



CAMEROON

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Approved By
The African Department

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Infrastructure Road Map

The government launched an ambitious public investment plan to reach its long-term development goal. Private sector participation is sought through responsible public-private partnerships. Policy options are discussed to increase public investment spending and efficiency, while preserving fiscal sustainability.

Poverty, Inclusiveness, and the Budget

Poverty in Cameroon has decreased slightly since 2007, but this evolution masks stark divergences between regions. Moreover, growth incidence curves point to less inclusive growth patterns. An analysis of budget policy shows declines in allocations to social sectors and a potential crowding out of pro-poor expenditure.

Fiscal Regime of the Oil Sector

Assumed parameters for the upstream fiscal regime for the oil sector are stylistically modeled and the results show that the government's take encompasses a large share of project net cash flows compared to other sub-Saharan African oil producers. Nonetheless, the regime could be made more attractive to investors and capture a higher share of rents by enhancing its progressivity.

Public Wage Bill Determinants

Although the wage bill is not particularly high, its sectoral composition has changed significantly, and recent hiring is likely to add pressure to public expenditure. The growing size of the civil service could threaten a sustainable wage bill and effective service delivery.

Financial Sector Review

The banking system appears to be undercapitalized, but profitable and liquid. Financial access and depth have improved, but remain constrained by structural bottlenecks. The sector could gain from reforms that foster financial stability and development.

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INFRASTRUCTURE ROAD MAP

The government launched an ambitious public investment plan to reach its long-term development goal. Private sector participation is sought through responsible public-private partnerships. Policy options are discussed to increase public investment spending and efficiency, while preserving fiscal sustainability.¹

A. Introduction

1. As part of its growth and employment strategy paper (GESP), the government launched a ten-year development plan giving priority to infrastructure development.

Accordingly, the government has been implementing a massive public investment program, comprising a dozen large infrastructure projects, including roads, a deep-sea port, a bridge, and thermal and hydraulic power plants. Improving the quantity and quality of infrastructure is essential to progress toward the Millennium Development Goals (MDGs) and to achieve the growth necessary to reach Cameroon's development objective.

2. Against this backdrop, the authorities plan to promote private sector involvement in the provision of large infrastructure projects through public-private partnerships (PPPs).

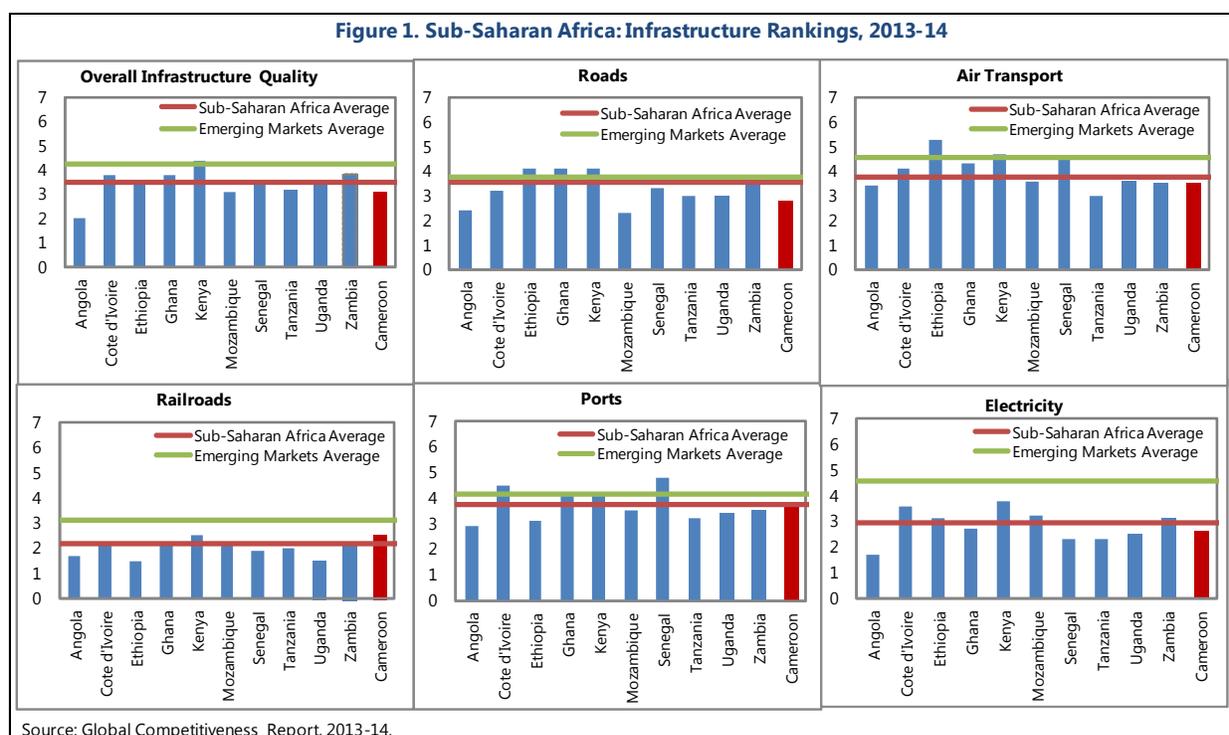
Starting in 1994, several PPPs were negotiated under a first-generation PPP legal framework, which was solely based on sectoral strategies. Since 2006, the authorities have established a comprehensive PPP framework and created the Council for the Realization of Partnership Contracts (CARPA), paving the way for second-generation PPPs. A number of small PPPs have been signed within the new framework in the social sectors (hospitals, schools, tourism centers). The authorities plan to increase private participation in large infrastructure projects significantly in transportation (deep-sea port, railways, tramways, roads), energy (wind farms, hydroelectric plants), urban development, and the agro-food industry.

