latter have not been incorporated as yet in a revised national law. "Enacted" indicates that the national law to transpose a given CEMAC directives has been approved. This last step, in itself, does not guarantee effective implementation of a Directives unless the concerned public administrations adapt their procedural approach, internal IT systems, and mode of cooperation with other public entities in accordance with the spirit of the CEMAC Directive.

18. **Transposition into national legislation does not guarantee that the regional framework of these PFM directives to enhance governance and prevent corruption is effectively implemented.** When a national law or regulation is enacted to transpose a CEMAC

directive, there are several administrative steps that need to follow, as well as sometimes deep modification of procedures, IT systems, and work practices, for the new legislation to be effective.

19. **A key role is played by the foundational CEMAC regulation 06/11 on Transparency and Good Governance** (Table 2). This regulation serves as the general framework for all the other directives, and sets the ground in terms of (1) attribution and responsibilities of each public institution, (2) the economic context in which the policy decision in the area fiscal policies are embedded, (3) the elaboration and presentation of the budget law, (4) the activities related to revenue collection and expenditure, and (5) the information to be provided to the public, and (6) a participative process, with involvement by the civil society, in defining key policy decisions. By design, this regulation provides a strong basis in terms of governance. It also provides clear-cut responsibilities and strong requirement of transparency, which are critical to support an environment that limits the potential for corruption.

Table 2. CEMAC: Selected Provisions of Directive CEMAC 06/2011 on Transparency and Good Governance

Article	Provision
Section I - Legality and Publicity of Public Financial Operations	
1	No public expenditure can be committed if it is not defined by a legislative or administrative law, regularly published
3, 4	The regulation related to public tenders need to be cohered with CEMAC 06/2011. The selling of "public goods" are to be disclosed to the public and open for competitive bidding.
5	All contracts between the (central) administration and (public or private) enterprises related to the exploitation of natural resources (and concessions of public service) are made available to the public. This principle covers both the allocation of the contract as well as its specific content. Such contracts are controlled by the Court of Accounts as well as the competent legislative bodies. The interaction of the government with the private sector will have to be conducted in transparency.
Section II - Attribution and Responsibilities of Institutions	
1	Establishes that allocation of competences, expenses, and public resources within all level of public administration would have to be communicated in a comprehensive and coherent way.
Section III - Economic Framework	
1	Establishes the requirement that the budget law be encapsulated into a medium-term fiscal policy framework
Section IV - Preparation and Presentation of Public Budget (Laws)	
8	Mandates the publication, in the budget law, of detailed information on all the (fiscal and nonfiscal) revenues, including those related to the exploitation of natural resources
9	The nature and budgetary costs of all (tax) derogations are to be included as part of the annual budget; their validity is to be presumed only for the year of presentation into the budget document
Section V - External Control	
3	All the operations involving public funds are subject to the external (and independent) control of the Court of Accounts, whose creation is obligatory for each member states

20. **The actual implementation of this key directive remains problematic** (Table 3). First, regional coverage is partial as Equatorial Guinea, a top oil producer in the region, has not transposed this central directive. In addition, some crucial principles of this directive are not actually implemented in countries that have adopted it. Fiscal reporting on natural resources management provides an emblematic example. While the directive requires the publication of financial operations concluded by the public sector, contracts with the oil sector are not made available to the public in a full and transparent manner. Public procurement is another example. The directive stresses that regulations on public procurement must comply with international standards. Based on these standards, open competition should be used as the preferred or default method of procurement and complaints review mechanism should be in place, which is not systematically observed in practice and creates vulnerabilities to corruption in public investment management.

Table 3. CEMAC: Selected Problems Encountered in the Full Implementation of the CEMAC Directive on Transparency and Governance 1/

Directive	Problem related to full implementation 2/	Possible impact
06/2011 – Directive on Transparency and Good Governance	Coverage is partial as Equatorial Guinea (a top oil producer) has not enacted this directive	<p>→ Total absence of a basis for the complete implementation of the CEMAC standards in the area of public financial management</p> <p>→ Lack of accountability in the area of signature of contracts by the State (and/or its state-owned enterprises) and private companies in the extractive sector</p>
	In most of other CEMAC countries, certain key principles are not applied in practice. Some critical areas include: (1) full and transparent publication of all contracts related to the extractive sector is very problematic, (2) the participation of civil society in the budgetary process is scant, (3) there is no publication of a medium-term budget	<p>→ As a consequence, derogations to CEMAC directives, including in the area of fiscal and foreign exchange regimes, are provided with very little scrutiny</p> <p>→ This limits the ability of national and regional institutions alike to assess the impact of such derogations for extractive industries onto the tax basis and projected inflow of foreign exchange</p>

1/ Source: Evaluations based on regional and bilateral surveillance, and technical assistance, by staff of the African and Fiscal Affairs Department of the IMF.

2/ The term "full implementation" refers to the actual translation of the directive into the full set of administrative regulations and reforms, including their impact on the work practices and flow of information between all entities involved in the management of public resources.

21. **The limited implementation of the CEMAC directive on the Budget Law increases also risks of exposure to corruption in several PFM areas** (Table 4). First, transactions to and from the State-owned enterprises (SOEs), including SOEs which are part of profit sharing agreements in the extractive sector, are not systematically covered by central governments' fiscal reporting. This weakens the scope of internal and external controls in this key area. It also adds to the difficulty to track the flow of foreign exchange back to the CEMAC related to this sector, which is a key pillar to support external stability. Second, tax exemptions and tax expenditures

are rarely detailed and assessed in the budget documentation or are maintained for several years without clear legal basis and economic justification. This may create governance problems and even provide undue ground for favoritism. Third, the consolidation and the full operationalization of the Treasury Single Account (TSA) still need to be completed. The TSA is not used extensively, in particular with regards to the domiciliation of the state's share in the extractive industry as well as in some external financing. In such cases, holdings related to the central government are even kept in foreign accounts. While the directive prohibits the deposit of public funds in commercial banks, maintaining fragmented banking arrangements outside of the TSA reduces the ministry of finance/treasury oversight of all government cash flows and weakens budget control and monitoring. This practice directly creates potential for weak governance.

Table 4. CEMAC: Selected Problems Encountered in the Full Implementation of the CEMAC Directive on Budget Law 1/

Directive	Problem related to full implementation 2/	Possible impact
01/2011 - CEMAC Directive on the Budget Law (Loi de Finance)	1 / Transactions related to state-owned enterprises (including the State's share in the PSA) are rarely covered by the finance law.	→ The budget law (preparation and reporting) does not allow for a clear evaluation of transactions with SOEs, which are in some cases an important source of foreign exchange earnings, for instance in the case of tracking expected flow of oil-related resources from state-owned enterprises involved in Profit Sharing Agreements (PSA) to the government and the budget.
	2 / The list of tax exemptions not clearly included and often maintained for years without justification.	→ This undermines the public and legislative control of the expected flows to the central government's.
	3 / Inappropriate presentation and coverage of subsidiary budgets and special accounts in the budget law.	→ The economic rationale for tax exemptions is not easily monitorable ex post, which may provide fertile ground for unjustified tax exoneration and even corruption. This undermines the attainment of one of the main objectives of the adjustment effort (which is not just to reduce spending): the increase in non-oil tax revenues to support priority spending.
	5 / The single treasury accounts are often not fully implemented and / or operational.	→ Cash management is fragmented, reducing the transparency of available cash resources and leading to inefficiencies in budget and debt control and monitoring.

1/ Source: Evaluations based on regional and bilateral surveillance, and technical assistance, by staff of the IMF.
2/ The term "full implementation" refers to the actual translation of the directive into the full set of administrative regulations and reforms, including their impact on the work practices and flow of information between all entities involved in the management of public resources.

22. **Finally, the implementation of the CEMAC Directive on Public accounting also needs to be completed to strengthen expenditure controls and reduce fiscal risks** (Table 5). Challenges in this area are of two types. First, expenditure controls are not effective and, in the practices, not streamlined in most CEMAC countries, and exceptions to the regular expenditure procedure defined by the directive have multiplied in practice. This creates incentives for expenses that are executed outside the normal spending chain, delinking budget execution from the resource envelope available and approved in the budget law. In turn, this explains the emergence of large stock of arrears that plague the region, in particular when the resource envelope is reduced by a decline in world commodity prices. Ex-post, it also severely weakens the legislative input to budget orientation and fiscal policy.

Table 5. CEMAC: Selected Problems Encountered in the Full Implementation of the CEMAC Directive on Public Accounting 1/

Directive	Problem related to full implementation 2/	Possible impact
02/2011 – CEMAC Directive on Public Accounting (Règlement général sur la comptabilité publique)	1 / Expenditure controls are not streamlined / effective.	→ Unauthorized expenditure contributes to weak financial reporting and, de facto, internal controls.
	2 / Proliferation of unorthodox procedures, bypassing regular controls.	→ They create or aggravate cash management problems (accumulation of arrears). → They reduce, ex post, fiscal space as defined in the budget law which went through the legislative approval procedure.

1/ Sources: Evaluations based on regional and bilateral surveillance, and technical assistance, by staff of the IMF.
2/ The term "full implementation" refers to the actual translation of the directive into the full set of administrative regulations and reforms, including their impact on the work practices and flow of information between all entities involved in the management of public resources.

23. **Assessment of governance in the management of public funds based on an analysis of the status of implementation of CEMAC directives closely match PEFA-based assessment and highlights several governance problems** (Table 6). Regular work is conducted, including by the IMF, to assess public financial management performance, as part of the Public Expenditure and Financial Accountability (PEFA) framework⁴. It identifies 94 characteristics (dimensions) across 31 key components of public financial management (indicators) in 7 broad areas of activity (pillars). Based on a selection of specific indicators more closely related to measures of governance in the management of public resources, the CEMAC countries (Gabon, Cameroon, Congo, and Central African Republic) are in most cases below the average for sub-Saharan countries, and these two groups are below the average for the rest of the world. Such assessment is consistent whether one look at the more recent or the pre-2013 PEFA indicators.

Recommendations

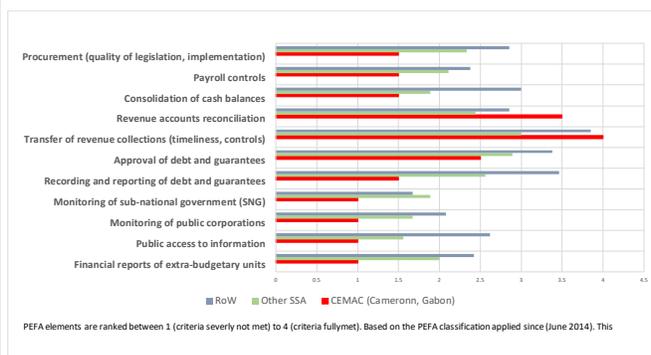
24. **The CEMAC Commission is working on several fronts to address weaknesses in PFM.** First, its core mandate to oversee the full and effective implementation of CEMAC directives translates into ongoing interaction with member countries to facilitate full transposition into national legislation and assess how work practices comply with the directives. A specific area is the gradual implementation of budget by program classification (e.g. Gabon and Cameroon; and, partially, Congo and Chad), which benefit from guidance from the CEMAC Commission. Second, the CEMAC regional surveillance framework provides a basis to relate outcomes in budget execution with the degree of implementation of CEMAC directives

⁴ For background information on the survey methodology, concepts, and definitions please refer to <https://pefa.org/>.

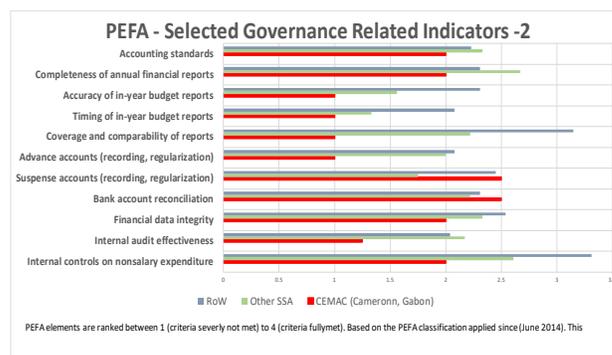
Figure 3. CEMAC and Selected Regions: PEFA Scores

Scores through 2016

PEFA – Selected Governance Related Indicators –1

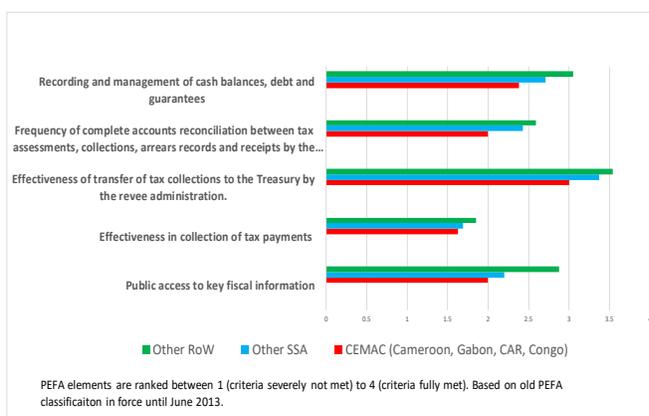


PEFA– Selected Governance Related Indicators – 2

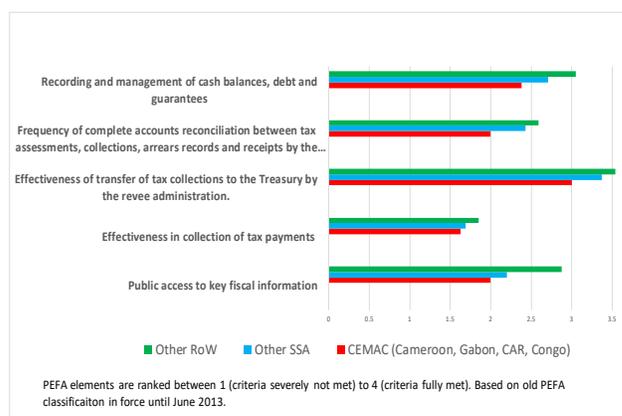


Scores through 2013

PEFA – Selected Governance Related Indicators –3



PEFA – Selected Governance Related Indicators –4



25. **However, strengthening PFM remains an imperative to enhance governance and reduce the potential for corruption in the CEMAC.** Progress in this area requires steps on different fronts:

- **Strengthen capacity of the CEMAC Commission to monitor and ensure the proper implementation of the CEMAC directives.** The CEMAC Commission faces a daunting task in covering a wide array of issues ranging from internal market regulation, to international treaties, and harmonized budget preparation and execution. It would be

critical to assign dedicated resources to a CEMAC Commission unit tasked to assess on a regular basis progress in the PFM area. Ideally, such unit would issue a periodic report on the status of implementation, describing gaps and actions in countries.⁵

- **Ensure the communication of petroleum contracts to a centralized unit within the CEMAC Commission.** Such contracts are often kept confidential to regional institutions. The specific tax agreements embedded in these contracts are known to be often in derogation of the CEMAC framework, thereby reducing the tax basis. Moreover, the exact terms of the benefit to the state from participating to profit sharing agreement (via SoEs) or concession are not known, as they result from complex formula described in confidential contracts dependent of oil volume, prices, and the cycle of investments. As a welcome step to strengthen governance in this area, the CEMAC Commission will request national authorities to share such contracts and use this information to enhance understanding of the revenue accruing from them.
- **Require CEMAC member countries to finalize their convergence report.** These reports would describe the convergence path over three years with regards to those convergence criteria not met. They are, therefore, a potentially useful instrument to relate full implementation of CEMAC Directives (e.g. in the area of tax regime) to the expected flow of resources, thereby enhancing accountability and scrutiny on the adoption of sustainable fiscal policy. To date, these reports have not been completed.
- **Coordinate with BEAC to develop and operationalize treasury single account (TSA) in CEMAC member countries.** Both BEAC and national treasuries need to interact and to develop shared practices and procedures to maintain the TSA in an operational manner. Developing TSAs requires adapting institutional arrangements between BEAC and treasuries to clearly define responsibilities, policies, including on the rates of interest paid on the TSA balance, and requirements of information exchange. Upgrades of IT systems and procedures used by the BEAC are also a prerequisite to ensure active and timely cash management.
- **In all areas of the governance agenda, enhancing transparency is essential.** As seen above, there is a serious lack of transparency in terms of disclosure of contracts in the extractive sectors, proper recording in budget documents of transaction at subnational level and with regards to state owned enterprises. Budget documents are often incomplete, for instance as regards to providing information of tax exemption, their economic rationale, and their estimated costs. From this standpoint, a significantly enhanced transparency will be key. This could initially start with a regular report, disseminated to the public, on the

⁵ Such an approach has been implemented successfully in the WAEMU. In principle, it is advisable that the entity in charge of overseeing the treaty establishing an economic union (“Commission” in the EU, CEMAC, and WAEMU case) be provided clear jurisdiction to determine whether national law is compliant with community directives. Moreover, ideally this verification process needs should be formalized: annual, peer review based.

