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SELECTED ISSUES

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SELECTED ISSUES

January 3, 2020

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NON-OIL REVENUE MOBILIZATION: KEY CHALLENGES AND REFORMS[1]

Non-oil revenue mobilization in the Republic of Congo has become a key strategic priority for the authorities to support fiscal consolidation efforts and restore debt sustainability. Revenue mobilization is particularly important given the projected decline in oil revenues over the medium-term, as oil production declines from the peak levels it is projected to achieve in 2019–20. This Selected Issues Paper (SIP) discusses reforms that could generate higher revenues from the non-oil sector through measures to rationalize the tax code, broaden the tax base, and increase administrative efficiency. These efforts should be complemented by economic diversification policies that support non-oil growth and thereby expand the potential tax base. The paper also reflects on lessons learned from other country experiences that could be relevant for the Republic of Congo.

A. Context

1. Non-oil revenue mobilization is a key strategic priority in the Republic of Congo. It would provide strong support for the financing of increased social demands, contribute to fiscal consolidation to restore debt sustainability, and rebuild buffers that can be used to increase resilience to future shocks. This paper discusses several steps that could help the authorities boost domestic non-oil revenue mobilization, including through reforms to strengthen basic institutions, broaden the tax base, and launch tax policy initiatives focusing on the modernization and optimization of existing taxes. In line with recent research,[2] the authorities' plans to mobilize domestic revenues should be supported by a medium-term strategy, a high level of political commitment, and capacity development. In addition, improvements in transparency and a reduction in corruption should increase compliance as citizens and companies become more convinced that the taxes they pay will have a broader positive impact on the economy.

Figure 1. Non-Oil Revenues
(Percent of non-oil GDP)

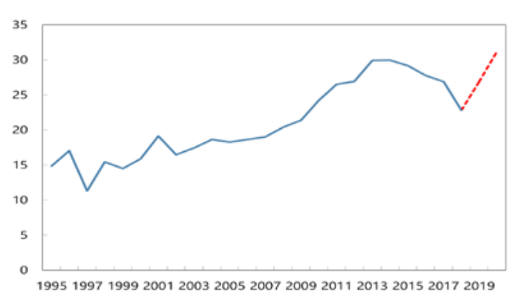
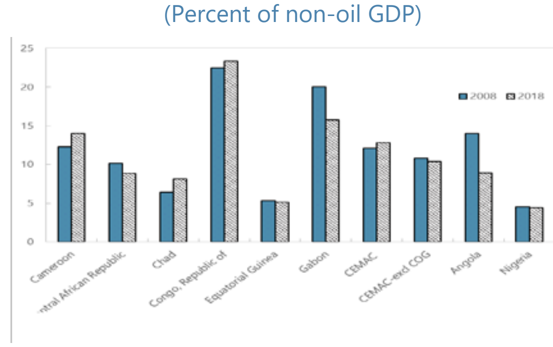


Figure 2. Non-Oil Revenues in Oil Producing Countries
(Percent of non-oil GDP)



Sources: Congolese authorities and IMF staff estimates.
Note: In Figure 1, the dotted line represents 2019 and 2020 projections.

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[1] Prepared by Concha Verdugo-Yepes (FAD) and Jose Sulemane.

[2] See IMF 2018.

2. Non-oil revenues in the Republic of Congo have followed a generally positive trend since 1995, though there has been a substantial decline in recent years. From 1995 to 2014, non-oil revenues doubled (Figure 1), reaching 30 percent of non-oil GDP. However, this positive trend was reversed in 2014 due to the decline in oil prices that triggered a deep economic crisis. Non-oil revenues in Congo are relatively high compared to other oil producing countries in sub-Saharan Africa (Figure 2). However, these calculations need to be interpreted with caution given the fact that non-oil GDP could be underestimated.[3]

B. Reforms Over the Last Decade

3. Some tax reforms were introduced in the last decade. Since 2009 several CD missions have suggested a series of reforms that would increase non-oil revenue mobilization by 3 to 5 percent of GDP. These recommendations have mainly focused on how to rationalize the tax code, broaden the tax base, and increase administrative efficiency. The authorities have mainly focused their efforts on reducing the most important taxes including the rate of Corporate Income Tax (CIT), which was reduced from 38 to 30 percent over the past few years. They have also reduced personal income tax (PIT) rates, but without simplifying the tax structure. Additionally, the authorities introduced a reduced rate of VAT and new custom duties and have implemented several other measures for revenue mobilization since the 2017 budget (e.g., an increase in excise rates, a new tax on car imports, and taxes on real estate transactions).

4. Tax reform efforts have had limited success so far. In parallel, the authorities adopted measures that undermined the tax base, for example, through the introduction of many new *ad hoc* taxes (*parafiscalité*), and the excessive use of exemptions. For example, the use of tax incentives for special economic zones, the proliferation of new conventions with generous tax exemptions envisaged by the investment code, and widespread use of reduced VAT rates and exemptions from the PIT code (notably for agricultural revenue).

5. Tax reform was not accompanied by a revised institutional framework, which has exacerbated the fragmentation and lack of tax policy coherence. In particular, tax policy responsibilities were split among (i) the tax departments of the Budget Ministry, (ii) the National Commission on Investments (in charge of the investment code), and (iii) a separate agency in charge of the administration of special economic zones.