3. This paper examines infrastructure needs in Cameroon and makes policy recommendations to address them. In doing this, it provides advice to strengthen the public investment management framework, including PPPs. In particular, the paper reviews the recent experience with public investment and PPPs and discusses policy options: (i) increasing spending on public investment through traditional public procurement, while preserving fiscal sustainability; (ii) increasing the efficiency of public investment institutional processes; and (iii) increasing reliance on private-sector participation in infrastructure (through PPPs), while properly addressing their associated fiscal risks.

¹ Prepared by Samah Mazraani.

B. Infrastructure Needs

Infrastructure indicators in Cameroon trail those of regional peers. Despite a slight improvement in the overall quality of infrastructure in 2013, infrastructure indicators remain low when compared to other sub-Saharan African (SSA) countries, especially for roads, air transport, and electricity (Figure 1). The World Economic Forum global competitiveness index (2013–14) ranked Cameroon 128th out of 148 countries for infrastructure quality. Inadequate supply of infrastructure was perceived among the top three problematic factors for doing business.



4. Closing the infrastructure gap is essential to achieve Cameroon's development

objective. Growth has averaged 3.6 percent since 2000, which remains well below the 5.5 percent average target rate in the GESP for 2010–20. Beyond the need to increase the “stock” of infrastructure, Dominguez-Torres and Foster (2011) estimate a potential gain of 3.3 percentage points in growth if Cameroon were to raise infrastructure “quality” to the level of middle-income peers.² Most of this potential growth could come from addressing infrastructure challenges in power supply by lowering production costs and increasing national access rates, and in transport services by improving road conditions and transport costs along the main transit corridors to neighboring countries.

² Calderon and Servén (2008) similarly estimate that low-income countries in SSA could increase their annual growth rates by 2 percent if they halved their infrastructure gap.

5. In practice, a country has four policy options to reduce its infrastructure gap. Each option has its advantages and disadvantages:

- *Increase the public investment rate via traditional procurement.* This option is appropriate when initial levels of public investment are low and the stock of public capital inadequate, and when fiscal space and appropriate financing conditions are available.
- *Improve the efficiency of public investment processes.* Reducing institutional inefficiencies³ increases the effectiveness of public spending and its impact on growth and ensures the execution and implementation of sound projects from an economic and social perspective. Moreover, strengthening public investment management, such as transparent and competitive public procurement processes, is important to attract private sector participation in infrastructure projects.
- *Increase reliance on PPPs (Box 1).* PPPs can offer efficiency gains from private sector management and innovation (higher quality service at a lower cost), while transferring some responsibilities and risks to the private sector. This option can be attractive when governments' borrowing constraints are tight, because financing is borne by private firms. However, in order for PPPs to offer better value for money (VfM) than traditional public procurement, efficiency gains need to offset PPPs' typically higher borrowing and transaction costs. Moreover, PPPs usually involve a very long-term contract with the private sector, reducing flexibility for governments in case public policy priorities change. Most importantly, in order for PPPs to be successful, governments need to put in place sound legal, institutional, budgeting, accounting, and reporting frameworks in order to limit rent-seeking and properly manage fiscal risks.
- *Increase reliance on privatizations.* Like PPPs, privatizations draw on the private sector's efficiency and financing. While privatizations fully transfer the risks to the private sector, a disadvantage is that governments cannot fully control the quality of services provided. This may not be an attractive option for some types of infrastructure (e.g., roads) or for services where social policies are considered desirable (e.g., education and health).

6. The next two sections examine the practical implications of these financing options for Cameroon. Section C focuses on options to increase the rate and efficiency of public investment (i.e., investment financed through traditional procurement), while Section D discusses PPPs.

³ "Institutional inefficiencies" refer to weak institutional public investment management frameworks throughout the paper.