- various budget documents and background reports which are expected, by CEMAC regulation, to be made available to the public, and are not at the moment.

G. The CEMAC Framework for Anti-Money Laundering and Combating the Finance of Terrorism (AML/CFT)

26. **The AML/CFT regime can be a powerful tool in supporting efforts to prevent, detect, investigate and prosecute acts of corruption.** The Financial Action Task Force (FATF), the international standard setter for AML/CFT, calls for the mobilization of the AML framework to help detect and trace the laundering of proceeds of corruption, and assist in the investigation and prosecution of bribery⁶. Specific elements of the AML/CFT framework are particularly relevant: implementation of enhanced due diligence requirements for domestic politically-exposed persons (PEPs), including the identification of PEPs that are the beneficial owners behind legal persons, and reporting to the authorities by financial institutions of transactions when they suspect or have reason to suspect that the funds are the proceeds of criminal activity, including corruption.

27. **The regionalization of the AML/CFT framework within the CEMAC is a much welcome effort in creating economies of scale and ensuring a level playing field within the Community.** An AML/CFT regulation was adopted in 2003 and was subsequently revised in 2010 and replaced in 2016. The current CEMAC regulation is of direct and immediate application in all the member countries. Other steps have also been taken at the regional institutional level with the establishment of the Groupe d'Action contre le Blanchiment d'Argent en Afrique Centrale (GABAC)⁷ and the creation of an AML/CFT supervisory function within the COBAC. Notwithstanding the regionalization effort, some important functions, such as law enforcement and financial intelligence responsibilities, remain at the national level.

28. **While the regional AML/CFT framework has been strengthened with the adoption of the 2016 CEMAC regulation, there remains significant scope to improve the compliance with the Financial Action Task Force (FATF) standards and its effectiveness.** Assessment of the CEMAC member countries' compliance with the 2003 FATF recommendations found strategic weaknesses in the 2003 and 2010 CEMAC regulation, with most assessment criteria being evaluated as non-compliant or partially compliant in areas related (Box 3). The 2012 FATF standard introduced new recommendations, including with respect to anti-corruption measures, and an emphasis on the effectiveness of the regime. The first assessment of CEMAC countries against this revised standard is ongoing and is scheduled to be completed by 2025. These assessments will highlight pending shortcomings of the 2016 CEMAC regulation and

⁶ See FATF publication: [Best Practices Paper: The Use of the FATF Recommendations to Combat Corruption](#)

⁷ The GABAC is a specialized organ of the CEMAC which mission is to assist its members in the fight against ML/TF. The GABAC became recognized as an FATF-style regional body in 2015.

deficiencies in the implementation and effectiveness of both the national and regional frameworks.

Box 3. Overview of the Assessments of CEMAC Members Against the 40+9 FATF Recommendations

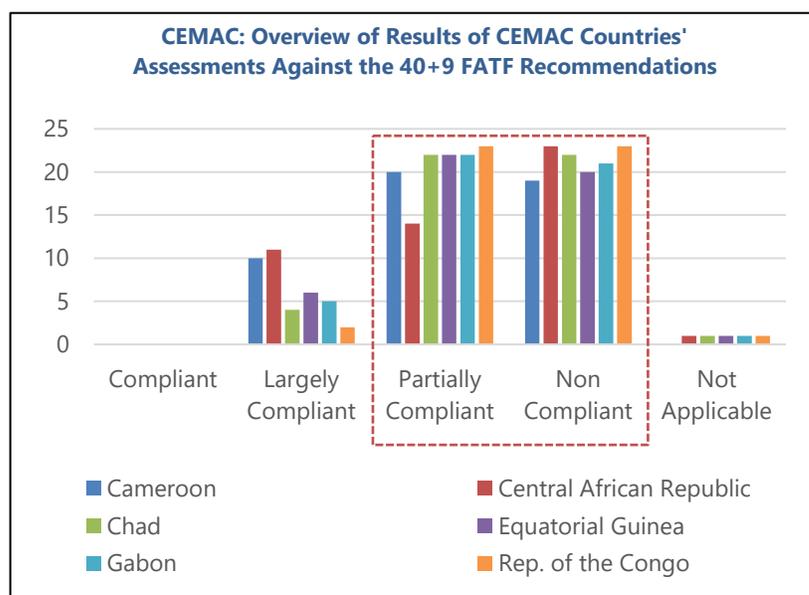
The GABAC is an FATF-Style Regional Body (FSRB) of which all CEMAC countries are members.

The GABAC was established in 2000 by the Conference of the Chiefs of States of the CEMAC as an organ of the CEMAC. It has been mandated to combat ML/TF, assess the compliance of its members against the FATF Standards, provide technical assistance to its member States, and facilitate international co-operation.

GABAC became an observer organization of the FATF in February 2012. It then worked with the FATF to meet the requirements of a FATF-Style Regional Body (FSRB). It was recognized as such in October 2015 and admitted as an associated member of the FATF.

The World Bank and the GABAC assessed all CEMAC member countries against the 40+9 FATF recommendations. The assessments were carried out between 2008 and 2015. The 2003 and 2010 CEMAC AML/CFT regulations as well as other related regional and national legal and regulatory instruments were assessed against the prevailing standards.

Overall, CEMAC countries were found to be not compliant or partially-compliant with most of the FATF recommendations. The assessment reports highlighted that the legal and regulatory frameworks were not aligned with the international standards. In particular, it found strategic deficiencies with preventive measures obligations for financial institutions relevant in the fight against corruption, namely provisions related to the identification of customers, politically-exposed persons, reporting of suspicious transactions, and transparency and beneficial ownership of legal persons.



Box 3. Overview of the Assessments of CEMAC Members Against the 40+9 FATF Recommendations (concluded)

They also stressed the need to issue guidelines to the private sector to help improve the implementation of the AML/CFT obligations.

In relation to the regional and national institutional structure, strategic weaknesses and low level of implementation were noted. The assessments revealed that in most countries, mechanisms for the supervision of money transfer and money exchange businesses had not yet been established and that resources and technical expertise for the supervision of supervised entities, including financial institutions, had to be mobilized to increase the number and scope of evaluations. They noted that while the frameworks for sanctions in case of breach of AML/CFT obligations were formally established, implementation was difficult to assess. The assessments also noted that most financial intelligence units had to strengthen their structure and capacity to assert their independence and put in place an effective financial intelligence in ML/TF investigations and prosecutions framework.

29. **AML/CFT banking supervision, a key component of the AML/CFT regime is under COBAC's responsibility.** While the onus of meeting the international AML/CFT standards remains with national authorities, individual CEMAC countries depend, in some respect, on regional bodies' actions and efforts. In particular, the COBAC has taken the responsibility of ensuring the strength of the regulatory framework and the proper implementation of preventive measures by credit institutions. The COBAC has carried out offsite and onsite examinations of credit institutions and has issued formal warnings and imposed administrative sanctions on institutions and their directors when important breaches were uncovered. The COBAC is in the process of introducing a risk-based approach to its overall supervision function and strengthening its capacity. To deepen its understanding of risks and better inform its supervision work, the COBAC is conducting an analysis of AML/CFT risks, the results of which it intends to publish in an advisory note by end-2018.

30. **Ensuring that the AML/CFT regime is effectively implemented through effective risk-based supervision by the COBAC will help support anti-corruption efforts across the CEMAC.** The COBAC supervisory role is critical in ensuring that credit institutions appropriately implement AML/CFT obligations to prevent and detect the laundering of proceeds of corruption. This would also support national AML and anti-corruption efforts, notably by ensuring that financial intelligence units receive useful suspicious transaction reports from credit institutions, which could trigger investigations for acts of corruption and the laundering of their proceeds.

31. **Another key international standard to guide reforms to reduce corruption (hence contributing to AML) is the UN Convention Against Corruption.** The United Nations Convention against Corruption is the only legally binding universal anti-corruption instrument. The Convention's far-reaching approach and the mandatory character of many of its provisions

make it a unique tool for developing a comprehensive response to a global problem. The Convention covers five principal areas: preventive measures, criminalization and law enforcement, international cooperation, asset recovery, and technical assistance and information exchange⁸. The Convention covers many different forms of corruption, such as bribery, trading in influence, abuse of functions, and various acts of corruption in the private sector. It has 186 states parties. The states parties submit to a voluntary peer review process. The first cycle of the review process has been completed for nearly the entire membership. It is not completed for three CEMAC member countries (Chad, Equatorial Guinea, and Congo).

Table 6. CEMAC: Country Compliance with the United Nations Convention Against Corruption

CEMAC Countries	Peer Review	Examples of Deficiencies (Para 2.3 of the Peer Review Report)
Cameroon	2017	Procurement
Chad	Not reviewed	
Central African Republic	2016	AML
Equatorial Guinea	Not reviewed	
Gabon	2015	Not specific
Congo	Not reviewed	

Source: United Nations Office for Drug and Crime (www.unodc.org).

Recommendations

- Continue to strengthen the regional AML/CFT framework, in particular for measures relevant in the fight against corruption.** The adoption of the 2016 CEMAC regulation is a positive step in bringing the regional framework in closer line with the 2012 FATF standards. The CEMAC should address the pending shortcomings to be identified in the upcoming assessments by the GIABA. The COBAC should also swiftly revise its 2005 regulation to implement the 2016 CEMAC regulation.
- Implement a risk-based approach to supervision will help focus the limited resources of the COBAC in the areas representing the most risks.** As called for by the 2012 FATF standard, jurisdictions should deepen their understanding of ML/TF risks and vulnerabilities and allocate more resources to high-risk areas. Hence, the COBAC should take steps to develop a risk-based onsite and offsite supervisory tool for credit institutions, notably by enhancing its understanding of the risks faced by the financial sector, developing risk profiles of supervised credit institutions to inform inspections and

⁸ Reference: <https://www.unodc.org/unodc/en/treaties/CAC/>

adapt the overall supervision strategy to residual risks. This should take into account the particular risks related to the laundering of proceeds of corruption.

- **Strengthen COBAC’s efforts in ensuring that AML/CFT preventive measures of high relevance for the prevention and detection of the laundering of proceeds of corruption are properly implemented by credit institutions.** The 2016 CEMAC regulation establishes preventive measures requirements in relation to the identification of customers and specific measures in relation to politically-exposed persons and beneficial ownership structures. However, implementation by the private sector is a challenge and national financial intelligence units continue to receive low levels of suspicious transaction reports. To address these shortcomings, the COBAC and domestic financial intelligence units should, amongst others, publish guidance to the private sector, conduct training and carry out more targeted supervision efforts.
- **Ensure that dissuasive and proportionate sanctions are imposed on credit institutions in case of AML/CFT breaches and reinforce the cooperation with national authorities to ensure the effectiveness of the AML/CFT regionalized regime.** As per the 2016 CEMAC regulation, the COBAC should communicate any administrative or disciplinary sanction imposed on credit institutions to the national financial intelligence unit and Prosecutor. Establishing effective channels of communication and exchange of information mechanisms between the regional and national levels will be key in strengthening the understanding of risks and following-up on institutions whose implementation of AML/CFT measures has been found as deficient.
- **CEMAC should also encourage its members to comply with the anti-corruption review UNCAC standard peer-process,** as part of a broader accountability infrastructure. The peer review process inter alia identifies gaps in the national legislative system in the implementation of the standards. Some of these gaps are directly relevant to CEMAC on matters related to AML/CFT or procurement.

H. The CEMAC Framework for Governance in the Extractive Sectors

Assessment

32. **Oil extraction and export plays a major role in the economy of most CEMAC countries.** Oil accounts for about 20 percent of GDP and covers roughly 75 percent of the region’s exports of goods. Tax and nontax revenues related to oil contribute to more than 40 percent of total revenues. Given the size of this sector and the importance in commanding public resources, good management in the oil sector is key to ensure governance in the rest of the economy.

33. **Oil sector is very complex, by nature, and pushes capacity of public administrations to their limits.** (Box 4.) The industry is organized basically around two typical arrangements. In a Profit Sharing Agreement (PSA) the state (normally through a state-owned enterprise-SOE), and a foreign private company (normally through a resident subsidiary), set up a partnership for the extraction and export of oil, and agree on a profit sharing scheme. In such scheme, a certain amount of oil (cost-oil) is used to pay the costs incurred in the exploration and extraction. The next part (profit-oil) is shared between the two parties according to an agreed formula. This agreement takes into consideration the investment cycle and depreciation of the fixed investment as a cost factor. In the concession scheme, the operator typically pays a royalty and an income tax for the right to extract and export oil. Sometimes a concession scheme includes sector-specific taxes, such as resource rent or additional profit taxes. The fiscal terms of concession systems are typically specified in legislation, rather than negotiated on a project-by-project basis.

34. **When countries enter into contractually agreed fiscal terms, it is good practice to set these out initially in model contracts (for example, for a production agreement).** The model PSA contract should specify which fiscal terms are biddable or subject to negotiation; best practice is to keep the number of fiscal parameters that can vary to a minimum. The general legislative framework for the petroleum sector can either be incorporated in the income tax legislation or in stand-alone legislation for more specialized taxes for extractives (petroleum code and mining code). The latter is the model mostly used in the CEMAC.

35. **In both cases-but particularly in the PSA-the quantification of the actual share of the oil transaction which will go to the state requires complex calculations,** which depends on the exact amount of oil produced and exported, its selling price, and the imputation of various costs factor. It must be noted that an important share of oil production is sold on future markets. As a result of the ever-growing complexity of this sector, in practice it takes time and steadfast investments for the state to build full capacity to manage and control such contracts and properly calculate (or audit) its share.