C. Short-term Measures Proposed by the Authorities (2019–20)

6. The success of the authorities' revenue mobilization in the short term will depend on the effective implementation of three key reforms. These include: (i) the strict implementation of new tax measures incorporated in the recent budget laws, including the elimination of the reduced VAT rate for imports, reductions in the VAT threshold, and new provisions on excises, including on beverages and tobacco; (ii) administrative measures to strengthen tax compliance, the collection of

[3] The authorities are currently reviewing the nominal GDP series. The adoption of a new base year and incorporation of additional information from various economic sectors could lead to a substantial upward revision.

tax arrears, and the taxation of refined oil imports; and (iii) other legislative measures, including telecommunication taxes. Specifically, discussions with the authorities have focused on strategies to estimate the probability of collection of tax arrears and to reduce exemptions; the feasibility of implementing measures proposed by the Tax and Customs Directorates for 2019–20; and the status of the work of the Congolese Commission which is responsible for renegotiating with private companies investment conventions and other bilateral agreements aimed at reducing exemptions.[4]

7. Administrative measures to recover tax arrears are critical. Recovery of tax arrears is a major challenge for the Congolese government, as they represented more than 29 percent of non-oil GDP in 2018. There are two main sources of arrears to be collected by the Tax and Customs Directorates: (i) large and medium-size private companies' arrears, estimated at 374 CFA billion (14.7 percent of non-oil GDP) that are currently being reviewed by administrative courts; and (ii) public enterprise arrears and associated penalties, estimated at 330 CFA billion (13 percent of non-oil GDP).[5]

8. A combination of measures approved by the Tax Directorate includes the potential recovery of private sector tax arrears equivalent to 6 percent of GDP (Table 1). Other measures identified for 2019–20 include (i) improving IT interconnections within the tax administration and with other entities and departments; (ii) intensifying tax audits; and (iii) analyzing and streamlining tax expenditures. However, the total expected recovery of tax arrears up to September 2019 had been insignificant and remains a concern. Furthermore, the potential recovery of these arrears could be much lower than current estimates and the challenge of recovering arrears could increase over the years if authorities contest their existence in court. When the arrears are older, the companies' incentives to repay them are also weaker. To improve the probability of recovering tax arrears, the authorities will prepare by February 2020 an inventory of tax arrears and administrative agreements and will define a medium-term strategy to collect them. The authorities noted the challenges faced by the Tax Directorate in recovering arrears from public corporations, and indicated that the Treasury is responsible for collecting those arrears.

9. The Customs Directorate proposed to IMF staff to eliminate some exemptions, and to improve the efficiency of collections and the effective application of the Hydrocarbons Code. Additional steps are being taken to improve information systems and reduce corruption. The following three measures could increase revenue mobilization by 17 CFA billion (0.6 percent of GDP) in 2020 (Table 2):

- Elimination of exemptions related to the export of natural resources and raw materials;
- Application of the provisions of the Hydrocarbons Code to petroleum sector imports; and
- Taxation of imports of refined petroleum products.

[4] The Minister of Finance created a Commission (2018) in charge of controlling the investment conventions and other regulatory framework. (November 2018, Note de Service N 0735/MFB-CAB).

[5] More than 60 percent of the public companies' arrears are related to the Electric National Company and the Chemin de Fer (Railway), Congo.

Table 1. Republic of Congo: Projection of Non-Oil Revenues by Tax Directorate (2020)
(Billions of CFA francs)

Evolution of the Tax Base	509
New Legislative and Administrative Measures	208.2
1. 2020 Budget Law	27.2
i. Enforcement of payment of personal income and wage taxes for managers of local branches of foreign companies. ii. Reinstatement of a Special Wage Tax. iii. Removal of VAT exoneration for raw materials (oil crude). iv. Reorganization of the tax rate on excise goods.	
2. Interconnexion of the various tax administrations[2]	20
3. Recovery of tax arrears for large companies in 2020	80
4. Recovery of tax arrears for small and medium companies	60
5. Recovery of other tax arrears.	13
6. Tax increase on telecommunications	8
Total	**717.2**

Source: Congolese authorities.

[1] Projection of tax collection (without measures).

[2] Establishment of an IT connection between the Treasury, Direction Générale des Impôts et des Domaines (DGID) and the Customs Directorate.

Table 2. Republic of Congo: Custom Administration Revenues Estimates (2020)
(Billions of CFA francs)

Evolution of trade flows and non-oil GDP	110
Improvement of information systems and interconnections	6
Revenue mobilization measures	17
Other measures to combat corruption and strengthening good governance	1.5
Total	**134.5**

Source: Congolese authorities.

10. **The authorities estimate that tax exemptions to the oil sector accounted for 18 percent of non-oil GDP in 2018 and investment-specific exemptions contributed a further 6 percent of non-oil GDP** (Table 3). However, a recent study by the Commission responsible for assessing investment-specific exemptions suggests that the fiscal costs associated with investment specific exemptions could be even higher (325 CFA billion, 12 percent of GDP). Furthermore, oil

sector and administrative exemptions continued to increase in 2019 as shown in Tables 3 and 4. The discussions with the authorities focused on the Commission's work to assess the fiscal costs of (i) incentives and exemptions provided for in laws and regulations;[6] and (ii) other incentives provided by the government which are outside the legal framework.

Table 3. Republic of Congo: Types of Tax Exemptions (2016–19)
(Billions of CFA francs)

Types of Tax Exemptions	2016	2017	2018	2019*
Oil sector exemptions	742	216	454	474
Regulatory exemptions	0	0	0	3
State contribution to investment	151	0	152	114
Conventional exemptions	na	128.4	245.9	25.3
IS (Corporate Tax)	na	10.5	126.9	8.2
TSS (Special Corporate Tax)	na	22.1	87.5	0.7
TUS (Special Payroll Tax)	na	0.3	0.6	0.1
TVA (Value Added Tax)	na	95.3	21.5	16.4
TVTS (Tax on Passengers Vehicles Companies)	na	0.0	0.0	na
TTF (Tax on Remittances)	na	na	9.0	na
Local Taxes	na	0.3	0.4	0.0
Administrative exemptions	na	3.6	8.5	9.7

Source: Congolese authorities.

Note: 2019 only includes data until September.

11. Many of the incentives enjoyed by investment companies do not comply with existing laws and regulations. These include a wide range of exemptions on (i) taxes and custom duties on imported products; (ii) profits and revenues generated by investment projects; (iii) a special payroll tax; (iv) the tax on funds denominated in foreign exchange; (v) PIT on non-resident members of the boards of these investment companies; (vi) the registration fees for the creation of companies, capital injections, and mergers; and (vii) social security taxes on retirement pensions.

12. The preliminary estimates of tax expenditures are based on a survey that demonstrates substantial problems in compliance with the investment code and other regulations. In particular, over one third of companies were not compliant with the existing regulatory framework and bilateral agreements. The Commission should finalize its work to produce full assessment. In addition, the fiscal cost estimates should include the loss of income to the state due to (i) private sector non-compliance with social security contributions; (ii) the environmental and

[6] Set of regulatory frameworks including advantages and exemptions includes: Law n° 2003–06 (on investment charter), decree n° 2004–30 setting the terms of agreements of companies to the benefits of the investment charter; General Tax Code; Customs Code, Mining Code, Hydrocarbons Code, Forest Code; and the Budget Laws.

social cost of private investment projects that have not been audited; and (iii) non-compliance with foreign exchange regulations.