Box 1. Public-Private Partnership versus Traditional Procurement?¹

A public-private partnership (PPP) is a long-term contract between a public institution and a private contractor to provide public services or infrastructure with a varying degree of risk transfer to the private sector. Specifically, the private contractor agrees to build, operate, maintain, and finance an asset at its own cost, while the government agrees to: (i) remain accountable for the service; and (ii) either pay directly for the service through availability payments (government-funded project) or allow the contractor to collect fees from users (user-funded project). In both cases, the government may provide additional support in the form of subsidies and guarantees. While the private contractor is typically the legal owner of all PPP-related assets and liabilities, the government may be considered the economic owner in cases where limited risks are transferred to the private partner.

An important difference between traditional procurement and PPPs is that under the latter, the government enters a contract with a single firm (special purpose vehicle). Construction, maintenance, operation, and financing can be undertaken by private firms both under traditional procurement and PPPs. What defines a PPP is that the government writes a contract with a single firm that agrees to provide the service (top figure).

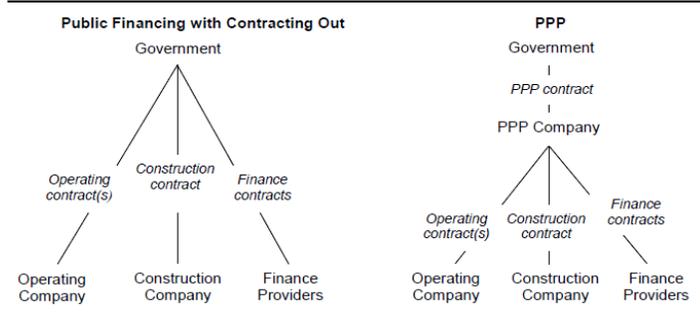
Cash flows differ between PPP and the traditional public financing, but are similar in present value terms. The lower figure illustrates stylized cash flows where possible efficiency gains and cost differentials are ignored. Under traditional procurement, the government fully pays for an investment in the year the investment takes place (year 0; grey bar). PPPs imply different cash flows:

- Under a government-funded PPP (left panel), the government pays for the expected full cost of the asset, but payments can be deferred over the horizon of the long-term contract (years 1-10; black bars).
- Under a user-funded PPP (right panel) in which user fees exactly cover the project's costs, the government does not make any cash payments (black flat line), but it gives up the opportunity to collect user fees, which would have been possible under traditional procurement (years 1-10; grey bars).

The difference in the timing of cash flows can create a bias in favor of PPPs, especially in countries with accounting and reporting systems on a cash basis.

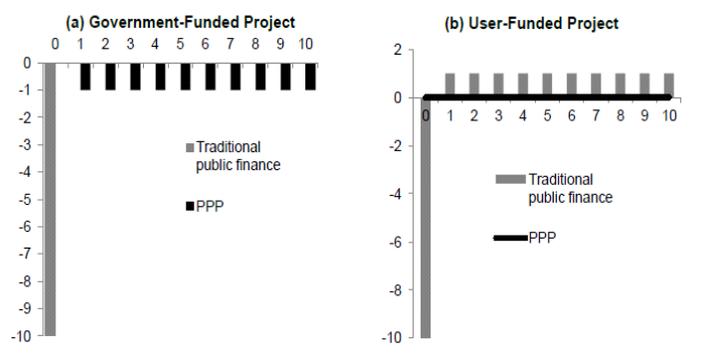
Even though the financing mechanism (PPP versus traditional procurement) does not reduce the net present value to the government by much, the difference in the timing of cash flows can create a strong bias in favor of PPPs. When governments with cash accounting systems want to reduce the budget deficit in the short term, PPPs may seem attractive, irrespective of whether they are affordable and more efficient than traditionally procured projects. The main fiscal aggregates on a cash basis (budget deficit and debt) are misleading in portraying the level of commitments and risk undertaken by the government.

PPP versus Traditional Procurement



Source: Funke, Irwin, and Rial (2012).