Box 4. Production Sharing Agreements Versus Concession Systems

The main fiscal regime types for the petroleum upstream sector are (i) concessional tax-royalty regimes; and (ii) contractual production sharing arrangements. Some countries combine a production sharing regime with tax-royalty instruments making this a hybrid fiscal regime. Moreover, both regimes can also include some form of state equity participation.

The tax-royalty regime combines a royalty providing early revenue from the start of production with one or more profit-based taxes capturing economic rent. Under this regime, the government issues a license or concession to the investor to explore for and extract natural resources within a specific license area. The licensee takes ownership of any resources that are extracted, with the government collecting revenue based on the assessment of royalty and taxes.

Box 4. Production Sharing Agreements Versus Concession Systems (concluded)

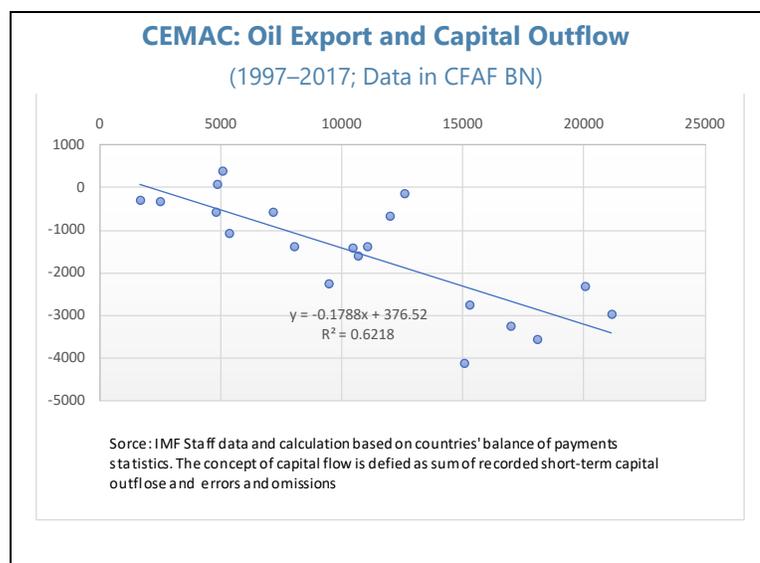
The production sharing fiscal regime is common for petroleum. Under this fiscal regime, the government or a government appointee (such as the national oil company) enters into a contract with one or more companies. The contractor explores for and extracts petroleum discoveries within a production license area in return for a share of the petroleum extracted from the development. Under this fiscal regime, the company only takes ownership of part of the petroleum resources. Another contractual type of fiscal regime is a risk service contract where a company is contracted to develop and produce petroleum in return for an agreed remuneration.

Direct state participation is very common. At one end of the spectrum are countries that have a national oil company, which may enter into joint venture arrangements with private sector companies. Other forms of state participation include the government having an equity position in a petroleum project with different options available for the government to finance its participation ranging from free equity, carried interest, to fully-paid equity.

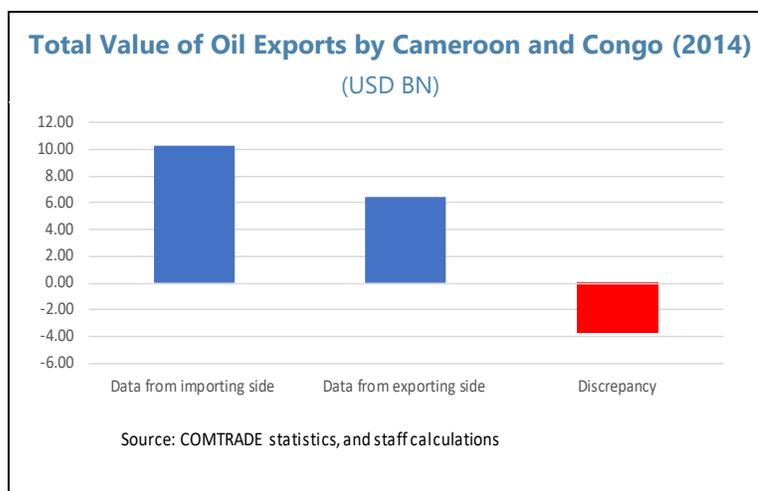
While the various fiscal regime types look different, their economic and fiscal impact can be very similar. This leads us to a general insight about fiscal equivalency. Simply put, the fiscal parameters under either a tax-royalty or a production sharing fiscal regime can be chosen to give the same government take or revenue profile over time.

36. An analysis of available data and studies suggest that oil export data in official statistics are sometime prone to miscalculation.

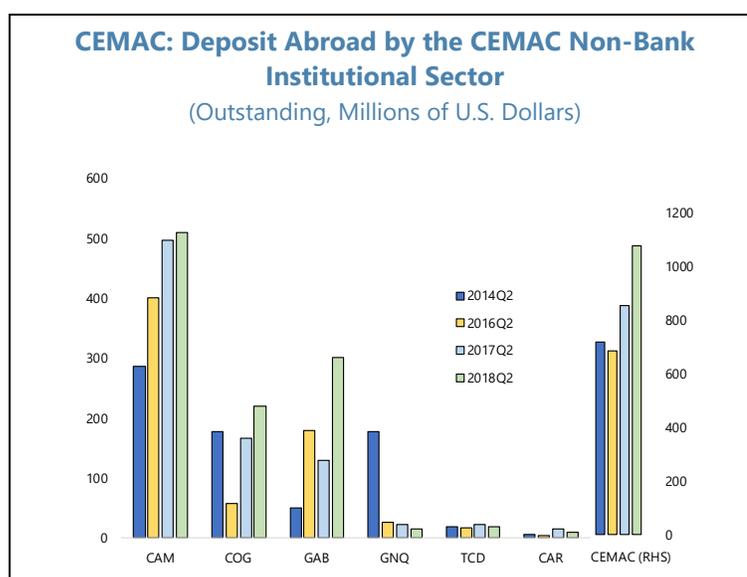
- First, an analysis of CEMAC balance of payments data suggest a strong correlation between recorded oil export and recorded capital outflows. In other words, the higher is the total value of recorded oil export, the higher is the estimated capital outflows. This is probably an indication that part of the counterpart to oil export is not repatriated into the exporting country and is recorded as capital outflow.



- Second, other studies suggest that oil export sector is plagued by the phenomenon of under-invoicing. This phenomenon relates to the fact that oil export as recorded by the exporting countries in several cases are lower than the partner data as recorded by the import countries, as seen in some cases for the total of exports.⁹



- Third, there is also evidence of very large deposit by CEMAC resident in foreign countries, which are likely not in total compliance with CEMAC foreign exchange regulation. Such regulation requires that holdings by CEMAC resident in foreign banks are kept only in limited amount and for justifiable reasons, such as to finance anticipated imports or to cover short-term debt service. Data from the BIS suggest that the stock of CEMAC's resident holdings with foreign banks (about USD 5 billion as of end 2017) are above such notional allowed amount. If this conclusion holds, and given the importance of oil as primary source for foreign exchange earnings (and evidence included above from the balance of payments),



⁹ Data from the COMTRADE database, based on Congo and Cameroon, suggests that the statistical discrepancy between recorded value of export and mirror data on import from the trading partners accounts can be very large (up to 60% in this example). The larger contributor is lower export volume data compared with partner data (discrepancy at about 43%) and to a smaller extent lower (implied) unit prices. If these data are indicative of a wider problem, they would suggest that what is called miss-invoicing is in fact under-reporting of actual export volumes. Since COMTRADE data are initially collected by customs, this would indicate that issues related to capacity and governance in this complex sector rests primarily with ineffective management at the customs level.

it is possible that part of such holdings is related to unrecorded oil export earnings proceeds.

- Fourth, there has been some concerns that the increase in oil prices through 2018 has not translated into higher oil tax revenue (and NFA accumulation). In fact, at their extraordinary meeting in November 2018, CEMAC's Head of States have called for stepping-up efforts to repatriate export proceeds, in particular by state-owned enterprises part of PSA, to help strengthening this link.

37. **The complexity of this sector and the vital importance that its governance plays in the CEMAC economic and monetary union calls for strong capacity to assess and monitor the link between oil prices/volumes and oil revenues.** It is possible to use spreadsheet modeling techniques to forecast the tax revenue and foreign exchange implications of alternative economic scenarios. Such models require information on the fiscal terms contained in a PSA, as well as projections of the costs of production and the quantity of production from the time of inception of a given petroleum project. This type of analysis is feasible for a limited number of oil fields, where such detailed data may be available. The outcome of a project-by-project analysis of the major petroleum projects in a country cannot be readily extrapolated to the national petroleum sector as a whole, but it may give useful indications of the order of magnitude of the effects of various economic shocks and it could help to identify potential problems in revenue collection and amounts of foreign exchange.

38. **The oil exporting countries can refer to the Extractive Industry Transparency Initiative, an international standard widely used to enhance and report on governance in this area**¹⁰. The EITI sets ambitious standards for strong governance and full accountability in the extractive industry. There is no formal relation between the CEMAC Commission (or other regional institutions) and the EITI as membership is by countries only. However, there is a strong synergy between the (voluntary) EITI requirements and the CEMAC guidelines for PFM (setting specific requirements for CEMAC countries).

39. **In fact, four of the CEMAC countries have a form of engagement with the EITI** (Table 7). Full membership is effective for Cameroon, Chad, and Congo. CAR was a member but was suspended. Gabon and Equatorial Guinea have committed to submit their EITI application as part of their engagement under IMF- and staff-monitored programs, respectively. It is interesting to note that among the corrective actions asked by Cameroon and Congo as part of the regular validation to address serious deficiencies are those related to contract transparency, license registration, state-participation, and (transparency and reporting on) SOEs transactions.

40. **However, possible membership to the EITI needs to be part of a wider effort to enhance governance in the oil sector.** By design, the EITI does not guarantee that the commercial part of the oil (the initial physical transaction) is covered in a timely manner. It deals

¹⁰ See at <https://eiti.org/>.

mainly (and above all) with the use of recognized resources. In fact, there have been instances of inefficient governance and even corruption related to the oil trade, even in countries formally part of the EITI (e.g. Congo). Opaque practices can even result from barter transactions (private companies working for oil) or commercial financing (leading to the prior commitment of oil exporters to repay their debt through credits provided by large foreign financial institutions). This complicates the challenge of reconciliation, as part of transactions may be in form of barter.

Table 7. CEMAC: EITI Membership and Compliance

CEMAC Country	EITI Member	Validation	Corrective measure deadline (suspension threat)	Board Decision on corrective measures [see below]
Cameroon	Yes	2017	29-Dec-19	License register (2.3), policy on contract transparency (2.4), state-participation (2.6), production data (3.2), in-kind revenues (4.2), SOE transactions (4.5), distribution of revenues (5.1), subnational transfers (5.2), SOE quasi-fiscal expenditures (6.2), public debate (7.1) and documentation of impact (#7.4).
Chad	Yes	Will be effected 2018		
CAR	Suspended			
Eq. Guinea	No			
Gabon	No			
Congo	Yes	2017	29-Dec-19	Requirements relating to civil society engagement (1.3), MSG governance (1.4), licence allocations (2.2), license register (2.3), state-participation (2.6), production data (3.2), in-kind revenues (4.2), barter agreements (4.3), SOE transactions (4.5), data quality (4.9), distribution of revenues (5.1), social expenditures (6.1), SOE quasi-fiscal expenditures (6.2) economic contribution (6.3) and public debate (7.1), with SOE quasi-fiscal expenditures being the main area of concern.

41. **As a result, CEMAC Member States must be proactive in ensuring good governance in such a complex sector.** The CEMAC legislation provides sound ground to ensure progress in this area (Box 5).

- The first problem is to ensure that customs are and remain scrupulously at the center of the declaration of export transactions and that this information is shared with the tax institutions (national level) and those charged with the governance of the monetary union (BEAC). The framework of the CEMAC in the field of customs legislation is very clear: nothing can leave the region without prior declaration to the customs and without authorization of customs.
- The customs legislation also establishes the specific obligation to provide any additional information that the customs authorities may need to verify the plausibility of the customs declaration.
- The customs law and the foreign exchange law also oblige CEMAC residents (including oil companies) to always include the invoice in the customs declaration (as part of this declaration) and to provide information on the expected timing and domiciliation of the

oil exports. This is also necessary to comply with specific obligations related to the foreign exchange law.

42. **In fact, CEMAC customs have a weak capacity to cope with this complex sector and have often not proactively applied these regulations** (Box 5). Customs declarations are often incomplete or incorrect. The strict monitoring capacity of oil transactions is limited. It is often assumed that, given the presence of the state in several benefit-sharing agreements, customs should not impose an additional burden.

Recommendations

43. **First, the CEMAC Commission should work to ensure full implementation of regional legal framework in this area, including through enhancing capacity the CEMAC Commission in this area.** Given the lack of concrete implementation in many areas, an option could be explored: Member States should submit an annual report to CEMAC on the status of implementation of the guidelines of the CEMAC which would be consistent with the sound functioning of a customs union.

44. **Membership in the EITI can help inform some of the data that should be published to fully implement the CEMAC directives (in particular on governance).** It is important to note that the CEMAC guidelines and the EITI standards both require full disclosure and transparency in the disclosure of contracts and activity related to the extractive sector and its share in the state.

45. **A second aspect relates to the full implementation of the foreign exchange law.** The issue of repatriation highlights an important difficulty that regional authorities need to consider in greater detail: the rule of law when individual members do not respect the regional legal framework. In particular, improvements could cover the banks' responsibilities in this area and the nature of (mostly ex-post) customs verifications and sanctions of non-compliance. This would need to cover oil traders, and perhaps extend to banks involved in settling the transactions.

46. **Given the complexity of extractive sectors, but also the importance of good governance to ensure its contribution to the budget, specific capacity should be built.** In particular, it will be important to establish a capacity at the regional level (ideally the BEAC) to assess the link between oil prices and volumes and expected tax revenues. This will be essential in determining whether the tax revenues that enter (and therefore the gross NFA inflows) are justified by the level of prices and output or if other policies are needed to strengthen external stability (including monetary policy at the CEMAC level, or fiscal policies at the country level). Discussions with regional institutions suggested that one step in this direction would be revisiting the adequacy of the documentation model to be provided by petroleum companies to the customs and the reporting system envisaged with the BEAC.

47. **It will be also vital to establish in the customs administration of the largest oil exporters a dedicated unit endowed with specialty knowledge of the oil sector (national level).** Such unit would have intelligence and risk analysis capabilities and would play a central role in directing, supporting, and monitoring overall customs control activities. In particular, it would define the exact information it will ask oil exporter to fill in order to monitor and respond to emerging governance risk (for instance when otherwise available information on oil prices and production do not match with the customs declaration). In other words, the dedicated unit would need to establish a cartography of the risks for mis- or non-reporting, so to direct controls to these risks. The dedicated unit would benefit from having representatives of the state-owned oil companies, as SOEs may be in an ideal position to obtain critical data for the analysis of oil and gas contracts.

48. **The CEMAC Commission needs also to strengthen the implementation of the transparency provision included in the CEMAC Directive on Transparency and Governance (06/2013).** In particular, it needs to urge member countries to provide a complete reconciliation of oil production and export data with the oil tax revenues included in the budget documents. Doing this would lay the ground for participation to the EITI membership, which should be encouraged.