D. Recommendations

Tax Policy

13. The expansion of the tax base should be at the top of the government's reform agenda. It is a pre-requisite to create space for possible reductions in rates and tax simplification that could help the business environment and the development of the non-oil economy. The most critical reform area would be to address without further delay the challenges associated with the proliferation of tax exemptions that are currently eroding the tax base and limiting potential revenue mobilization.

14. Other steps on tax policy reform can help complement the ongoing efforts to expand the tax base. In particular, there is scope to raise additional revenue from property taxes, and improve the capacity of the audit office to enhance tax compliance in extractive industries. Reviewing international tax rules (notably in relation to natural resources) to assess the impact of double taxation treaties and transfer pricing issues could also play a useful role. Consideration should also be given to the expansion of excises and simplification of the VAT, through the elimination of exemptions and reduced rates. However, other options remain limited. For example, creating new taxes in an already clogged up tax system would further complicate and depress the business environment.

Institutional Reforms

15. A key step to reduce fragmentation and improve fiscal policy is the recent creation of a Tax Policy Unit (UPF) in the Ministry of Finance. This unit can develop medium-term plans for tax mobilization, provide a strategic orientation to reforms and help coordinate various tax policy initiatives.[7] The main challenge for the UPF is to ensure that it has a mandate to guide fiscal policy, and provide the Minister of Finance with advice on tax policy issues.

16. Further progress to modernize tax administration is also needed. The government should prepare and publish a medium-term strategy for reforming the customs and tax administrations and improving service delivery. These reforms should focus on modernizing human resource management, implementing a results-based management system, and increasing transparency and reducing corruption. In addition, the formalization of a framework for consultation and collaboration with the private sector, civil society, and international development partners can also play a useful role to ensure broader understanding and ownership of tax reform efforts.

17. Reversing the current trend will require institutional reforms and steps to strengthen the tax policy framework. A proper assessment and evaluation of tax expenditures should be a key

[7] The Tax Policy Unit was created by the Minister of Finance in October 2019 by note num. 0242/MFB-CAB. The creation of a Fiscal Unit was proposed by previous IMF Technical Assistance reports.

instrument to help the authorities focus on the dangers of eroding the tax base through an excessive use of exemptions. A similar approach has been used in other countries in Africa (e.g., Senegal and Morocco), and can play a useful role to assess the trade-offs associated with the use of tax exemptions.

E. Conclusion

18. The authorities should step up revenue mobilization as a key component of their medium-term fiscal strategy. This will require a well-sequenced structure of reforms that includes three key elements. First, the newly created Tax Policy Unit in the Ministry of Finance should reduce institutional fragmentation and facilitate the design, coordination and implementation of a medium-term revenue strategy. Second, the government should urgently address the erosion of the tax base generated by an excessive and discretionary use of tax exemptions that do not comply with existing laws and regulations. Finally, the government should continue to focus on rationalizing the tax code, and increasing administrative efficiency to recover tax arrears, including through the modernization of existing IT systems.

Reference

International Monetary Fund, 2018. "Domestic Revenue Mobilization in Sub-Saharan Africa: What Are the Possibilities?" April Regional Economic Outlook: Domestic Revenue Mobilization and Private Investment.

FUEL PRICE SUBSIDIES IN THE REPUBLIC OF CONGO[1]

In 2005 the Congolese authorities introduced a new regulatory framework for fuel prices. It was based on a pricing formula that adjusts retail petroleum products prices to reflect import and domestic production costs, including margins and taxes, and avoid fiscal subsidies. However, this framework has not been applied. As a result, retail prices have been administratively set by ministerial decree, and have remained unchanged since 2008 below average cost recovery. The analysis shows that the refinery prices are structurally higher than international import prices by about 13–15 percent, due to production and administrative inefficiencies. As a result of the non-application of the pricing rule, and other structural inefficiencies, the government has incurred large budgetary transfers toward its refinery of over 2 percent of GDP per year, on average, during 2005–19.

A. Oil Sector Regulatory Framework

1. **Congo's downstream oil sector is dominated by the state-owned national oil company SNPC and its oil refinery CORAF, which together provide about 75-80 percent of domestic demand for oil products**.[2] The State, however, allows the direct importation and distribution of refined petroleum products by 5 other private oil marketing companies (OMCs) to satisfy the growing demand of fuel products in the country. On the demand side, domestic consumption of refined products is mainly for diesel, representing 61 percent of domestic consumption) and gasoline accounting for 22 percent (Figure 1). Other petroleum products include aviation fuel, kerosene and LPG.

2. **In 2005, the Congolese authorities introduced a regulatory framework to set domestic fuel prices.** The framework is based on a one-price rule and a cost-plus principle**.** In particular, the authorities established one retail price for each petroleum product based on a formula that would adjust retail petroleum product prices to reflect import and domestic production costs (i.e. ex-refinery price), including margins and taxes, and therefore should avoid the occurrence of fiscal subsidies (Table 1).[3]

3. **The main component of the retail price is the Entry Distribution Price (EDP), which is computed as a weighted average of import prices and ex-refinery prices.** While the import prices are based on CIF prices plus other market-based fees, the ex-refinery price (PSR) is based on import parity prices with one-month lag and is augmented by a monopolistic markup or "economic adjustment" factor (Text Figure 1). This markup was administratively set initially in 2005 at