Government Cash Flows: PPP versus Traditional Procurement



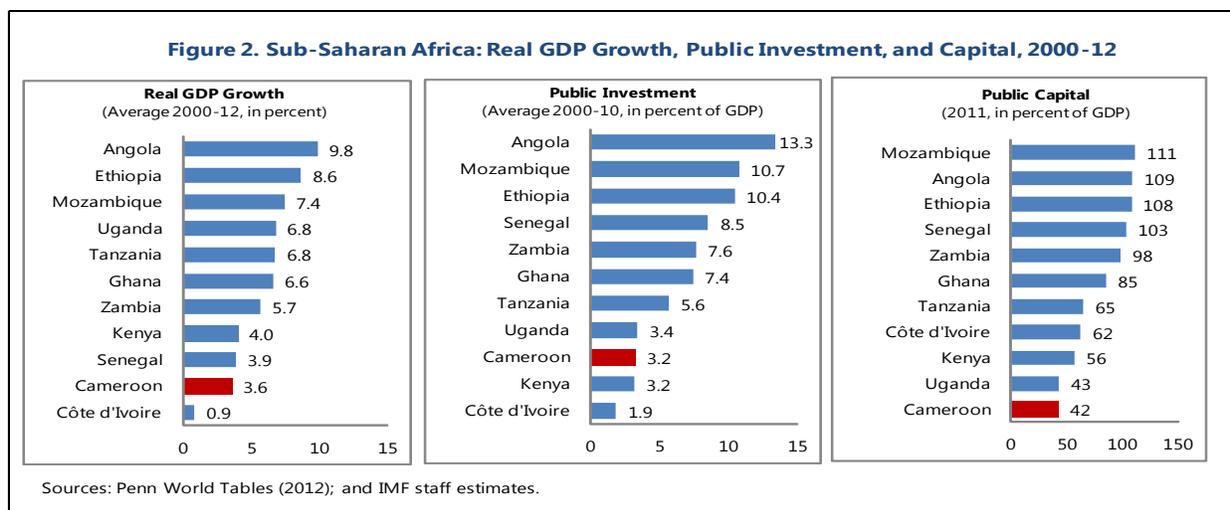
Source: Funke, Irwin, and Rial (2012).

¹ Adapted from Schwartz, et al. (2008) and Funke, et al. (2012)

C. Public Investment

7. A large body of theoretical and empirical work finds a positive relationship between public investment and growth. Physical and social infrastructure is widely considered to be a critical input for economic growth, productivity, and welfare. From a theoretical standpoint, this is based on the premise that public investment in infrastructure turns into a public capital stock, which not only is a direct input in the aggregate production function, but also boosts private capital productivity through crowding-in channels. Several empirical studies estimate a positive relationship between public capital and growth, although the estimated productivity of public capital varies widely across studies depending on the approach used.⁴

Cameroon's public investment has been low and insufficient to accelerate growth. The public investment-to-GDP ratio averaged 2 percent over the last 50 years and 3.6 percent since 2000, which is well below the investment level of peer countries in SSA (Figure 2). As a result, GDP growth has been sluggish compared to regional peers, and the public capital stock, estimated at about 42 percent of GDP, is considerably lower than the 109 percent average in SSA, and the 84 percent average in peers.



8. Moreover, less than half of cumulative public investment translated into productive capital because of institutional inefficiencies. The efficiency-adjusted public capital stock is estimated at about 17 percent of GDP at end-2011 in Cameroon, less than half of the unadjusted public capital stock (Box 2). As discussed in World Bank (2006), this reflects weaknesses in public investment management processes, particularly: (i) project planning and appraisal; (ii) project selection and budgeting; (iii) project procurement and implementation; and (iv) ex post project evaluation.

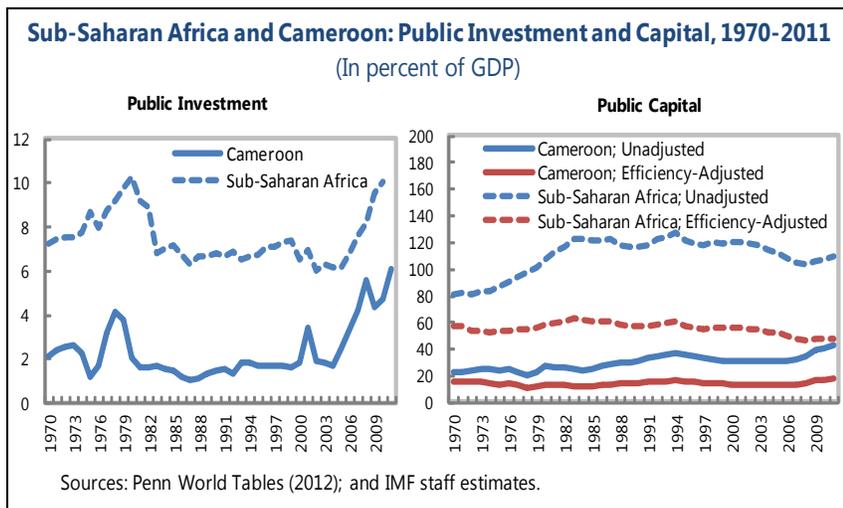
⁴ See for example, Aschauer (1989); Munnell (1990); Lynde and Richmond (1993); Romp and de Haan (2007); and Gupta, et al. (2014).

Box 2. Constructing the Public Capital Stock

The public capital stock is constructed following the perpetual inventory equation

$$K_t = (1 - \delta_t) K_{t-1} + \left(1 - \frac{\delta_t}{2}\right) I_{t-1},$$

where K_t is the stock of public capital at time t ; δ_t is a time-varying depreciation rate; and I_{t-1} is public investment spending at time $t-1$ assuming that new investment is operational in the middle of the period.¹ Data start in 1960; for the period prior to 1960, an artificial investment series is built assuming that investment grew by 4 percent a year to its observed level in 1960. The public capital stock is then constructed using the initial capital stock (starting at zero in 1860), public investment flows, and depreciation rates.