Box 5. Customs: An Assessment of Standards 1/

Customs' role is important in controlling the oil and gas sector. Customs' existing mandate to control exports should be effectively carried out to assist CEMAC with the management of this sector, enhancing governance, and receiving the due amount of revenues from natural resources.

The CEMAC Regulatory Framework

The customs authorities of CEMAC Member States have the unconditioned right and obligation to control introduction in and exit of goods from the Community and authorize these operations only after compulsory import and export formalities have been accomplished. Regulation 05/01–UEAC-097–CM-06 of August 3, 2001 establishing the revised Customs Code (CC) of the CEMAC provides that exported goods shall be reported to Customs (Art. 94), subject to a customs declaration (Art. 110–1) even if no customs duty is applicable (Art. 110–3) and can be inspected (Art. 127–1). Customs shall authorize boarding of exported goods on ships (combined Art. 84–2 and 145) and exit of goods from the territory is only possible when customs formalities have been completed (Art. 146). The Customs Code is directly applicable by Member States.

There is no exception, based on the law, to the fact that all resident economic agents exporting goods are subject to the obligations mentioned above. To oppose the exercise of customs functions is an offense (Art. 62 of the CC). Article 2 of the CC provides that Customs laws and regulations must be applied without regard to the quality of the persons; and goods imported or exported by the State are not subject to any immunity or derogations. As a result, there is no suspension of customs obligations in any way when the economic entity exporting consists of a partnership between a private entity (e.g., an oil company, through its resident arm) and an SOE.

1/ Prepared with guidance from Gilles Montagnat-Rentier, from the Fiscal Affairs Department.

Box 5. Customs: An Assessment of Standards (concluded)

Trade Data Collection, Sharing and Analysis

Customs declarations must contain all information required for the establishment of external trade statistics (Art. 120 of CC). Given the strategic importance of the oil and gas sector in CEMAC, a regional framework should be implemented for the sharing of customs-collected oil and gas export data with the Commission and the Central Bank, data-matching of physical flows with capital and revenue flows and economic indicators and conducting gaps analysis. A CEMAC directive should be adopted to establish such framework.

Moving to an Efficient, Risk-Based Customs Control Model

Customs administrations should make sure that the content of export declarations is correct, including nature and volume of products, export value, and payment arrangements. Modern techniques adjusted to challenges presented by oil and gas transactions should be used. An illustrative list includes:

- Strong intelligence and analysis capabilities to detect compliance risks;
- Receiving details of approved places of loading,
- Product flow measurement through properly located, installed and calibrated equipment, sending stream data to Customs;
- A well-designed electronic declarative procedure that prevents unreported transactions and facilitate unannounced risk-based inspection and quality testing;
- Extensive use of Article 76–1 of CC to obtain further documentation from any party involved in the transaction;
- A post-clearance audit program (which may cover three past years, Art. 76–2 of CC);
- Enforcement of Customs Code sanctions (Title XII, Chapter VI) for non-compliance with formalities and control or misdeclaration (even if no customs duty has been compromised).

Building Customs Capacity

To ensure effectiveness and credibility of customs' interventions in the oil and gas sector, and their input into the proposed control framework, Member States customs administrations need to significantly strengthen their capacity. Focus should be on: (1) setting up their dedicated oil and gas unit; (2) specialist training for the unit staff combined with an adequate HR management policy; and (3) providing them with adequate IT, communications, inspection, testing, and transportation equipment to carry out their functions. Control oil and gas export should be elevated as a core customs mission (even though customs revenue is not directly collected), and this should be reflected in specific performance indicators and incentives.

The IMF may mobilize TA resources to help with building capacity in the national customs administrations and developing the regional framework.

I. Conclusion: Enhancing Growth Through Better Governance

49. **The analysis included in this note has underscored that there is great potential to enhance governance in the CEMAC and make this an engine for sustained and inclusive growth.** There are two common themes to the set of recommendations included here.

- First, there needs to be a “transparency shock” in the regular production and sharing of basic documentation related to public resource management. This step is an absolute priority, well inscribed in CEMAC’s own institutional set-up, in particular the key directive on transparency and governance.
- Second, and relatedly, there needs to be a continuous focus to turn the CEMAC regional framework, which is overall well designed, into consistent procedures and work practices within public institutions.

50. **As this note suggest, there are specific lines of actions.** First, there need to be an ongoing effort to translate the CEMAC directives related to PFM into work practices that are fully consistent with the premises and vision of the very directives. This translates into giving absolute priority to ensuring more transparency, full disclosures, ongoing reconciliation, and internal and external audit of transactions of the public sector. Second, efforts to enhance the AML/CFT framework, reflecting the CEMAC’s directive in this area, need to deepen. Finally, the full system of check and balances already provided for by the CEMAC legislation institutional design needs to be forcefully implemented in the extractive sector. This covers, critically, the full disclosure and regular reconciliation of contracts and transactions in the oil sector. It also covers the rigorous implementation of a stronger networks of CEMAC customs, with better governance and more capacity (in particular, in complex sectors such as oil).

51. **The CEMAC regional institutions will have to play a central role to lead progress in these areas, and support member countries’ own efforts.** Because such actions result in giving a coherent framework to actions conducted at the country level, the synergic dimension can spur a virtuous circle, key to earn the benefit of an economic and monetary union. The success of the regional strategy that CEMAC member countries and regional institutions are implementing to exit the severe crisis they are facing depends critically on creating the conditions for laying the ground for a diversified economy, within a well-functioning regional market and an environment that provides opportunities for all and where public resources are geared to most productive use. The single most important element in this effort is good governance of public resources and reducing the perception of wide-spread corruption. The CEMAC regional institutions can play an important role in achieving this, in support of member countries’ own effort.

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FISCAL CONSOLIDATION EFFORTS: MOVING THE FOCUS TO NON-OIL REVENUE-ENHANCING MEASURES¹

CEMAC countries' fiscal consolidation efforts have so far relied heavily on the streamlining of non-priority expenditures, while little progress has been made in increasing non-oil revenue, which remain quite low.

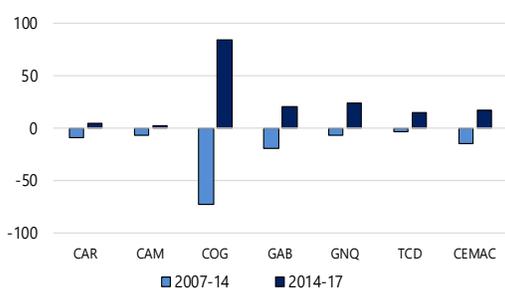
This Selected Issues Paper makes the case for giving non-oil revenue-enhancing measures a more prominent role in the fiscal consolidation efforts going forward, reviews the reasons behind non-oil revenue's current low level and makes specific policy and reform recommendations on how to increase them while minimizing their growth and social impact.

A. Background: The Need to Increase Non-Oil Fiscal Revenue

1. CEMAC member states' fiscal consolidation efforts have made good progress.

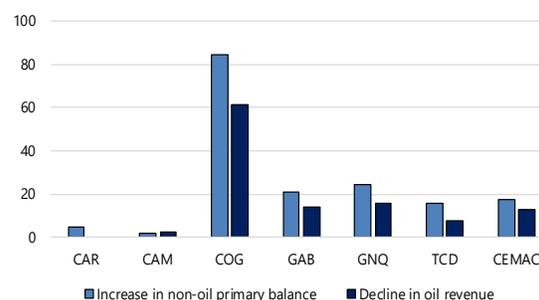
As committed at the extraordinary summit of Heads of State of December 2016, CEMAC member states have implemented ambitious adjustment programs to help avert the depletion of regional reserves and continue to support the monetary union arrangement. Together with the measures that had already been implemented in 2015–16 following the sharp decline in oil prices, the adjustment measures implemented by the member states as part of the regional strategy have contributed to a decline in the region's non-oil primary fiscal deficit from 25.1 percent of non-oil GDP in 2014 to 10.2 percent of non-oil GDP in 2017. This reduction broadly reversed the increase in the non-oil primary deficit that had been observed over 2007–14, a main driver behind the region's fiscal and external woes. This reduction is also commensurate to the decline in oil revenue over that period.

Figure 1. CEMAC: Change in Non-Oil Primary Balance, 2014–17
(Percent of non-oil GDP)



Sources: Country authorities; and IMF staff estimates.

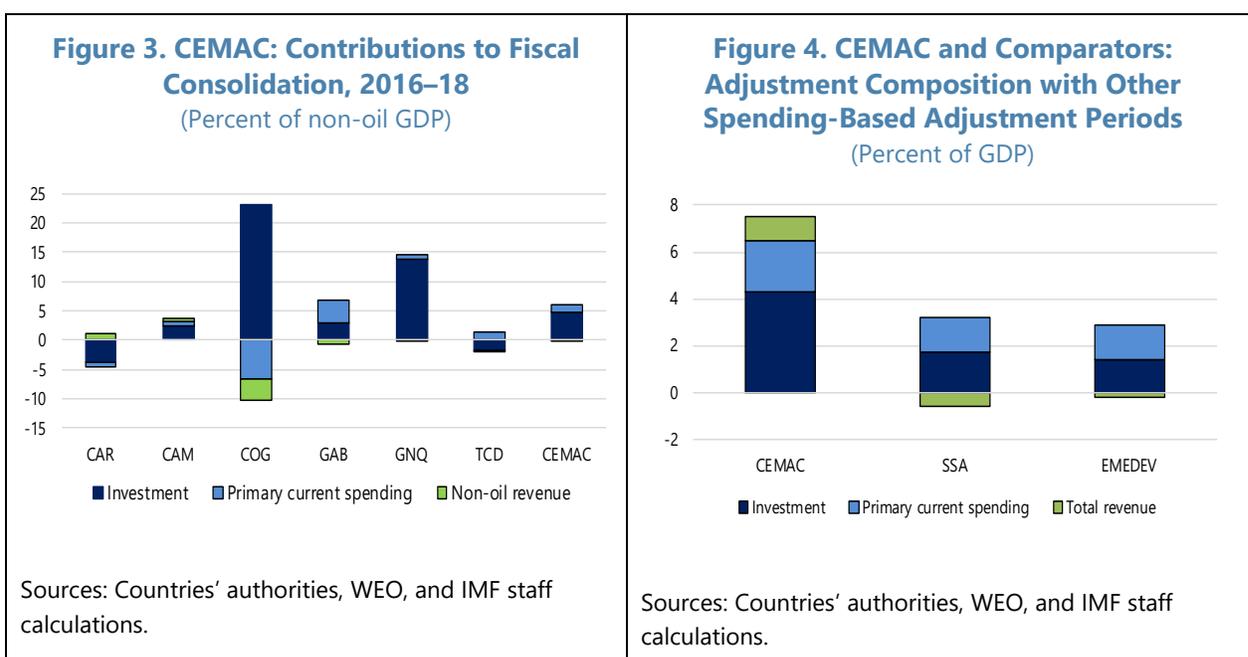
Figure 2. CEMAC: Oil Revenue and Non-Oil Primary Balance, 2014–17
(Percent of non-oil GDP)



Sources: Country authorities; and IMF staff estimates.

¹ Prepared by Sébastien Leduc, Édouard Martin, and Mathilde Périnet.

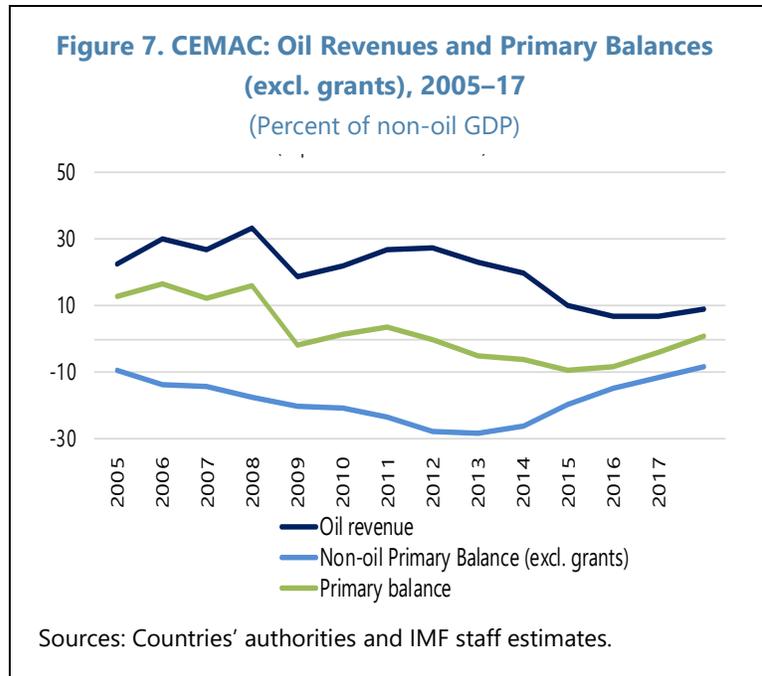
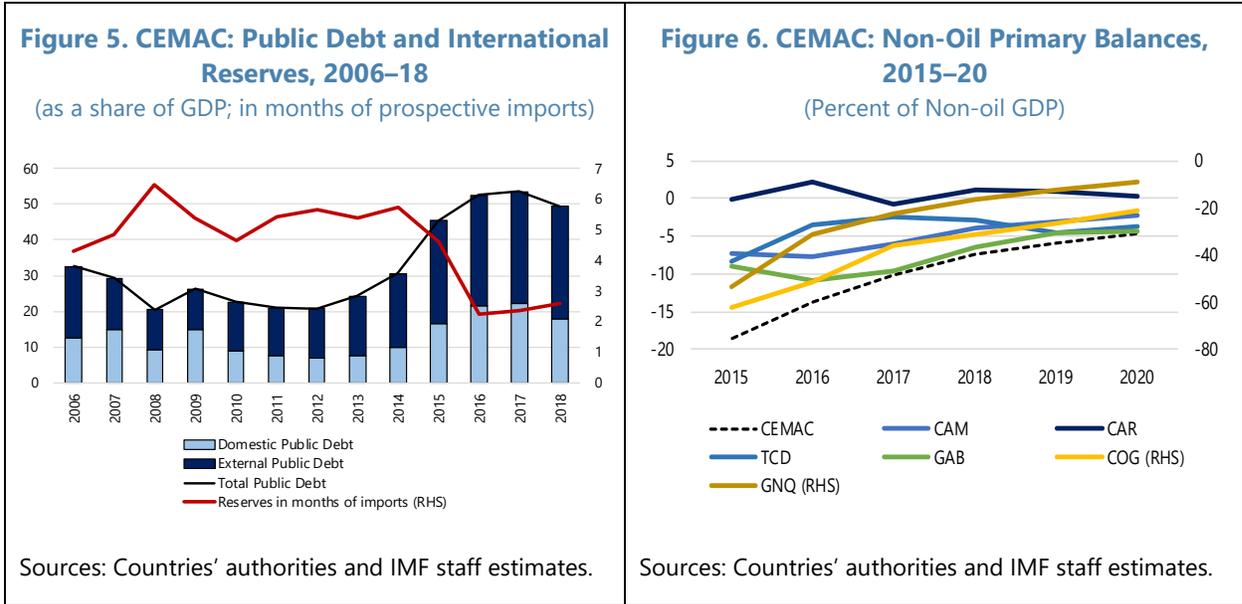
2. **Contrary to what had been initially envisaged, these efforts have so far relied essentially on the streamlining of non-priority expenditures.** Assuming that the member states 2018 fiscal deficit objectives are met, the overall reduction of the deficit over 2017–18 will have been broadly in line with what was envisaged at the regional strategy’s outset. While the reduction of the non-oil deficit was supposed to result in part from an increase in non-oil revenue, this increase has, however, not materialized, with non-oil revenue now projected to be slightly lower in 2018 than they were in 2016. If CAR and Cameroon had some success in increasing these revenue over this period, others (Congo and Gabon) saw their non-oil revenue decline significantly. Instead, the targeted fiscal adjustment came from larger than initially envisaged cuts in investment spending, while the rationalization of primary current spending was also less ambitious than initially envisaged.