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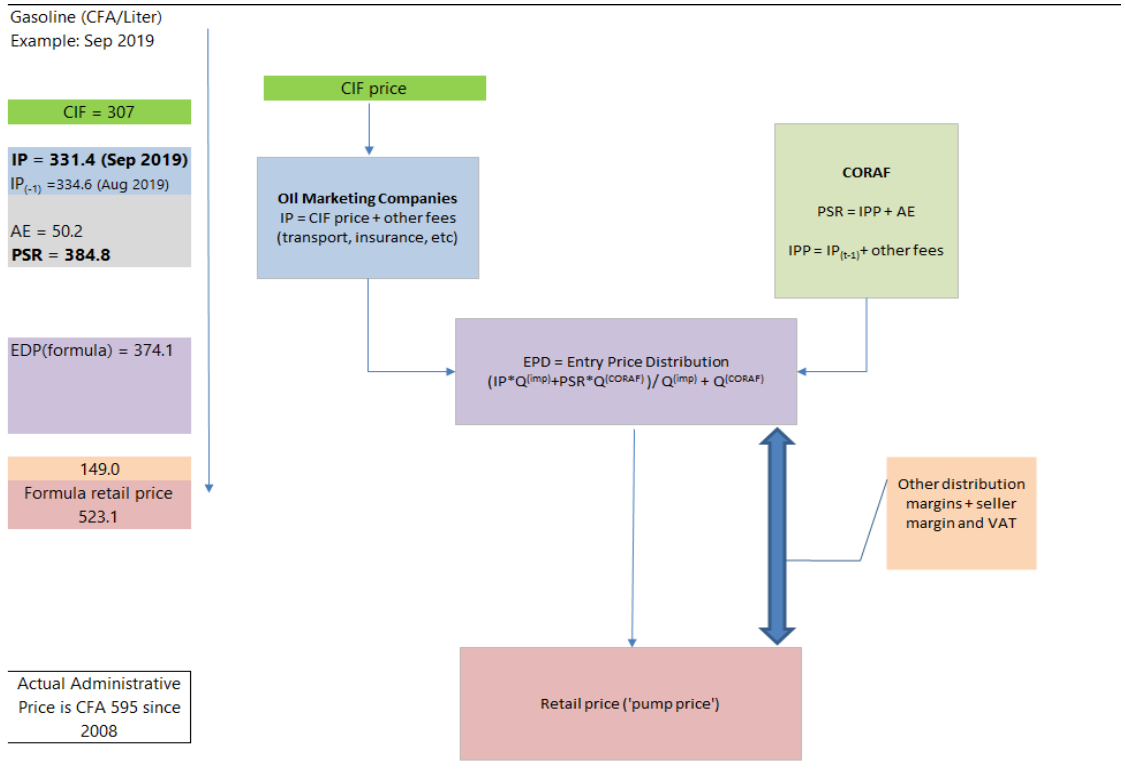
[1] This SIP has been prepared by Alfredo Baldini and Alun Thomas. We thank Alex Segura-Ubiergo, Tonadio Nsongui (all AFR) for helpful comments and suggestions, and the Congolese authorities for their insightful suggestions during the seminar held at the Ministry of Finance in Brazzaville on November 4, 2019. Linnet Mbogo (AFR) provided excellent research assistance.

[2] By looking at unpublished aggregate data on production and consumption, we estimate that SNPC imports and distributes about 5–10 percent of finished oil products and provide crude oil to CORAF.

[3] These dispositions on the price structure were implemented with the Presidential decree 2005–699 issued on December 30, 2005.

25 percent above the import parity price and then set to decline gradually over time, assuming CORAF gains efficiency and achieves refinery costs close to import parity prices.[4] Text Figure 1 shows how the price structure works, including an example on how the formula would set the pump price for September 2019. Other features of the regulatory framework included: (i) the set-up in 2006 of a control authority (Agence de Regulation de l'Aval Petrolier (ARAP)) with oversight responsibilities on the sector and: (ii) a Technical Committee (CTSAPA), created in 2002 whose main responsibility was to evaluate on a monthly basis the price structure and propose adjustments in case the gap widens between expected and actual fuel product prices.

Text Figure 1. Description of the Fuel Price Structure[1]



[1] The fuel price structure as originally set in decree 2002-263, applies to all main fuel products (gasoline, diesel, kerosene, etc.). For few other products (bitumen, lubricants, paraffin, and petroleum spirit) the retail price is not regulated.
Legenda: IP = Import Prices; IPP = Import Parity Prices; EA = Economic Adjustment factor (set by Congolaise authorities); PSR = Ex-Refinery Price.

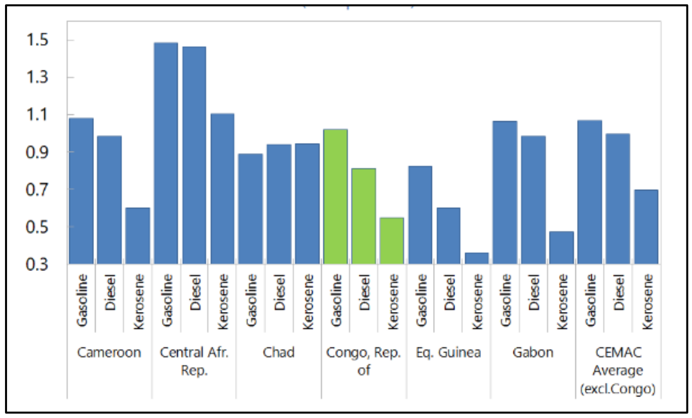
4. **The authorities have not been implementing this price-based formal regulatory framework.** In practice**,** regulated retail 'pump' prices have been set by ministerial decree at a level that on average has been below average costs and has remained unchanged since 2008.

[4] We are estimating a CORAF markup of 15 percent. This is calculated with data reported by the authorities and import prices for diesel and gasoline that closely follow import data provided by the authorities for the period 2016–17.

5. Retail prices in Congo are lower than the average for the CEMAC region. While the average CEMAC region is influenced by the higher prices in the Central African Republic (the only non-oil producer), the price for diesel in Congo (which accounts for almost 2/3 of domestic consumption) is lower than in Cameroon, Gabon, or Chad (Text Figure 2). The only CEMAC country with generally lower prices than Congo is Equatorial Guinea. At the same time, the price for Gasoline is well-aligned with the price in other countries.

Text Figure 2. Retail Price in CEMAC, June 2019

(USD per liter)



Sources: IMF staff estimates.