An “efficiency-adjusted” public capital stock series is constructed taking into account that public investment is unlikely to translate fully into productive capital assets under weak institutional frameworks. Gupta, et al. (2014) argue that in countries with weak public investment management processes, the traditional public capital stock series may not provide comparable and accurate information. For example, the cost of building infrastructure assets can be much higher in countries with weak project appraisal or competitive bidding processes, leading to inflated project cost. The “efficiency-adjusted” public capital stock series is constructed using a proxy for efficiency:²

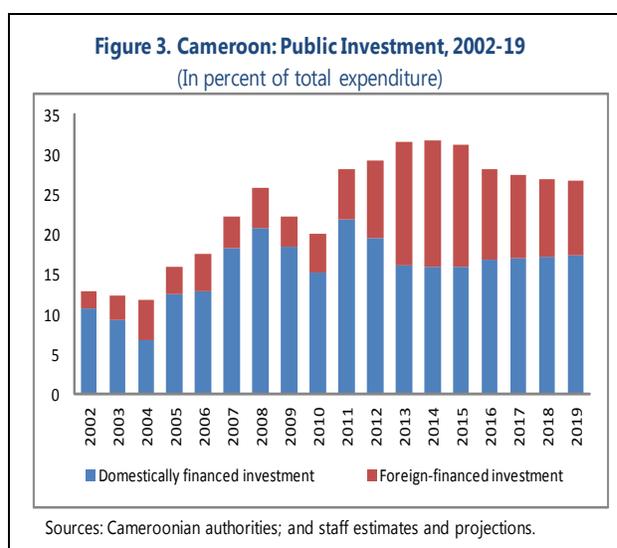
$$K_t = (1 - \delta_t) K_{t-1} + \left(1 - \frac{\delta_t}{2}\right) I_{t-1} * q,$$

where q is a time-invariant index (varying between 0 and 1) capturing the efficiency of public investment.

¹ The methodology is similar to that used in the literature; e.g., Gupta, et al. (2014) and Kamps (2006).

² Gupta, et al. (2014) use the Public Investment Management Index (PIMI) constructed in Dabla-Norris, et al. (2012) as a proxy. Owing to lack of PIMI data for Cameroon, the Global Competitiveness Report’s index for “quality of roads” is used as a proxy instead.

9. Cameroon recently almost doubled its public investment-to-GDP ratio and plans to stabilize infrastructure investment rates over the medium term. Public investment-to-GDP increased from about 4 percent in 2010 to 7.4 percent in 2013, financed in large part through external borrowing on nonconcessional terms. One of the GESP goals is to increase the share of public investment to total expenditure progressively from 20 percent to 30 percent. This objective was already reached in 2013 and the public investment share is now projected to stay not far below 30 percent over the medium term (Figure 3).



10. Priority areas where increased investment is planned until 2020 are (Table 1):

- Electricity.** The GESP objective is to bring the installed energy capacity from 1,000 MW in 2010 to 3,000 MW in 2020 by building two gas power stations and several hydroelectric dams. The privatization of the state-owned electricity company in 2001 helped improve national access to power, but access in rural areas remains poor, and power tariffs fail to cover production costs. Looking ahead, cost reductions could come from low-cost hydroelectric power, with a potential for Cameroon to export electricity to Chad, the Republic of Congo, Gabon, and Equatorial Guinea (Dominguez-Torres and Foster, 2011).

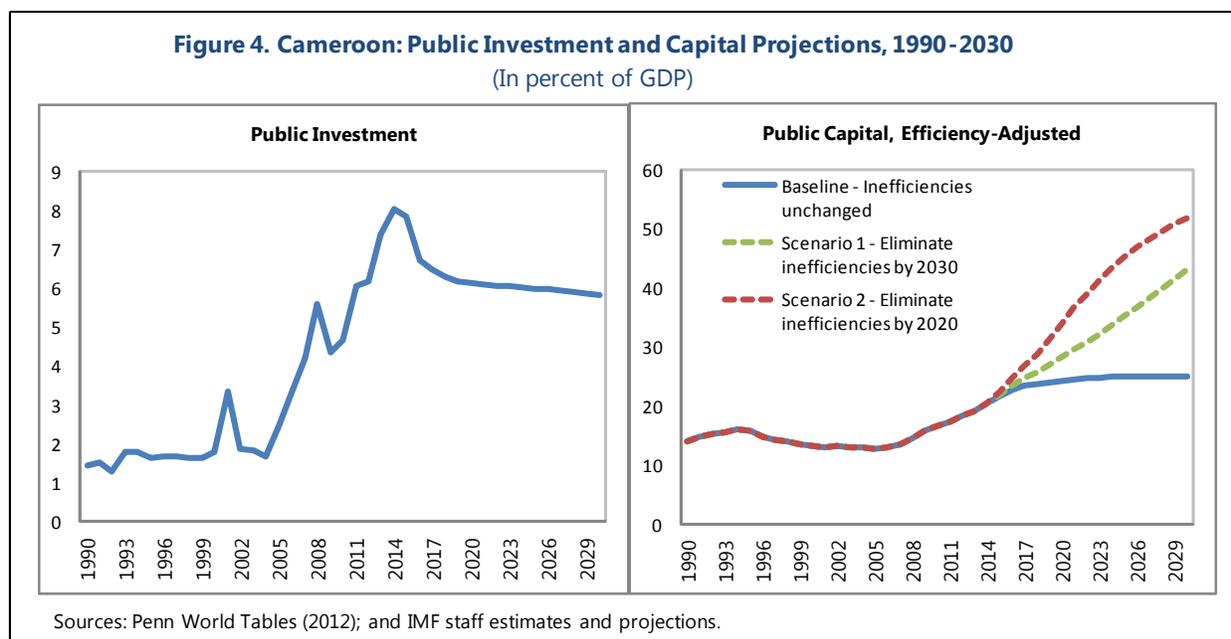
Table 1. Cameroon: Selected Large Infrastructure Projects Planned¹