3. **Further fiscal consolidation efforts are necessary, in a context of structural decline in oil revenue.** Public debt has increased from 20.7 percent of GDP at end-2012 to 53.6 percent of GDP at end-2017. Over the same period, BEAC’s international reserves have declined from CFAF 8,865 to 3,128 billion (and from 5.6 to 2.3 months of prospective imports). To put public debt firmly on a downward path while contributing to the rebuilding of an adequate buffer of international reserves—and possibly, in the case of oil producers, to the accumulation of savings for future generations²—member states need to pursue their fiscal consolidation efforts while implementing structural reforms to support higher and inclusive growth. In addition, after rebounding to about 7½ percent in 2018 owing to the recent increase in oil prices, the oil revenue-to-GDP ratio is expected to decline further from 2019 onward, to 4½ percent by 2023

² Martin and Périnet (2017).

on account of a gradual decline in oil production (from about 370 millions of barrels in 2019 to about 330 millions of barrels in 2022) and lower oil prices. This adds to a need to reduce further the regional non-oil primary balance, which is projected at close to 6 percent of non-oil GDP over 2018–20.



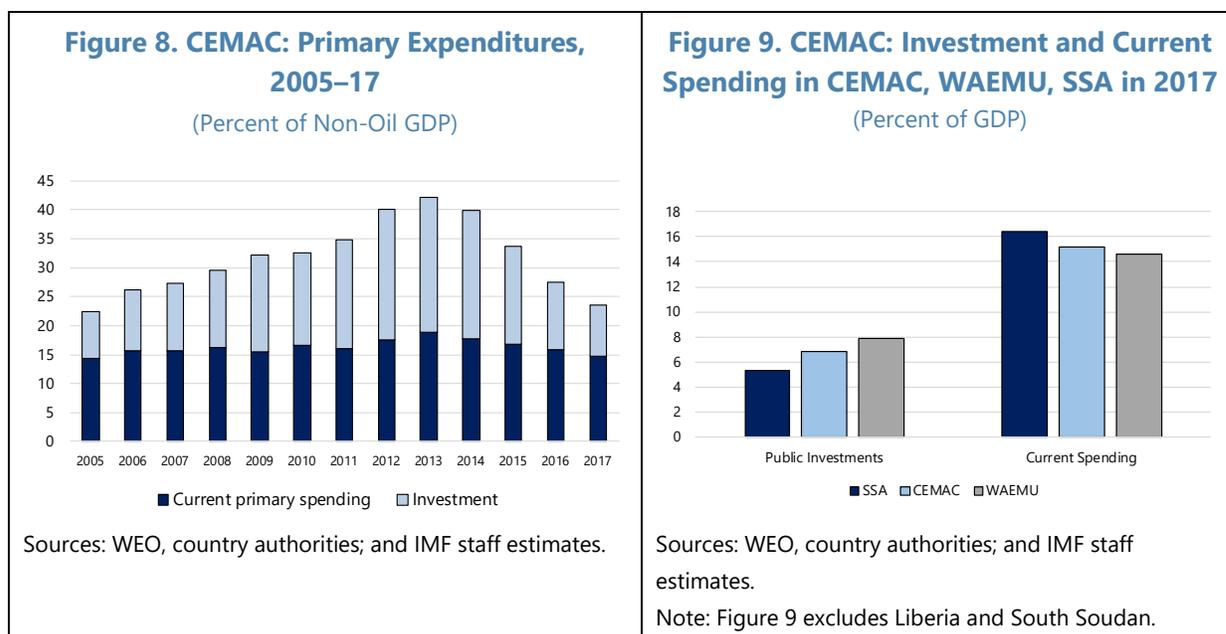
4. **Revenue-enhancing measures could contribute significantly to these efforts:**

- In addition to the need to further reduce their non-oil fiscal deficits, the CEMAC member states need to finance additional capital and infrastructure spending, preserve social spending, and create fiscal buffers against risks (global and security). To do so, they will have to rely on the further rationalization of non-priority spending and measures to increase non-oil revenue. While there is still room to advance the former, the low-hanging fruits (such as the curtailing of inefficient investment projects) have already been harvested and remaining reforms in this area (such as the rightsizing of the wage bill or the elimination of fuel subsidies) are harder and require more preparation to implement. At the same time, with non-oil revenue relatively low (see below) and efforts to increase them very limited so far, there appears to be significant room to increase non-oil revenue to support fiscal consolidation efforts.
- Revenue-enhancing measures have generally a less negative impact on growth than cuts in spending and particularly than cuts in investment spending. This is particularly the case during economic slowdowns when fiscal multipliers are higher.³ A recent study on Cameroon estimated the revenue multiplier close to nil, implying that a revenue-based fiscal consolidation would indeed be less harmful to growth in the medium term.⁴ Also, large expenditure-based consolidations tend to increase inequality, which can undermine long-term growth.
- In low-income countries, revenue-based adjustment leads to more durable consolidation episodes, with greater benefits for growth. Increase in revenue mobilization can accelerate growth and development.⁵ Also, non-oil revenues are less volatile than oil revenue and therefore constitute a more stable resource for the budget.

³ IMF (2017).

⁴ Kalonji, K and al. (2018).

⁵ Gaspar, Jaramillo and Wingender (2016a, 2016b) show that once the tax-to-GDP level reaches around 13 percent, real GDP per capita increases sharply and in a sustained manner over the following decade. The authors suggest that the existence of tipping points epitomizes the presence of enabling political conditions to support the building of state and tax capacity, namely constitutive institutions, inclusive politics and credible leadership.



5. **This paper is organized as follows:** (i) section II reviews recent revenue trends in CEMAC; (ii) section III analyzes the reasons behind these trends; (iii) section IV proposes measures that could be adopted to allow a significant growth-friendly increase in non-oil revenue; and (iv) section V concludes.

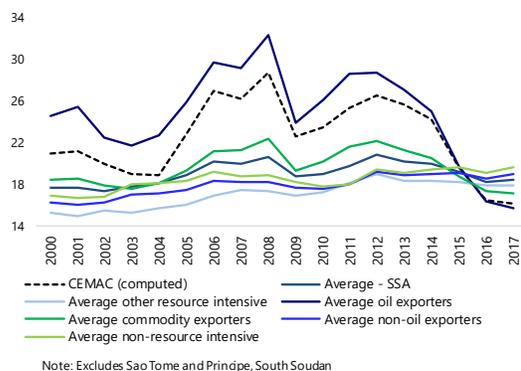
B. Trends in Revenue Mobilization in CEMAC

Fiscal revenues have declined sharply over the last few years, reflecting primarily the decline in oil revenue but also the persistent low level of non-oil revenue.

Oil Revenue Dependency

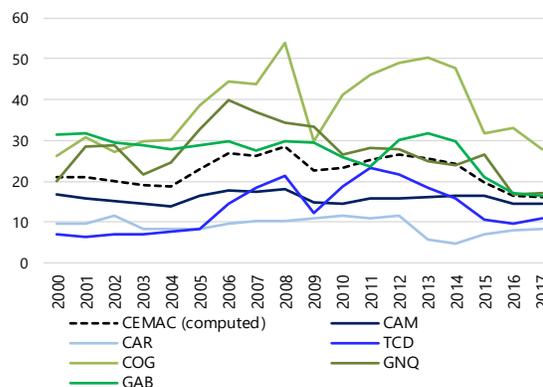
6. **The 2014–15 drop in oil prices led to a sharp decline in fiscal revenue.** Government revenue have declined by more than 10 percentage points of GDP over the last five years, from 26.5 percent of GDP in 2012, to 16.1 percent of GDP in 2017. This decline essentially reflected the decline in oil revenue, which declined by 12.2 percentage points of GDP over that period, from 18.2 percent of GDP in 2012, to 5.9 percent in 2017. Accordingly, the drop in revenue was much more marked in the main oil producing countries, including Congo (-21 percent of GDP) and Gabon (-14 percent of GDP) than in countries less dependent on oil revenue, as the Central African Republic (-1.3 percent of GDP) and Cameroon (-3.2 percent of GDP).

Figure 10. CEMAC and Comparators: Total Revenue Excluding Grants
(Percent of GDP)



Sources: WEO; Country authorities; and IMF staff estimates.

Figure 11. CEMAC: Oil Revenues, 2000-17
(Percent of GDP)

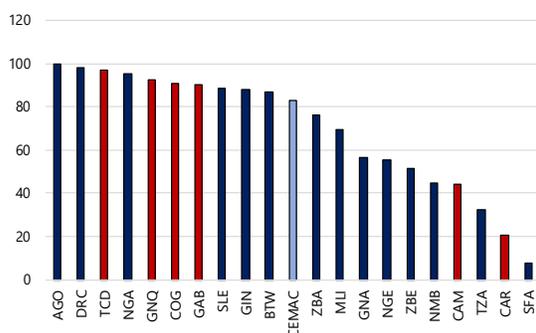


Sources: WEO; Country authorities; and IMF staff estimates.

7. **This revenue decline epitomizes the region’s oil dependency.** Four (Chad, Eq. Guinea, Congo, and Gabon) of the region’s six countries are among the seven SSA countries for which the ratio of exports of natural resources to total exports are the highest over 2007–17. The same is true for the ratio of governments revenue from these resources to total revenue, with Cameroon also having a high ratio. This dependency to oil revenue, and the insufficient diversification of the region’s economies, are a source of vulnerability that the member states need to tackle more forcefully.

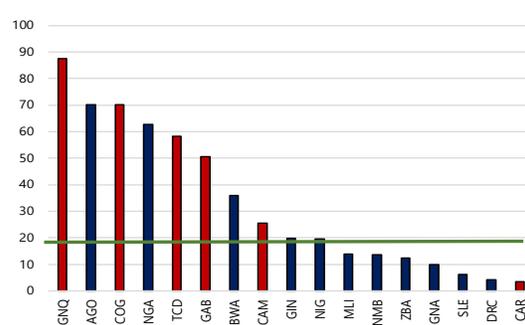
Figure 12. Resource Exports in Resource-Intensive Countries

(Percent of total exports of goods, average 2007–17)



Sources: WEO; Country authorities; and IMF staff estimates.

Figure 13. Oil Revenues, 2000-17
(as a share of total revenues, average 2007–17)



Sources: WEO; Country authorities; and IMF staff estimates.

Non-oil Revenue

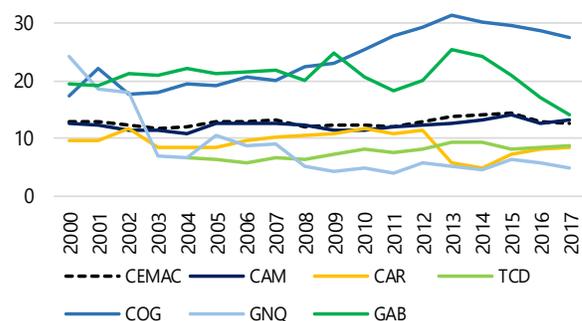
8. **Over the last few years, the fall in fiscal revenue also reflects the poor performance of non-oil revenues (relative to non-oil GDP).** After increasing gradually from 11.9 percent of non-oil GDP in 2011 to 14.3 percent of non-oil GDP in 2015, non-oil revenues fell rapidly the two following years, to 12.5 percent of non-oil GDP in 2017. This decline appears to have been primarily cyclical, as it coincided with a sharp decline in non-oil growth (with a regional recession in 2016) and was particularly marked (between 1.4 and 6.9 percentage points of non-oil GDP) in the countries experiencing recessions, namely Congo, Gabon and Equatorial Guinea. Non-oil revenue actually increased in Central African Republic (which continued recovering from the 2012–13 crisis) and in Chad, while declining only mildly in Cameroon. The impact of the slowdown on economic agents' finances was compounded by the fiscal consolidation efforts of, and the accumulation of domestic arrears by, the member states.

9. **Looking at longer-term trends, contrary to what has been observed in other SSA countries, little progress has been made in increasing CEMAC's relatively low non-oil revenue.** Since 2000, the non-oil revenue-to-non-oil GDP ratio has essentially fluctuated, with no clear trend, in a narrow range (11¾–14¼ percent) around an average of 13 percent. This contrasts with the experiences of the median SSA country and of the WAMEU, which had similar ratios in 2000 but have since seen these ratios increase by 4 and 4½ percentage points, respectively. As a result, CEMAC's non-oil revenue are now particularly low relative to these comparators, and this even though SSA has the lowest revenue-to-GDP ratio when compared to other regions in the world. In three countries (Central African Republic, Chad, and Equatorial Guinea), non-oil revenues were even lower than 10 percent of non-oil GDP in 2017.⁶ At the same time, Congo's non-oil revenue amounted to 27.6 percent of non-oil GDP, among the highest in SSA.⁷

⁶ Recent IMF research found that once the tax ratio reaches about 13 percent, the growth of real GDP per capita increases sharply. As a general rule of thumb, countries should thus aim to remain comfortably above this tipping point. For details, see Gaspar & al. (2016a).

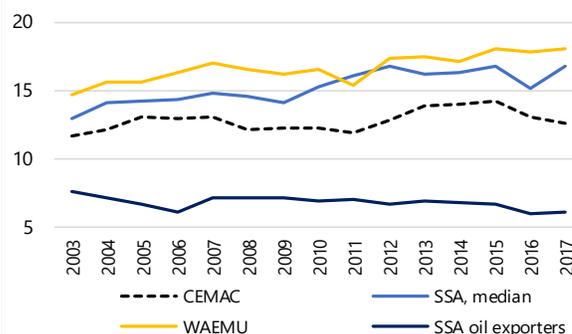
⁷ Congo's relatively high non-oil revenue to non-oil GDP ratio may be explained by the large size of its oil sector and the fact that its non-oil revenue inevitably includes some incidental revenue from oil-related activities (such as the wages and profits of sub-contractors).

Figure 14. CEMAC: Non-Oil Revenue, 2000–17
(Percent of Non-Oil GDP)



Sources: WEO; Country authorities; and IMF staff estimates.

Figure 15. CEMAC and Comparators: Non-Oil Revenues, 2003–17
(Percent of non-oil GDP)

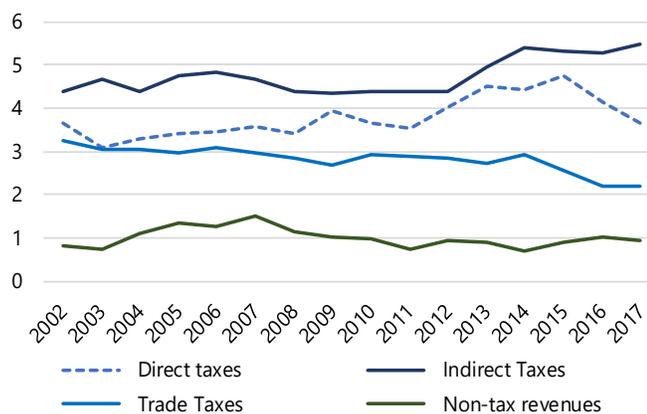


Sources: WEO; Country authorities; and IMF staff estimates.