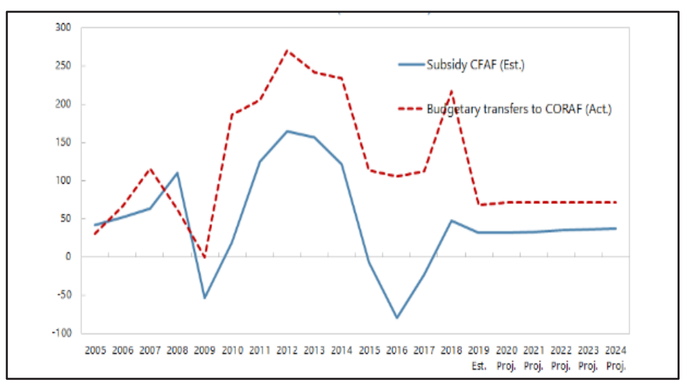
B. Trends and Fiscal Implications of the Domestic Fuel Subsidy

6. After the 2005 fuel price reform, the authorities increased retail prices only once (in 2008), despite a growing wedge between regulated and formula-based retail prices. At their peaks in 2008 and 2012–13, the price gaps for diesel and kerosene were estimated in excess of CFA 240 and CFA 300 per liter, respectively. The price gap for Gasoline was less pronounced around CFA 120 per liter. The total amount of the subsidy in 2012 is estimated to have increased to about CFAF 164 billion (USD 84 million), or 7.3 percent of non-oil GDP. During 2015–17, however, when international oil prices fell dramatically from previous peaks, and the country was hit by a deep economic recession, the authorities did not revise downwards the retail prices, and the price-gap became even negative for diesel and gasoline fuel products.

7. Failure to implement the 2005 fuel pricing formula has been associated with large fiscal transfers from the central government to CORAF. Since 2005, budgetary transfers from the central government to the state-owned oil refinery CORAF have exceeded the estimated subsidies. During 2005–19, the central government transferred over 6 percent of non-oil GDP per year, on average, to the state-owned oil refinery CORAF (Text Figure 3). The difference between the implicit subsidy and the transfer to CORAF is on average

Text Figure 3. Budgetary Transfers to CORAF and Estimated Subsidies, 2015–19

(Billions of CFA francs)



Sources: Congolese authorities, WEO database, OCDE database, and IMF staff estimates.

50 percent of the subsidy since 2005. This suggests that half of these transfers are claimed by CORAF or SNPC to cover other operational or capital expenses.

8. The tax regime of the sector yields a relatively low net fiscal contribution, also due to hidden exemptions. There is an additional "hidden subsidy" in that the price charged by the importers includes a tax component that does not seem to be collected by the state. The tax component is the sum of import duties and VAT on the imported petroleum products and amounts to about 20 percent of the retail price. Over the period 2013–17, the state could have collected about 36 billion CFA per year for imputed taxes on imports of gasoline and diesel. This calculation excludes any VAT on the production of CORAF refined products.

C. Reform Options

9. The authorities need to implement the regulatory formula to limit fiscal exposure, and improve transparency. In addition, the pass-through of international prices to domestic prices is necessary to provide adequate price signals to consumers who currently perceive fuel prices as fixed and could assume that their immutability is a permanent entitlement**.** Under current conditions, with international prices close to the regulated retail price,[5] the application of the price formula would not imply significant price increases. Moreover, previous Fund research has shown that the benefits of the subsidy regime are skewed in favor of higher income households, though poor households could also be adversely affected by price increases given the high share of energy in their total consumption.[6]

10. The reform strategy could include a smoothing mechanism to moderate short-term price changes and a system to compensate vulnerable groups. In particular, the reform could consider an automatic fuel pricing mechanism with a smoothing component, in line with the experience in a number of other countries.[7] Liberalized retail prices would eliminate the potential re-emergence of the price gaps that have led to the subsidy in the past. At the same time, a more market-oriented system may also provide opportunities for broader reforms to promote sector efficiency.

11. Fiscal transfers to the state-owned refinery are very large and savings could be used for more efficient, poverty-focused programs. To put this in perspective, the estimated fiscal cost of fuel subsidies in 2019 (CFA 68 bn or 2.6 percent of non-oil GDP) amounted to almost four times the budget commitment for the social cash transfer program "Lisungi". Efforts to reform energy subsidies should be well-designed and take into consideration the impact on vulnerable households,

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[5] As of 2019, the application of the formula for retail prices would imply a reduction in gasoline prices by 13 percent and an increase in diesel prices by about 14 percent.

[6] See IMF 2015 for a summary of the distributional impact of fuel subsidies in Congolese households. The results are consistent with Alleyne (2013) which shows that subsidies in SSA countries have tended to provide some benefit to all segments of the population, though the benefit has been disproportionately larger for higher income households.

[7] In the SSA region, Mozambique, Togo and Zambia have a recurrent smoothing price mechanism that allow the Energy Regulatory Agency to pass-through prices within some pre-set margins.

including from interventions in the form of conditional cash transfers and subsidies for public transportation.

12. The fact that the explicit budgetary allocation to CORAF is much larger than the implicit fuel subsidy is problematic. The current approach of covering CORAF's inefficiencies through the economic adjustment factor or markup in the EDP should be gradually eliminated by making CORAF accountable for its performance and transform it into a more efficient company. The recent cap on budgetary transfers to CORAF for the 2019 budget imposed by Parliament is a step in the right direction, but a more comprehensive cost-cutting exercise needs to take place. This may take place following an audit of CORAF operations that is expected to take place over the coming months as the closure of the bidding process for the audit service was expected to be finalized at end November.

D. Conclusions

13. The downstream fuel sector in Congo faces some deep-rooted structural challenges that need to be tackled to make it more efficient and contain large fiscal subsidies. The analysis presented in this SIP suggests that there are four considerations that the government needs to bear in mind as they prepare their reform strategy.

14. The Pricing mechanism needs to become functional. The freeze of fuel prices since 2008 is problematic because it gives consumers the impression that fixed fuel prices are an entitlement. Best practice suggests that the new price system should be transparent, easily understood, and predictable for consumers and distributors alike. It should also include a smoothing component to prevent large swings in prices.