Project	Cost (CFAF billions)	Expected completion	PPP signed or considered
Energy			
Kribi gas station		2013	
Yassa thermal station	169		
Lom Pangar dam	140	2018	
Memve'ele hydroelectric dam	145	2018	
Mekin hydroelectric dam		2016	
Menchum hydroelectric dam	87		✓
Vogzhoum hydroelectric dam			
Other dams (e.g., Nachtigal, Song Mbengue, Warak)			✓
Transport and Public Works			
Kribi deep-sea port	300	2014	✓
Limbe deep-sea port	100		✓
Second bridge over the Wouri river	110	2018	
Limbe oil yard			
Rehabilitation of 2,000 km of roads			
Construction of 3,500 km of roads			
Construction of 1,000 km of railways			✓
Tramways (Douala and Yaoundé)			✓

Sources: Growth and Employment Strategy Paper (GESP) 2010; and IMF staff projections.
¹ Missing values indicate the information is not available.

- Transport.** Cameroon provides transit corridors for landlocked countries in Central Africa, but transport costs to Chad and the Central African Republic (CAR) are among the highest in SSA because of poor road quality and port performance. The GESP objective for 2020 is to construct two new deep-sea ports. Cameroon attracted private-sector participation in the Douala port container terminal in 2004, but the port lags behind the average SSA time for handling containers and is quickly approaching maximum capacity (Dominguez-Torres and Foster, 2011). Looking ahead, the two new ports will help fill the demand for additional port facilities, as robust growth in the region continues. Plans to rehabilitate 2,000 km of existing roads and to build 3,500 km of new roads will help improve the current situation.

11. To illustrate the importance of addressing inefficiencies in public investment management, three scenarios are estimated (Figure 4): (i) a baseline scenario, corresponding to a medium-term public spending plan, under which public investment rates stabilize while inefficiencies in public investment management persist; (ii) a moderate scenario where inefficiencies are fully eliminated by the year 2030; and (iii) an ambitious scenario under which inefficiencies are fully eliminated by 2020. Under all three scenarios, public investment is maintained around 6 percent of GDP over the medium term, financed through a combination of external borrowing (30 percent) and domestic financing (70 percent).



12. The envisaged scaling up of investment spending cannot contribute to the desired growth objective, unless accompanied by reforms to strengthen the efficiency of public investment. Under the baseline scenario, the “efficiency-adjusted” capital stock rises from 17 percent of GDP in 2011 to about 25 percent in 2030, as the investment rates are not sufficiently high to offset rising depreciation rates at current inefficiency levels.⁵ The capital stock-to-GDP ratio could only rise substantially under one of the two alternative efficiency improvement scenarios (43 and 52 percent of GDP by 2030, respectively). Eliminating all inefficiencies by 2030 could boost the GDP growth average by an additional 0.6–0.9 percentage point, while eliminating all inefficiencies by 2020 could deliver a potential gain of 1.0–1.3 percentage points of GDP.⁶

⁵ Following Gupta et al. (2014), the depreciation rate is assumed to increase monotonically from 2.5 percent in 1960 to 4.5 percent in 2012. This assumption is based on the observation that, as countries become richer over time, the share of assets with shorter life span (such as information technology) tends to grow, therefore raising the depreciation rate.

⁶ These estimates assume a marginal productivity of public capital ranging between 0.5 and 0.7, which is the range estimated for a middle-income country in Gupta et al. (2014).

Policy Recommendations

13. There is a need to mobilize domestic resources or alter resource allocations to increase public investment spending. Public investment and capital in Cameroon are low, and a large infrastructure investment program is needed to raise potential growth. The planned increase in public investment is not sufficient to reach the desired development objective. Given limited fiscal space, high external borrowing rates, and the expected increase in debt levels over the medium term, Cameroon may want to consider reforms to mobilize domestic resources (such as non-oil revenue) or to reallocate spending from less productive purposes (such as fuel subsidies).