10. **This trend primarily reflects the decline in trade taxes.**

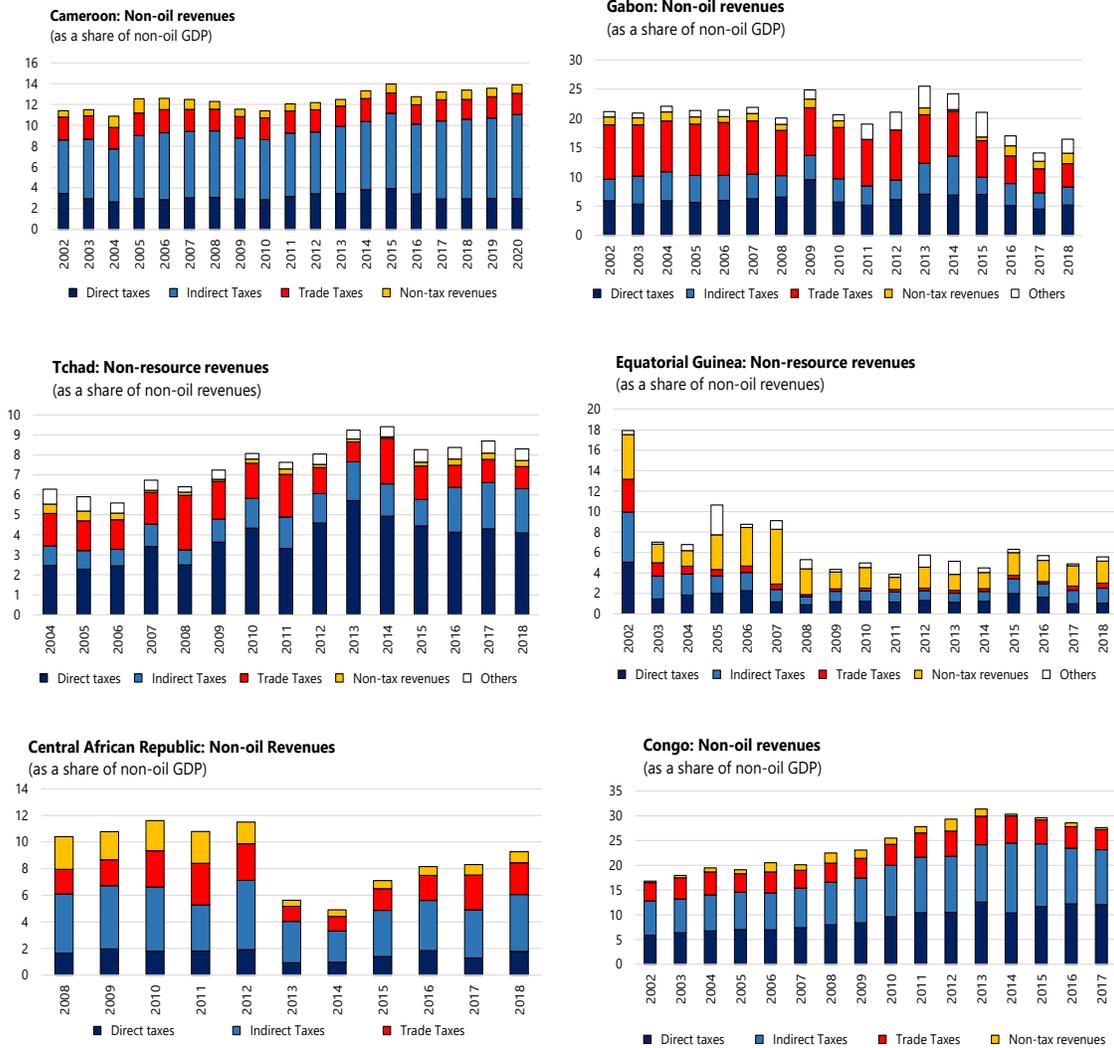
Reflecting the liberalization of the trade regime, these taxes have declined by one percentage point of non-oil GDP since the early 2000s. Over the same period, direct taxes have been broadly stable, except a cyclical increase in 2013–15. Non-tax revenues have remained particularly low, below 1 percent of GDP. Indirect taxes are the only non-oil revenue category that has seen an uptick over the last 10/20 years, increasing by more than 1 percent point of non-oil GDP over that period.

Figure 16. CEMAC: Trend of Different Non-Oil Revenue Categories
(Percent of non-oil GDP)



Sources: WEO; Country authorities; and IMF staff estimates.

Figure 17. CEMAC: Composition of Non-Oil Revenues
(as a share of non-oil GDP)



Sources: Country authorities, and IMF staff estimates

C. Reasons Behind the Low Level of Non-Oil Revenue

CEMAC's performance in non-oil revenue mobilization is well below the average in sub-Saharan Africa, as well as in the WAEMU countries. This partly reflects the fact that CEMAC member states are far from fully exploiting their respective tax revenue potentials, including with regard to the VAT.⁸

Tax Frontier and Tax Efforts

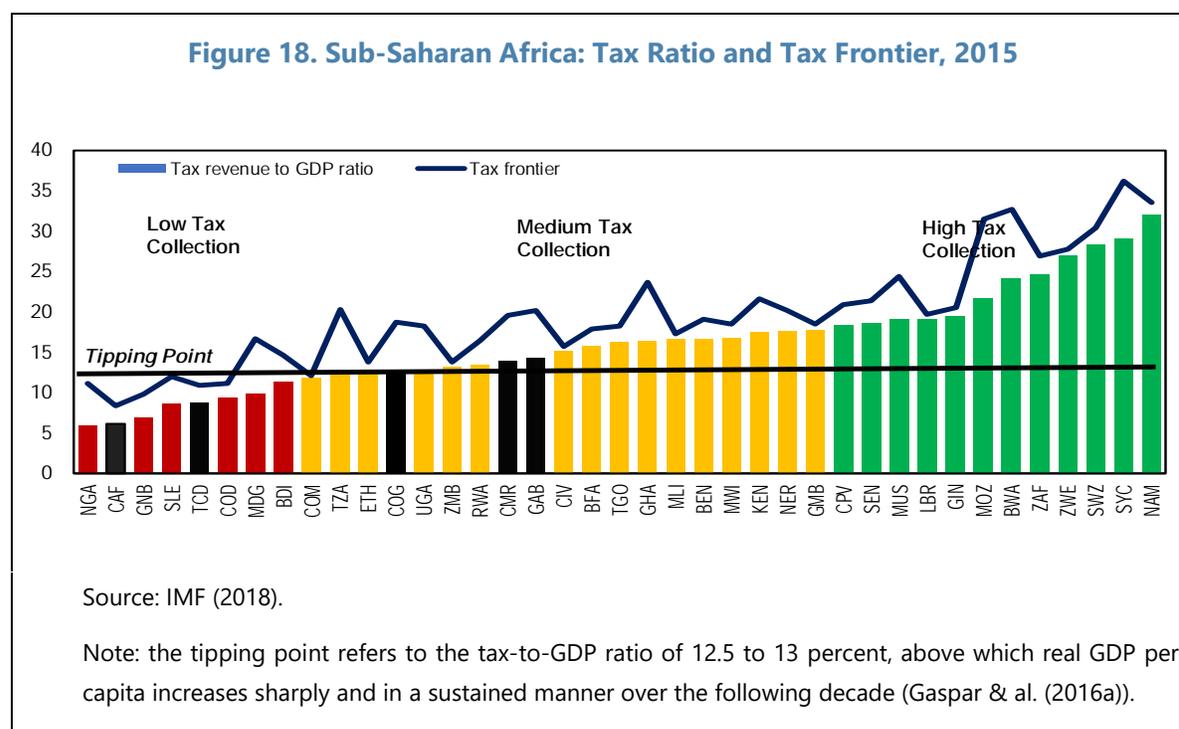
11. CEMAC's low non-oil revenue performance reflects in part a low tax effort:

- A way to assess a country's tax effort is to compare its current tax revenues-to-GDP ratio with its *tax frontier*. The tax frontier is the level of tax revenues-to-GDP ratio that can be achieved by a country given a series of macroeconomic and institutional characteristics.⁹ The gap between the current tax-to-GDP ratio and its tax frontier reflects potential improvements coming from tax reforms or higher efficiency of tax collection.
- Following Fenochoetto and Pessino (2013), IMF (2018) estimates the tax frontier for sub-Saharan countries using panel data during 2002-16. Results suggest that the tax potential varies quite significantly in the CEMAC. For Central African Republic and Chad, which have low tax collection rates (below the 13 percent 'tipping point'), the estimated tax gap is about 2 percent of GDP. Congo, Cameroon and Gabon, which have significantly higher levels of tax collection, also seem very far from their tax frontiers (around 5.5 percent of GDP, much higher than the average of Sub-Saharan countries, at 3.3 percent of GDP). This means that if they were to implement tax reforms and improve the efficiency of tax collection, these countries could mobilize as much as 5.5 percent of GDP in additional revenues.

⁸ CEMAC's relatively low non-oil revenue is consistent with the findings of Crivelli and Gupta (2014a), who found a statistically significant negative relationship between resource revenues and total domestic (non-resource) revenues, amounting to a reduction in domestic (non-resource) revenues of about 0.3 percentage points of GDP for each additional percentage point of GDP in resource revenues.

⁹ Variables include GDP per capita, trade openness, the value added of the agriculture sector as a percentage of GDP, the level of education, the Gini coefficient, a dummy for oil exporters, a dummy for general government tax revenues, and a corruption index.

Figure 18. Sub-Saharan Africa: Tax Ratio and Tax Frontier, 2015

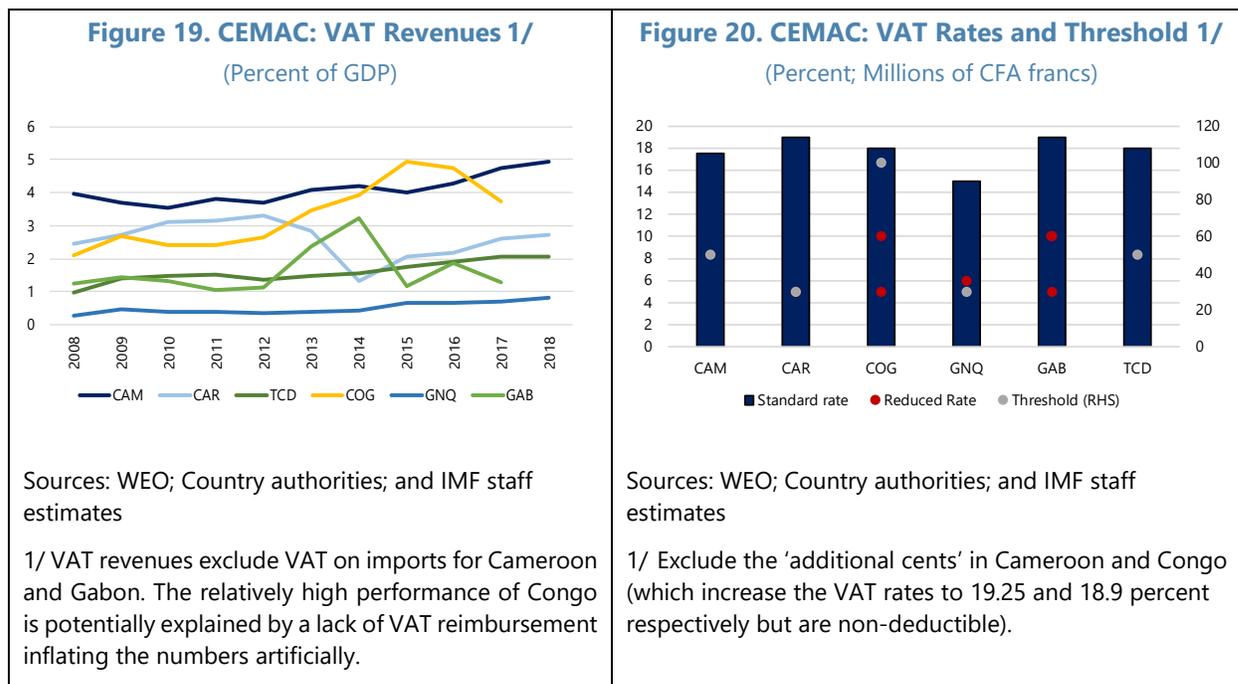


12. A number of factors, examined more closely in the following sections, explain this low tax effort:

- widespread tax exemptions, special regimes, and discretionary tax incentives (such as bilateral tax conventions);
- the underusage of some taxes, such as excise taxes or the property tax;
- the absence of an adequate institutional setting for tax policy making;
- insufficiency of anti-abuse provisions aimed at safeguarding domestic revenues against profit shifting by multinational enterprises;
- weak tax and customs administrations;
- tax avoidance/evasion, large informal sectors, and weak compliance;
- the collection of extra-budgetary revenue by some public entities, which are not transferred to the budget/single treasury account (most notably in CAR);
- difficult security conditions in some areas (notably in CAR and Cameroon)
- governance and corruption challenges; and
- deficiencies in the current tax coordination framework.

Indirect Taxation: VAT and Excise Taxes

13. **While being the largest source of non-oil revenue in the CEMAC (around 40 percent in 2017), indirect taxes are well below their potential.** This is evidenced by a low revenue productivity for both the VAT (c-efficiency measure) and excise taxes.



14. **This low productivity stems primarily from the multiplication of exemptions, in part attributable to the weakness of refund mechanisms.** The member states generally follow the framework established under the applicable regional directive,¹⁰ including in terms of rates (with a standard rate of 15–19 percent and a reduced rate of 5–10 percent).¹¹ The exemptions provided by this directive are broad, covering not only standard activities such as health, education, and financial services,¹² but also most of the domestic agricultural sector (both inputs and outputs), many basic foodstuffs, new equipment and material for certain construction projects or for the production and promotion of renewable energy, fishing equipment, household consumption of water, electricity and gas, etc. The list agreed to in the directive is intended to be exhaustive, but offers member states some limited flexibility in providing

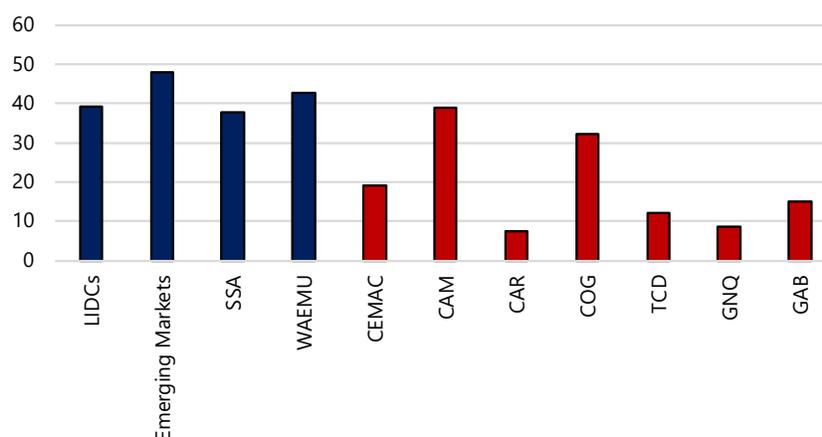
¹⁰ Directive n°07/11-UEAC-028-CM-22.