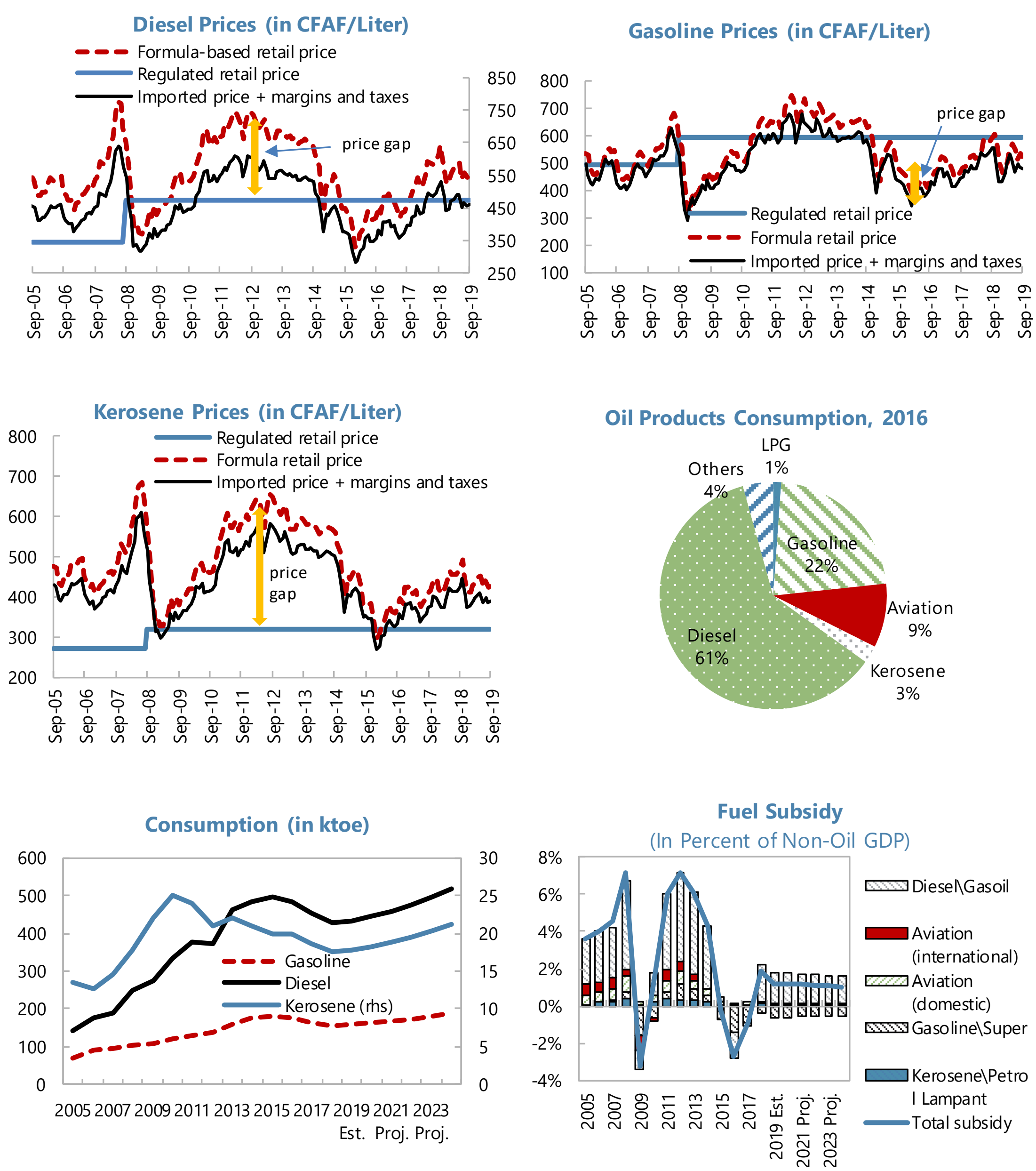
15. The government needs to develop a clear communication strategy. The strategy should explain how the regulatory framework works and include information on how the price mechanism operates so that consumers are able to understand future price fluctuations.

16. Mitigation measures to protect vulnerable groups should be a key element of any reform proposal, and should be in place before the automatic pricing mechanism is implemented. Consumers, especially the most vulnerable groups, should receive reassurances that the application of the formula will be accompanied by measures that mitigate the potential negative impact of price increases on their household income. The priority should be given to the expansion of a well-targeted social safety net for the most vulnerable groups. The development of the Lisungi cash transfer system offers a good option in this regard.

17. Reforming the CORAF refinery is key. The government needs to restructure the state-owned oil refinery CORAF to make fuel products competitive with the internationally imported petroleum products. This concern goes beyond the issue of applying the formula, given that he current formula allows CORAF to operate despite its inefficiency. Having a domestic refinery can be justified on strategic or economic grounds if it helps provide a more secure supply of energy and helps develop other positive externalities through various economic linkages with other sectors.

However, CORAF has been receiving excessively large subsidies that are much higher than the level that would be needed to contain fuel prices. This practice needs to stop, and the government should evaluate the trade-offs of having a refinery that should only be preserved if it can have a minimum level of operational efficiency, which does not seem to be the case at present.

Figure I. Fuel Prices, Consumption, and Subsidies: 2005–23



Sources: Congolese authorities; Organization for Economic Co-operation and Development; and IMF staff calculations.

Table 1. Republic of Congo: Petroleum Products Price Structure and its Components: October 2010

	Super Fuel	National Diesel	Kerosene	Jet (Aviation)	Fuel oil
Entry distribution price (regulated)	**446.02**	**329.52**	**184.30**	**204.68**	**202.84**
Storage fees and margins	13.00	13.00	13.00	13.00	13.00
VAT on Storage fees and margins	2.46	2.46	2.46	2.46	2.46
Transport costs	40.00	40.00	40.00	40.00	40.00
VAT on Transport costs	7.56	7.56	7.56	7.56	7.56
Transport losses	0.74	0.65	0.45	0.50	0.50
Distribution margin and fees	38.00	38.00	38.00	38.00	38.00
VAT on Distribution margin and fees	7.18	7.18	7.18	7.18	7.18
Financing expenses (security)	1.68	1.00	0.65	0.75	0.60
Financing of regulation authority	0.70	0.40	0.25	0.70	0.25
Retailer margin	12.00	10.00	10.00	10.00	10.00
VAT on Retailer margin	2.27	1.89	1.89	1.89	1.89
Terminal transport costs	11.00	11.00	11.00	11.00	13.50
VAT on Terminal transport costs	2.08	2.08	2.08	2.08	2.55
Insurance of environmental risks	0.21	0.21	0.14	0.16	0.14
Financing technical committee	0.10	0.05	0.04	0.04	0.03
Contribution to Stabilization	10.00	10.00	1.00	10.00	10.00
Memo Item: VAT (total)	21.55	21.17	21.17	21.17	21.64
Regulated price	**595**	**475**	**320**	**350**	**351**

Source: National authorities, Ministerial Order no. 9195 issued on October 19, 2018.