14. Cameroon's investment plan in infrastructure needs to be complemented by institutional reforms designed to increase the effectiveness of capital spending:

- *Project planning and selection.* There is considerable scope to strengthen project cost-benefit analysis. Line ministries submit their three-year project proposals to the Ministry of Economy (MoE), but with the exception of large infrastructure and public works projects with external funding, projects do not pass through a rigorous cycle of evaluation to ensure that only those with the highest economic and social returns are retained. The limited capacity both in line ministries and in the MoE results in sub-optimal choices of investments, slows down the pace of implementation of public investment, and leads to low execution rates.
- *Capital budgeting.* Achieving a higher quality of public investment requires strengthening budgetary processes. In Cameroon, as in many SSA countries, there is a dual budgeting system with the recurrent budget managed by the Ministry of Finance (MoF), and the investment budget managed by the MoE. This creates costly coordination problems and does not allow a coherent and strategic vision of the budget. There are considerable capacity improvements to be gained by shifting the investment budget to the MoF and integrating the recurrent and investment budgets in a medium-term expenditure framework, while focusing the role of MoE on project assessment and selection. Moreover, the inability of line ministries to shift spending from investment to recurrent expenditure is incompatible with the recent shift to budget programming. There is also a need to budget for externally funded investment in an exhaustive manner, and for the MoF to play a strong coordination role between donors and line ministries.
- *Project procurement and implementation.* Addressing infrastructure deficiencies will require considerable improvements in implementation capacity in order to increase execution rates. The establishment of a new Ministry of Public Procurement (MoPP) in 2012 initially slowed down the pace of contracting of investment projects. This has since then been largely addressed. Tightening of procurement procedures is needed to ensure open competition and greater disclosure of procurement information on awarded contracts.
- *Project evaluation.* A systematic monitoring and evaluation of project performance needs to be incorporated in the medium-term expenditure framework. The identification of performance indicators can help assess what went right and what went wrong, refine the project selection criteria, and ensure proper budgeting of maintenance needs for existing projects.

D. Public-Private Partnerships

15. Given fiscal constraints, PPPs could be an important vehicle to increase infrastructure investment and efficiency, but risks need to be properly addressed. Investment financed through PPPs contributes to the capital stock and to aggregate income. Additionally, when PPPs offer higher VfM than traditionally procured projects, they can contribute to even higher growth potential because of increased efficiency. However, international experience shows that PPPs also entail significant fiscal costs and risks, if not properly accounted for and managed. For this reason, PPPs should be introduced gradually to gain experience, while the institutional framework to properly manage associated risks is strengthened. Best international practices shows that risks can only be properly addressed by ensuring: good projects, good laws, good institutions, and good fiscal accounting and reporting standards.

16. There has been some experience with PPPs in Cameroon since 1994 in all sectors, but total PPP investments have remained low. Table 2 shows the PPP portfolio in 1994–2013.

Currently, there are about 14 PPP contracts totaling about US\$2 billion.⁷ The top four investments are in electricity generation and ports:

(i) a 20-year concession agreement (Build-Rehabilitate-Operate-Transfer) between the national electricity company (56 percent shareholding) and the government (44 percent) with a total investment of about US\$530 million; (ii) a 20-year Build-Operate-Transfer (BOT) scheme for the construction of a 216 MW natural gas power plant in Kribi with an investment of US\$342 million; (iii) a 20-year BOT scheme for the construction of an 88 MW diesel power plant in Dibamba for US\$126 million; and (iv) a 27-year BOT scheme for the construction of a platform at the Limbé port for about US\$214 million. Overall, Cameroon's experience PPPs has been positive, with all projects currently operational and no renegotiations so far.

Table 2. Cameroon: Public-Private Partnership Projects by Sector, 1994-2013

Sector	Subsector	Project	Type	Year
Energy	Electricity	AES Sonel	BROT-20	2001
		Dibamba Power Plant	BOT-20	2009
		Kribi Power Plant	BOT-20	2010
Telecom	Telecom	Orange (Cameroon)	Merchant-15	1999
Transport	Airports	Aéroports du Cameroun	BROT-15	1994
	Railroads	Cameroon Railways	BOT-30	1999
	Seaports	Douala Container Terminal	Management-15	2004
		Limbé Port Terminal	BOT-27	2013
Water and Sewage	Utility	Camerounaise des Eaux	Lease-10	2007
Education and Health	Education	University of Buéa	BOT-15	2012
	Health	Douala General Hospital	n.a.	2012-13
		CNPS Hospital Yaoundé	n.a.	2013
Other	Urban Community	2 Commercial Centers in Douala	BOT-10	2012
	Social Housing	5,000 Social Houses	n.a.	2013

Source: World Bank PPI database and Cameroonian authorities.

with

⁷ The PPP capital stock in Cameroon is estimated at only about 6 percent of GDP at end-2011 (Figure 5). The construction of the PPP capital stock follows the same methodology as that of the public capital stock (Box 2).