¹¹ Cameroon and Chad do not have a reduced rate. While it conforms to best international standards, this, combined with high standard rates, may complicate the removal of exemptions in these countries.

¹² Special problems arise in trying to apply a standard invoice-credit VAT to margin-based financial services and life insurance. Other financial services, such as fee-based services and property and casualty insurance, do not pose the same difficulties and should, in principle, be subject to VAT under a broad base approach to taxing final domestic consumption.

additional exemptions (such as those granted as part of the fight against the high cost of living (“lutte contre la vie chère”), as is currently the case in Cameroon and Gabon). In addition to reducing revenue, these exemptions impair the proper functioning of the VAT system, which should be neutral for production activity and consumption choices. They can also result in the smuggling of exempted products to neighboring countries (such as rice from Cameroon to Nigeria). The VAT system is also hindered by weak refund mechanisms, which lead the companies with VAT credits to request VAT exemptions on inputs or the reimbursement of their excess credits through the reduction of their other tax liabilities (as in Cameroon, Congo, and CAR). The non-reimbursement of VAT credits can also encourage VAT registered businesses to use non-registered suppliers, thereby sustaining existing problems related to the size of, and incentives for transitioning to, the informal sector.

Figure 21. CEMAC and Comparators: VAT C-Efficiency



Sources: Longitudinal Revenue Database and IMF staff estimates

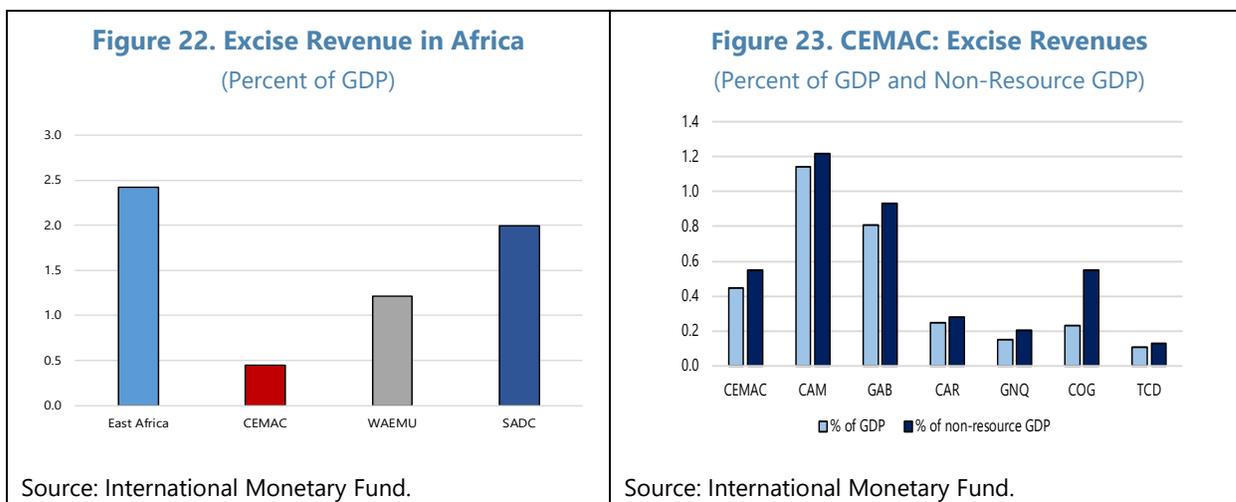
Note: WAEMU excludes Guinea-Bissau owing to lack of data.

15. **The level of excise tax revenue is also particularly low in the CEMAC.** These revenues averaged 0.5 percent of non-oil GDP in 2017, ranging from about 0.1 percent of non-oil GDP in Chad to 1.1 percent of non-oil GDP in Cameroon. This is significantly lower than what is collected in the WAEMU region (1.4 percent of non-oil GDP) as well as in other African economic unions (2–2½ percent of non-oil GDP, in SACU and EAC). It is explained in part by:

- The relatively low ceilings imposed by the applicable regional directive. These ceilings are set at 25 percent, including for key goods such as alcoholic drinks and tobacco

products.¹³ In comparison, the WAEMU regional directive sets a 50 percent ceiling on alcoholic beverages, while a newly-adopted directive on tobacco sets a 50 percent floor (no ceiling).

- Protectionist measures aimed at providing a competitive advantage to domestic suppliers. Such measures, which discriminate between imported and locally produced products and which are present in most CEMAC countries, take multiple forms including lower rates and reduced tax bases. Such measures are hardly justifiable in view of CEMAC member states' commitments under the World Trade Organization and externalities and public costs associated with the consumption of these goods.
- A lack of understanding of values/quantities both imported and produced domestically—and porous borders which complicate proper control over smuggling activities.
- Lack of political appetite to address weaknesses in current excise tax practices. For example, domestic brewers (often subsidiaries of large multinationals) are highly influential and concerns over the possible pass-through of higher excise taxes to consumer prices is politically sensitive given the relatively high beer consumption.¹⁴



Direct Taxation

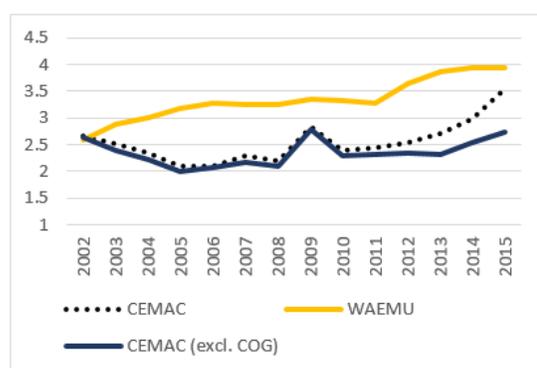
16. **The direct taxation of individuals under the personal income tax (PIT) and businesses under the corporate income tax (CIT) remains a key challenge.** CEMAC revenues from direct taxes amounted to 2.6 percent of GDP in 2002, a level which was then comparable to the performance in the WAEMU. The two groups have since adopted diverging paths, although

¹³ A new CEMAC excise tax directive, which, consistent with advice from the IMF's Fiscal Affairs Department, does not impose any ceiling, is currently awaiting member states' review and approval.

¹⁴ As per the World Health Organization, average beer consumption exceeds world average in Gabon, Congo, and Cameroun.

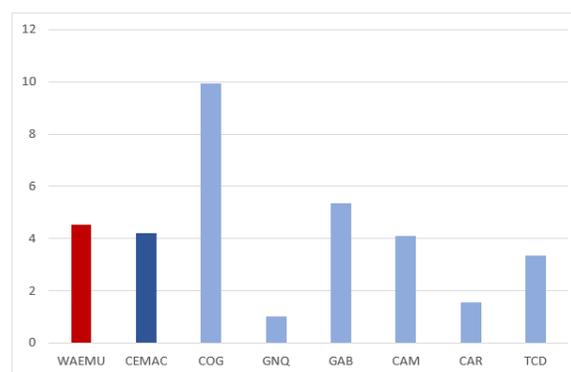
the gap has significantly narrowed in recent years, mostly on account of good performance by Congo (Figure 27). At around 3.6 percent and 4 percent of GDP in 2015, direct tax ratios in the CEMAC and WAEMU remain low compared to other SSA countries such as Ghana (5.5 percent), Rwanda (6.3 percent), Kenya (8.1 percent) and South Africa (14.1 percent). When measured against non-resource GDP, the CEMAC direct tax ratio increases to 4.2 percent of GDP (or 3.1 percent if Congo is excluded), as compared to just over 4.5 percent for the WAEMU. Considerable heterogeneity can be observed in terms of country's performance within the CEMAC, with Congo and Gabon having relatively good performances, while direct tax ratios remain considerably low in Equatorial Guinea and CAR.

Figure 24. CEMAC and WAEMU: Direct Tax Revenues
(Percent of GDP)



Source: IMF Fiscal Affairs Department, SSA Database.

Figure 25. CEMAC: Direct Tax Revenues
(Percent of Non-Resource GDP, 2015)



Source: IMF Fiscal Affairs Department, SSA Database.

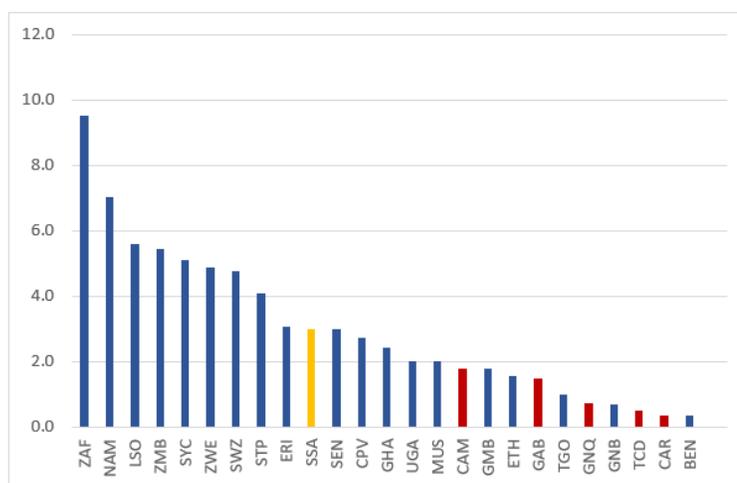
17. **Many factors contribute to the CEMAC's low CIT productivity.** A regional directive governing member states' CIT regimes requires that countries adopt a single statutory rate between 25 and 40 percent.¹⁵ The tax base set forth in that directive is for the most part consistent with practices in other francophone SSA countries, but appears vastly insufficient to adequately protect member countries' tax bases against common international tax avoidance strategies, including transfer pricing and deductibility of intra-group expenses such as interest,

¹⁵ Directive n°02/01/UEAC-050-CM-06. CEMAC states are generally at the lower end of this bound, using rates of either 25 or 30 percent. Most countries use multiple rates, either to lessen taxation for agriculture (e.g., CAR and Congo) or to capture possible rents in others (e.g., Gabon for oil and mining).

royalties, and service fees.¹⁶ This is particularly important as stocks of inward foreign direct investment in the CEMAC rose from 27 percent of GDP in 2007 to over 95 percent in 2017, making international tax more relevant today than it has ever been.¹⁷ Special regimes that offer multiple tax incentives, including tax holidays, are also quite common and pose a risk to the CIT base.¹⁸ The high concentration of CIT revenues among subsidiaries of multinationals and the prevalence of tax incentives contribute to low CIT productivity ratios across the CEMAC, particularly in CAR (3.6 percent), Congo (6.3 percent), and Cameroon (7.5 percent).

Figure 26. PIT Tax Ratio

(Percent of GDP)



Source: IMF WEO

Note: Data shown for most recent year available. SSA average based on countries shown here.

18. **CEMAC's PIT productivity is also low, reflecting in part its global income approach.** CEMAC's member states raise an average of 1 percent of GDP from the PIT, as compared to a SSA average of 2.9 percent. Cameroon (1.8 percent) and Gabon (1.5 percent) have the highest PIT tax ratios in the region. However, these performances appear weak in light of what is achieved elsewhere such as in Senegal (3 percent), Ghana (2.4 percent) and Uganda (2 percent). A regional directive, adopted in 2004, coordinates national PIT policies and provides for the adoption by

¹⁶ Cameroon attempts to mitigate this problem by adopting blunt anti-abusive provisions, such as a cap on the deductibility of some royalty and service payments. Similar rules have also been adopted by others, including Congo and Chad.

¹⁷ UNCTAD STAT data. Excludes Equatorial Guinea for which information is not available.

¹⁸ For example, as of September 2017, it is estimated that Chad had signed 150 to 250 bilateral tax conventions. The mere fact that the exact number is unknown, and that the range is so large, is indicative of the opacity of these agreements, whose discretionary nature is conducive to abuse and possibly even corruption.

member states of a global PIT regime, under which income from seven income categories are to be aggregated and subjected to taxation.^{19, 20} Experience has shown that this approach has proven particularly complex for countries to administer and challenging to enforce in the presence of weak tax administrations. In this context, it could be desirable to move towards dual or quasi-dual income tax regimes, where a progressive income tax schedule would be applied to labor income (e.g., wages and pensions) and a low-flat rate to capital income (e.g., interest, dividends, and royalties) through final withholding at source. This would greatly simplify PIT systems and thereby support enhanced transparency, taxpayer compliance, and effective administration.

19. **Further actions can also be taken to enhance PIT's revenue productivity, equity, and progressivity.** One would be to move away from the "family quotient" deduction scheme (e.g., Gabon and Chad), which is proving costly in terms of revenue foregone and is disproportionately benefitting higher income individuals.²¹ The most straightforward alternative would be the adoption of an income tax credit. Alternatively, the family quotient could be eliminated altogether and integrated into lower PIT rates and revised brackets. Other presumptive deductions based on a specified percentage of income, such as a general deduction or a deduction for professional fees, are also quite common and should similarly be reconsidered.²²

Tax and Customs Administration

20. **Weak tax and customs administrations also contribute significantly to the low level of non-oil revenue.** Some of the problems are common to these two administrations, such as weak capacity (in some cases, owing to an excessive staff turnover), the need to update the IT systems, weak accounting procedures, and the insufficient recourse to a risk-based approach of controls and audits.

- The tax administration's other significant weaknesses include: the insufficient segmentation of taxpayers; weak collection from public enterprises; the insufficient reliability of taxpayer databases.

¹⁹ Directive n°01/04-UEAC-177.

²⁰ These categories are: 1) commercial, industrial and craftsmanship profits; 2) non-commercial profits; 3) agriculture profits; 4) real property income; 5) wage, pension and annuity income; 6) mobile capital income; and 7) capital gains.

²¹ The value of an income tax deduction is a function of an individual's marginal tax rate.

²² If such deductions cannot be eliminated or replaced by an income tax credit, the benefit they confer should at a minimum be capped.

- Customs administration also suffers from the systematic underestimation of imports (including through the application by customs officers of illegal exemptions and reduced rates), and the weak implementation of the common external tariff.²³
- In addition, the collaboration and sharing of information between the tax and customs administrations has been insufficient. This creates a fragmentation in the revenue collection process (e.g., due to absence of necessary information), which taxpayers may be able to exploit to their advantage. This has been a longstanding challenge that persists to this day. A recent example illustrating this lack of coordination is one member state's use of codified VAT provisions at customs (i.e., in the ASYCUDA system) that differ from the applicable legislation under the tax code.