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IMPROVING GOVERNANCE AND COMBATTING CORRUPTION IN CONGO—SOME PROGRESS, BUT MORE TO BE DONE[1]

Congo has started to undertake a number of reforms aimed at improving governance and combating corruption. Reforms in these areas are critical to delivering sustained and inclusive growth, and to the authorities' diversification plans. As the key reforms to date have concentrated on architectural issues, continued efforts will be necessary to achieve their full and proper implementation. This will require ongoing commitment on the part of the authorities to ensure that progress is made, and that sustained and inclusive growth is realized.

1. **The Congolese authorities correctly recognize the importance of governance reform and addressing corruption.** Under their policy of "rupture", the authorities have taken initial steps to improve governance and address corruption vulnerabilities. They have committed, in the context of a diagnostic study of governance and corruption issues prepared in consultation with Fund staff (the "Governance Diagnostic"), to a bold reform agenda.

2. **Governance reforms are necessary to deliver sustained and inclusive growth and to support the authorities' diversification plans.** Given that Congo is currently assessed to perform poorly in relation to its peers on issues of governance, improvements in this area are critical. This aspect is recognized in the authorities' development plan, which identifies improving governance as a critical first step for diversification of the economy away from its dependence on oil revenues. Fund research has highlighted a positive correlation between improvements in governance and stronger and more inclusive economic growth, with particular benefits for countries starting from a weak base and high perceived corruption.[2] In the specific context of Congo, research estimates that depending on the reforms taken by the authorities, increased growth of between 0.8 and 1.8 percent per year over the next 10 years could be attained through governance improvements.[3]

3. **This SIP assesses several of the reforms taken to date, and highlights the need for continued efforts.** The SIP explores reforms taken in critical areas of transparency, oil sector governance, combatting corruption and public financial management. In all of these areas, steps have been either been taken by the authorities or are pending, but these reforms need to be coupled with further action in order to ensure that meaningful progress is realized, and that Congo can benefit from increased economic growth.

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[1] Prepared Jonathan Swanepoel (LEG) and Concha Verdugo Yepes (FAD).

[2] IMF (2019) *World Economic Outlook* Chapter 3.

[3] Selim, Verdugo and Melina (2019) *Macro-Fiscal Gains from Anti-Corruption Reforms in the Republic of Congo* IMF WP/19/21.

A. Reforms to Increase Transparency

4. Increasing transparency is a critical step in improving governance. A cross-cutting weakness identified in the Governance Diagnostic centers on a lack of transparency present across government functions and ranges from an absence of basic to data to issues relating to the accounting of aspects of the government's oil revenues.[4] Improved transparency is necessary to improve accountability, as well as to reduce Congo's vulnerabilities to corruption.

5. Steps have been taken to operationalize a law providing for broad access to information. A 2017 law, designed to give domestic effect to CEMAC community regulations on transparency of public finances, provides for broad public access to information in relation to the financial affairs of the state.[5] This law, though has not yet been implemented.[6] Steps are currently underway to establish the committee necessary to implement the law. Once formed, it will be critical for the committee to ensure that the law is correctly and fully implemented, and that the information required under the law to be made public finds its way into the public domain.

6. Going forward, increased transparency should be maintained. Steps taken in the context of Congo's ECF-supported program, such as the regular publication by the Ministry of Finance of basic economic statistics, should be embraced beyond the period of the Fund-supported program. Publication of court decisions, including in relation to cases involving corruption, will help to improve the rule of law and the maintenance of a government website including laws in force as well as secondary regulations should help to improve the business environment and reduce corruption vulnerabilities.

B. Reforms to Improve Governance of the Oil Sector

7. Congo's high dependence on oil revenues places a high premium on proper governance of the oil sector. The outsized part that oil plays in the Congolese economy, and the centrality of oil revenues to the state's budget mean that proper governance of the oil sector is critical. In particular, the role of the *Société Nationale des Pétroles du Congo* ("SNPC") as a state-owned enterprise is critical to ensuring that Congo's oil resources are managed in a prudent and transparent manner. Mismanagement of these resources has a direct impact on the economy, and opacity around the oil sector gives rise to corruption vulnerabilities.

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[4] For example, a key issue raised by EITI evaluations involves the lack of transparency around Congo's reporting of "in-kind" oil transactions, predominately around the use oil revenue in barter transactions, in particular to finance infrastructure. See https://eiti.org/scorecard-pdf?filter%5Bcountry%5D=52&filter%5Byear%5D=2017.

[5] Critically, this law also seeks to implement key aspects of the EITI code into domestic law.

[6] The law has not been implemented due to the fact that a separate law was needed to establish the committee responsible for the administration of the 2017 Transparency Law. That second law was finally adopted in February 2019, but a decree establishing the committee remains outstanding in order to operationalize the 2017 Transparency Law.

8. A new management structure at SNPC and increased transparency over its operations are welcome steps. In 2017, Parliament adopted new statutes for SNCP, placing SNPC under the supervision of the Ministry of Hydrocarbons, and requiring that SNPC's annual financial accounts be subject to external audit. Publication of SNPC's financial accounts is a welcome step, but these should in future include further information about the operations of its subsidiaries, including CORAF. The agreement between SNPC and the government, required under the 2017 statutes, setting out the operations performed by SNPC on behalf of the government should be made public.[7] The resumption of regular reports, prepared by external auditors, reconciling the state's share of oil revenues with the amounts paid into the budget should be maintained.