Other Factors

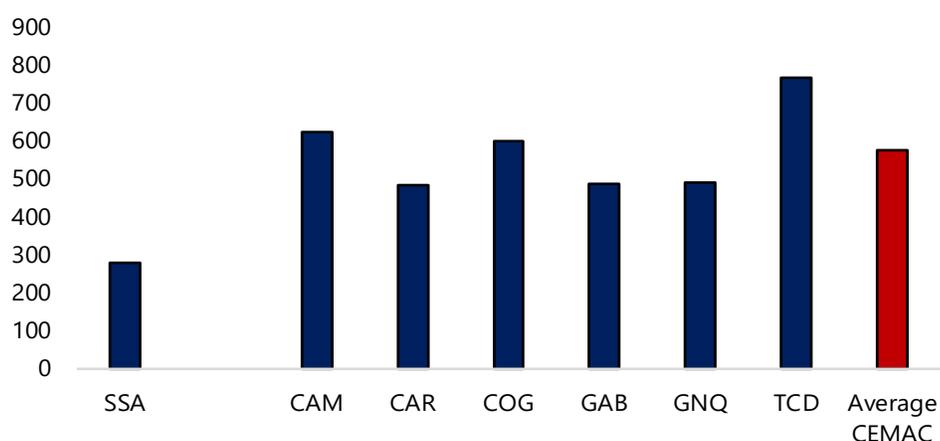
21. **Numerous other factors contribute to the challenges the CEMAC faces in mobilizing additional non-oil revenues.** Among them are a series of institutional insufficiencies, which include:

- *The absence of an adequate institutional setting for tax policy making.* Tax policy is most often still conducted on an *ad hoc* basis by officials from the tax and/or customs administrations, as opposed to being undertaken by a separate tax policy unit whose mandate is to advise the Minister of Finance on the proper design of the tax system.
- *Deficiencies in the current tax coordination framework.* The CEMAC Commission lacks the financial and human resources to play a proactive role in monitoring revenue mobilization challenges and in proposing prompt changes to the tax coordination framework. This not only undermines the CEMAC Commission's credibility vis-a-vis member states, but also the credibility of tax coordination more generally. Part of the challenge may reside in the Commission's incapacity or unwillingness to enforce member states' commitments under applicable regional instruments (e.g., through sanctioning mechanisms).

²³ The poor security situation in some border regions (notably in Central African Republic and in Cameroon) has also hampered the collection of trade taxes. In Cameroon, these have also been eroded by its Economic Partnership Agreement with the European Union, which reduces or eliminates tariffs on a number of imported goods.

- *The prevalence of parafiscal taxes and extra-budgetary spending.* Several public entities collect revenue which finance their expenditures without being transferred to the single treasury account and reflected in the budget.²⁴ This results in the fragmentation of tax policy—i.e., multiplication of various small levies which serve specific objectives, without regard to the overall efficiency, equity, simplicity, and transparency of the tax system—and undermines the central role of the Ministry of Finance in managing countries' fiscal policy.
- *Relatively high costs faced by economic agents to comply with tax laws.* For example, it takes on average 600 hours per year for a medium-size company to comply with its mandatory tax payments, against less than 300 in sub-Saharan Africa.

Figure 27. CEMAC and Sub-Saharan Africa: Yearly Hours Spent by a Medium-Size Company to Pay its Taxes



Source: Doing Business Indicators 2018, World Bank.

²⁴ For example, there are over 50 such agencies in CAR alone. A process to bring revenues of these agencies into the general budget is under way.

D. Ways to Increase Non-Oil Revenue

With non-oil revenue well below their potential, CEMAC member states have significant potential for increasing them. To do so, the member states will need to combine tax policy measures with measures to strengthen tax and customs administration. To broaden the tax base, these measures will have to be accompanied by structural reforms aimed at improving the business environment and strengthening governance. The authorities should also be aware of the potential equity and social impact of the reforms and take alleviating measures when necessary.

Tax Policy

22. **The choice of the revenue-enhancing measures that the authorities will implement must take into account a number of factors:**

- The specificities of the country, including the size of its fiscal adjustment needs, its existing tax structure, and the main weaknesses in its revenue administration.
- The potential impact of these measures on growth. Corporate income taxes have the most negative effect on growth, followed by labor income taxes, then indirect taxes, and finally property taxes. Rent taxes are most neutral, as they do not distort investment decisions.
- Equity considerations, as they will ultimately influence the feasibility and sustainability of proposed reforms. Direct taxation—and perhaps property taxation—are likely most promising to achieve better equity outcomes.
- The need to establish a proper tax reform strategy which identifies priorities and provides an appropriate timeline for the implementation of various measures.
- Current challenges faced by tax and customs administrations. Effectively addressing tax evasion/avoidance, curtailing the informal sector which many view as gaining unfair competitive advantages over formal businesses, and improving taxpayers' confidence in the fair and partial application of the tax system (including by addressing cases of corruption) are some of these challenges.

VAT and Excise Taxes

23. **VAT and excise tax reforms offer immediate opportunities for revenue mobilization.** Closing VAT policy and compliance gaps could readily contribute to improving revenue collection and tax neutrality. However, political concerns remain high over the application of indirect taxes on a broad tax base, given low income levels and the perception that consumption taxes can reduce the progressivity of the tax system and thus increase or sustain inequality. This in large part explains the widespread use of VAT exemptions on various foodstuffs. What is often forgotten, however, is that the tax expenditure for such exemptions

mostly benefits the rich.²⁵ The regressive impact of indirect taxes is best addressed through other policy tools, such as expanding pro-poor spending through targeted programs (such as conditional cash transfers) or reforms to direct taxation (e.g., income-tested benefits). If elimination of VAT exemptions is too politically sensitive, member states should consider using the reduced VAT rate in order to facilitate the transition towards the eventual application of the standard rate.

24. **A pre-condition for improving the revenue productivity and economic efficiency of the VAT is the refunding of credits.** The lack of prompt cash repayment of VAT credits affects the economic neutrality of the tax and affected businesses' cash flow position. More fundamentally, it breaks the confidence taxpayers have in the tax system. Two complementary options to address this issue are the adoption of a deferred payment VAT procedure at customs (in lieu of exemptions) and the setting up of a dedicated account at the BEAC, funded by a specified share of VAT collected at customs.²⁶ The effective implementation of these provisions should facilitate the elimination of VAT exemptions, which are currently widely used as investment incentives and which hamper the VAT from fulfilling its role of ensuring some taxation of the informal sector.²⁷ CEMAC countries currently do not refund credits or adopt a compensation scheme that allows taxpayers to use unrefunded VAT credits to offset against other tax liabilities (e.g., Cameroun, Congo, and CAR).

25. **Increasing excise taxes on alcohol, tobacco, passenger vehicles, and possibly sugar, could also contribute to increasing revenue while addressing other public policy objectives.** Given their current low rates, there should thus be ample room to incrementally increase tax rates without having smuggling pose a risk to revenue mobilization efforts. Such increases would also be justified on the grounds of the demonstrated harmful health or environmental effects of these goods.²⁸ The new regional directive on excise taxes that is currently being considered by member states would support these efforts by:

- Requiring member states to apply higher rates on tobacco products (minimum of 30 percent, instead of the existing maximum of 25 percent);

²⁵ For example, it is estimated that 46 percent of the total revenue foregone because of VAT exemptions on foodstuffs in Chad benefit individuals in the top-two deciles, while only 7 percent benefit the bottom-two deciles.

²⁶ In Côte d'Ivoire, for example, 12 percent of VAT collected at customs is sent to a dedicated account at the BCEAO.

²⁷ Most—if not all—informal enterprises are not registered to the VAT, and hence incur unrecoverable VAT on their business purchases.

²⁸ Further, an increase in excise tax rates may also be consistent with greater progressivity in the tax system. While consumption taxes are generally viewed as regressive, increasing excise taxes may be progressive if low-income individuals have a greater price-elasticity than high-income individuals (which is generally assumed to be true).

- Setting minimum rates and eliminating maximum rates on other products such as alcoholic beverages and passenger vehicles;
- Prohibiting the discrimination between imported and locally produced products, which will serve to broaden the excise tax base in most CEMAC states.

Direct Taxes

26. **Work on a fundamental reform of direct taxation ought to start now.** CIT reforms should primarily target two key areas: investment incentives and international taxation. PIT reforms should aim at simplicity and equity. Further, reforms to small-taxpayer regimes may also be needed to ensure that they do not support informality or provide incentives for the artificial fragmentation of business activities.

27. **Tax incentives are often redundant, and neither efficient nor effective in developing countries.**²⁹ Also worrying is the fact that they often lack transparency and can be granted on a discretionary basis, thereby opening the door for abuse. The regional Investment Charter limits the incentives that can be offered by member countries to attract foreign investment.³⁰ However, the Charter has seemingly not succeeded in refraining member states from handing out generous incentives through their investment codes, special zone regimes, or bilateral tax conventions. It would be desirable to unify national investment promotion systems and repatriate all tax incentives to the tax code or, at a minimum, within a single derogatory regime (e.g., national investment charter). Further, member countries should systematically assess the fiscal cost and economic merits of the various exemptions and remove those that cannot be proven to be cost-efficient. This could be undertaken as part of an annual exercise aimed at quantifying and publishing all tax expenditures.

28. **International taxation is a complex area that requires sustained efforts.** Modern anti-abuse provisions that are adapted to, and strike an appropriate balance between, the CEMAC's limited administrative capacity and multinationals' sophisticated tax planning schemes should be adopted as soon as possible. High-level expertise would be highly desirable to ensure that the rules appropriately target abusive cases while not being detrimental to legitimate business investments.

29. **PIT systems could be simplified and used to improve the equity of the tax system.** Reforms in this area could consequently alleviate concerns over VAT reforms, which could be perceived as being regressive. As noted in paragraphs 18 and 19, there are two key priorities for reforming PIT regimes in the CEMAC. First, member states should consider moving towards a dual or quasi-dual income tax system (incl. in Gabon, Cameroon, Chad), with progressive taxation

²⁹ "Options for low income countries' effective and efficient use of tax incentives for investment", Report to the G-20 development working group by the IMF, OECD, UN and World Bank, October 2015.

³⁰ Regulation n°17/99/CEMAC-20-CM-03.

of labor income and proportional taxation of capital income through final withholding at source. Second, member states should consider eliminating family quotients and other presumptive deductions based on income, or at least consider moving towards a credit-based approach.

Other Reforms

30. **Other tax policy reforms could also be considered.** Property taxation is receiving increased attention in the CEMAC, as it is currently being under-exploited and would be expected to greatly improve the fairness of members' tax systems. That said, property tax reforms generally require fundamentals (such as land registers) which are often not currently in place and offer limited potential in terms of expected revenues.³¹ Reform of taxes on fuel and petroleum products could also be considered, although such changes should be integrated into a broader reform that also looks into current price-subsidy schemes.

31. **The adoption of an adequate institutional framework for tax policy analysis could facilitate tax revenue mobilization reforms.** This would include the setting up and adequate staffing of a dedicated tax policy unit (TPU), whose mandate is to advise the Minister of Finance on the proper design of the tax system.³² In doing so, the TPU should undertake qualitative, quantitative and distributional analysis, including through a tax expenditures report that is published annually.

32. **Ongoing work on updating and strengthening existing regional instruments should be maintained.** The CEMAC Commission should continue, with the technical assistance of the IMF and with support from member states, to conduct an extensive review of existing regional tax instruments (incl. on PIT, CIT, VAT, excises) and consider the adoption of new instruments (e.g., on tax expenditures analysis and reporting). In line with the aforementioned considerations, immediate priority should be given to amending and approving new excise tax and VAT directives.

33. **The current tax coordination framework should be better exploited to support member states' need for sustained increases in non-oil revenues.** Tax coordination is desirable, particularly in the context of a longstanding customs and monetary union like the CEMAC. This coordination can serve multiple objectives, among which are to address cases of harmful tax competition and contribute to development of a common market with low barriers to the free movement of capital and labor. However, the current tax coordination framework appears underutilized. A particular challenge is that member states tend to view regional coordination as a means to legitimize current domestic tax policies (irrespective of their underlying desirability), as opposed to using supranational instruments such as directives to

³¹ For instance, property taxes in South Africa raise only about 1 percent of GDP in revenues. While the revenue potential may be limited, property taxation can also be desirable insofar as it serves the purpose of providing a reliable source of funding for sub-national jurisdictions.

³² For additional details on tax policy units, see Grote (2017).

more easily address domestic political-economy issues. Consideration should be given to reviewing the role of the Commission, its resources, and its powers in enforcing regional instruments such as tax directives.

Strengthening Tax and Customs Administration

34. **Tax and customs administration reforms can contribute significantly to efforts to increase non-oil revenue.** Crivelli and Gupta (2014b) estimate that tax revenues increased by approximately ½ percentage point of GDP in a given year in low-income countries where Fund-supported programs included conditionality on tax policy and administration.³³ The simplification of laws and procedures can also help reduce the cost of taxpayer compliance. Reforms should also aim at enhancing the efficiency and fairness of the tax system.

35. **Tax administration reforms should be organized around the following priorities:**

- The optimization of taxpayer segmentation, including through the creation of dedicated services (such as large taxpayer offices or units specialized on high-income earners) and increases in minimum thresholds (e.g. for VAT or large taxpayer offices);
- Marking further progress in introducing a risk-based approach for controls, audits, on-site inspections, and refunds;
- The strengthening of the VAT administration, including to enhance its collection from public enterprises;
- The streamlining of parafiscal/extrabudgetary revenue and their inclusion (along with the corresponding expenditures) in the budget;
- Strengthening the control of the (domestic and foreign) sources of incomes of wealthy individuals;
- The modernization and simplification of procedures, including for small enterprises;
- Strengthening the administration and collection of tax liabilities;
- The modernization of the IT systems, including to update taxpayer databases; allow for the digitalization of tax payments and exhaustive recording of all operations; and strengthen the monitoring of tax arrears;
- Strengthening of human resources, notably through training and reduced staff turnover.

36. **Custom administration reforms should aim at:**

- implementing fully the common external tariff;

³³ This increase is estimated at 0.4 percent of GDP for middle-income countries.

- strengthening the valuation function and reduce the abuse of the reduced tax rate and duty suspension provisions, including through the automation/digitalization of procedures and enhanced ex-post controls of valuations;
- Strengthening the management of import exemptions, including in: implementing harmonized categories of exemptions on imported goods; enforcing the implementation of the codification of exemptions (including as part of the preparation of clear customs clearance guidelines); automatizing the customs exemptions authorization; and improving the control of exempted goods;
- Develop further a risk-based approach for controls, including through a closer monitoring of infractions, which will help better identify risks;
- Establishing a customs single window;
- Modernizing the IT systems, including through the broader use of ASYCUDA World.

37. **The collaboration between the tax and customs administrations also needs to be strengthened, notably with regard to the exchange of information.** The IT systems of the two administrations should notably allow for rapid cross-checking of the information provided by taxpayers and importers.

E. Conclusion

38. **CEMAC Member states need to intensify their efforts to increase non-oil revenue.** While, as part of the IMF-supported programs, the CEMAC countries have started implementing policy and reform measures in that direction, these efforts have so far been too timid, bearing little fruit. They need to be intensified over the coming years to meet the member states' remaining fiscal consolidation needs in a way that is supportive of higher and inclusive growth. This will also provide CEMAC countries with a more stable revenue base to finance their considerable infrastructure and spending needs. To enhance their efficiency and minimize tax competition, these efforts should be harmonized and better coordinated at the regional level, starting with the adoption of the new directive on excise taxes.

39. **To be sustained, these efforts should be complemented by reforms to alleviate their social impact and promote inclusive growth.** When necessary, part of the increase in non-oil revenue could finance well-targeted social expenditures (such as conditional cash transfers) benefiting the most vulnerable. Structural reforms aimed at promoting growth and at diversifying the CEMAC economies will also contribute to a durable increase in the tax base. In this regard, much remains to be done to improve the business environment and strengthen governance.

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