9. Congo should continue to take steps to improve EITI reporting, and to ensure the transparency of oil-related transactions. The EITI in 2018 assessed Congo's implementation of the 2016 EITI standard. In this regard, Congo was assessed to have made meaningful progress towards implementing the standard, but corrective actions were requested from the authorities. Full implementation of these actions, including in relation to reporting on SOEs, are important to ensuring proper management of oil resources. Similarly, while it is welcomed that in May 2019 the authorities reported to Parliament in relation to historic transactions involving the financing of infrastructure projects with oil revenues and the use of oil pre-purchase transactions to raise financing, it will be important going forward to ensure transparency over operations involving the government's oil revenues. These reports should also be made public in order to account more broadly for these transactions.

C. Reforms to Combat Corruption

10. The authorities are in the process of a comprehensive reworking of the formal anti-corruption architecture. Key reforms that the authorities have committed to under both the Governance Diagnostic and their ECF-supported program involve a strengthening of Congo's anti-corruption regime. In particular, an independent High Authority for combatting corruption with broad investigative powers was established by law in February 2019 and is in the process of becoming operational. The High Authority contains several important innovations when compared to the previous National Commission for combatting corruption, not least of all the scope of its powers and its independence.

11. The authorities have finally taken steps to institute a financial disclosure regime, but more work is needed. While both the 2002 and 2015 Congolese Constitutions have required that every citizen elected or appointed to high public function declare his or her assets,[8] until early 2019 no law existed to give effect to this provision, so has never been implemented. The passage of a new law in February 2019 requiring that such citizens declare their assets upon assuming their functions

[7] SNPC performs a number of roles on behalf of the government, most notably being responsible for the marketing of the state's share of in-kind oil revenue. Under this role, SNPC is responsible for selling these resources and transferring the proceeds to the budget.

[8] See Article 55 of the 2015 Constitution.

is thus a positive step.[9] Going forward, however, further work, will be necessary to bring Congo's asset declaration regime in line with international good practices. Key issues requiring further work include expanding the scope of assets to be declared, enabling public access to the core content of each declaration, routinely verifying the veracity of completeness of declarations submitted, and establishing proportional and dissuasive sanctions for non-or false declaration.

12. Amendments to Congo's anti-corruption law should bring this law in line with Congo's obligations under the UNCAC. Congo ratified the United Nations Convention against Corruption ("UNCAC") in 2006, but its implementation of the UNCAC's provisions under the implementation review mechanism has not yet been assessed. That being said, there is room to improve the criminalization of corruption under domestic law. To this end, the authorities are currently in the process of revising their anti-corruption law to give effect to what it is required under the UNCAC. Ensuring the fullest criminalization of corruption under domestic law will provide for a solid foundation for the authorities' anti-corruption efforts.

13. While these architectural reforms are necessary, they are insufficient without full implementation. Architectural reforms represent necessary preconditions to ensuring that the authorities have the necessary machinery in place to take action against corruption, but they are insufficient themselves to address corruption. Rather, the authorities will need to ensure that the High Authority is provided with adequate human and material resources, as well as the space to conduct its work, and that corruption-related offences are systemically investigated and prosecuted. The strengthening of the financial disclosure framework will provide a powerful accompaniment for these efforts.

D. Public Financial Management Reforms

14. The authorities should expedite plans to finalize a medium-term strategy for PFM reforms. The authorities have already taken some steps to improve PFM systems in the last two years, however, they have not finalized a comprehensive medium-term strategy for PFM reforms with a three-year rolling action plan. Key elements of this strategy should include PFM reforms for credible budgeting, better commitments and expenditures controls, proper liquidity management, and enforcement of noncompliance by line ministries to minimize the accumulation of arrears. To implement this strategy, the authorities should also create and operationalize an organizational structure of the Ministry of Finance and Budget that would facilitate the implementation of PFM reforms to improve the expenditure cycle, the accounting system, the cash management, the fiscal risks stemming from SOEs, the public investment management, and the transparency of oil revenues.

15. The authorities have taken action to improve domestic arrears management but more needs to be done. The Treasury continues to use opaque mechanisms to settle payments orders issued in previous budget years, but unbudgeted within the budget year in which the expenditures

[9] An implementing decree is required to address some of the modalities around the financial disclosure regime and is expected to be adopted shortly.

were made. This practice meant that the payment orders were never classified as domestic arrears and send to the debt management unit and audited prior to payment, as regular practice would require. This practice also means that the principles of budget annuity were not respected. In the case of Congo, arrears accumulation continues to be the result of weaknesses at various stages of the expenditure cycle, poor commitment controls, poor cash management, delays in processing payments, deliberate deferral of payments, and inadequate sanctions for noncompliance by line ministries with procedures and processes.

16. The authorities should also strengthen external controls by adopting a law on the organization and functions of the supreme audit institution of Congo (*Cour des Comptes et Discipline Budgétaire*, CCDB) as well as its implementing regulations. While the CCDB functions, albeit with significant backlogs, it lacks the necessary legal underpinnings. More specifically, it lacks an organic law and implementing regulations setting out its organization and functions. The authorities are in the process of preparing the draft legislation required to address this issue, and are encouraged to do expeditiously. More generally, the authorities should ensure that the CCDB is adequately staffed to perform its crucial functions. In this regard, the CCDB should also play a role in assessing the fiscal risks emerging from state-owned enterprises in Congo.

17. The government should finalize the audit of state-owned enterprises. The government is currently conducting a detailed analysis of its public enterprise portfolio, to assess better the strategic position and viability of 32 public companies, and to propose a privatization strategy for each enterprise. So far, 18 companies have been analyzed. Several public enterprises shown an absence of structural profitability, an unfavorable financial situation, and require their ongoing operations to be financed by public guarantees. In some public enterprises, the balance sheets obtained indicate that these enterprises hold assets and liabilities that are not in line with their purposes. The authorities are therefore urged to establish and maintain a database of guaranteed and unguaranteed debt, both domestic and internal, held by state-owned enterprises.

18. The authorities will further take measures to revamp the public investment framework. In this regard, they plan to implement the Public Expenditure Tracking Survey (PETS) to identify losses in the investment process. They should also develop a pipeline of projects ranked by priority based on adequate feasibility studies and cost-benefit analysis (with assistance from the African Development Bank), and end the practice of supplier-lender procurement by disassociating the negotiation and signing of loan agreements from the awarding of contracts to ensure a more competitive tendering process.