17. More recently, the government signed PPP contracts in several sectors. Seven small projects were signed in the areas of education, health, social housing, and tourism in 2012–13, totaling about US\$240 million. Other PPPs are currently under consideration for larger infrastructure projects, with the most important being the construction of the Kribi port terminals.

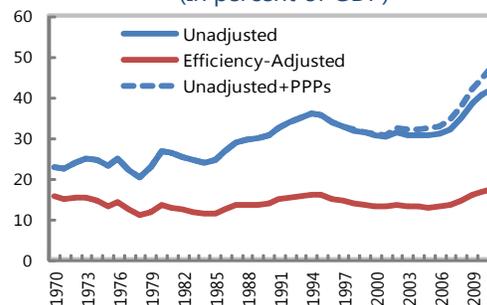
18. Cameroon established a legal and regulatory framework for PPPs in 2006. It comprises the 2006 PPP law (Law 2006/012) with its accompanying regulations.⁸ A 2008 decree

created the CARPA, which is an expert entity, supporting ministries, local governments, and public enterprises in assessing and negotiating PPP contracts, and monitoring projects. It was originally placed under the authority of the Prime Minister, but was moved to the MoE in 2012, where the Minister holds veto power over its recommendations.

Policy Recommendations

19. The PPP framework has room for improvement and risks are significant. PPPs are legally and technically complex schemes requiring strong government capacity and expertise to handle their associated fiscal risks. Given existing weaknesses in public investment processes in Cameroon—an important prerequisite for a solid PPP framework—entering such arrangements without capacity building to monitor them could lead to disproportionate costs and potential contingent liabilities for the government.

Figure 5. Cameroon: Public Capital and Public-Private Partnership Capital Stocks, 1970-2011
(In percent of GDP)



Sources: Penn World Tables (2012); World Bank PPI database; and IMF staff estimates.

⁸ These are: (i) Decree 2008/035 of 2008 which created the Support Council for the Realization of Partnership Contracts (CARPA); (ii) Decree 2008/0115/PM of 2008 specifying the regulatory decrees of Law 2006/012; (iii) Law 2008/009 of 2008 stating the accounting, financial, and tax systems applicable to PPP contracts; (iv) Order 186/CAB/PM of 2011 fixing the rates and conditions for the collection of fees payable for PPPs; and (v) Decree 2012/148 of 2012 to amend and supplement Decree 2008/035. The World Bank is assisting the Central Africa region, including Cameroon, in ensuring harmonization of laws and standardization of contracts in order to minimize transaction costs for the private sector. The application texts for the Law 2006/012 and Law 2008/009 are yet to be completed.

Project planning, selection, and execution

- As in the case of projects executed through traditional procurement, line ministries, local governments, and public enterprises conduct their own pre-feasibility studies of projects to be financed with PPPs. There is a need to strengthen the capacity and the economic and financial analysis used in the planning and selection process. This process involves two stages: first, project appraisal and cost-benefit analysis determine the viability of a project; and second, the use of a public sector comparator can help decide whether to pursue a project through traditional procurement or PPP depending on which option offers higher VfM. Although the CARPA offers advice in project selection methods when it comes to PPPs (including VfM), it is a relatively new institution with less than 20 employees and only 5 experts. Meanwhile, the direction in charge of planning at the MoE also advises on projects procured traditionally. In order to benefit from economies of scale in building capacity, there is a need to explore possible synergies and increase communication of information between the two units.

Legal framework

- The 2006 law has a generally good definition of PPPs, clearly noting that PPPs could be selected if analysis shows that they offer high VfM and are fiscally affordable. However, a weakness in the legal framework allows PPPs to be selected for “emergency” and “complexity” reasons, such as when there is an urgent socioeconomic necessity to accelerate growth in a given sector, or when public agencies do not have the capacity to analyze complex projects. These types of criteria do not ensure that PPPs are selected for efficiency reasons.
- The legal framework should clarify procurement procedures for PPPs to ensure maximum transparency. Although a MoPP exists, the PPP legal framework assigns launching of tender bids to public agencies, which initiate the project with assistance from CARPA, and then gives the authority for tender to the Prime Minister who forms an ad hoc committee to analyze bids. This approach is not transparent and does not promote competition. Furthermore, it is not clear how “unsolicited proposals” are handled in practice. International experience shows that the latter may lead to corruption and poor VfM, and therefore they should be subject to a competitive tendering process.
- The law establishing the tax system applicable to PPPs (Law 2008/009 of 2008) offers several tax benefits to the private sector. For example, the public partner takes charge of the value-added tax (VAT) on imports and local materials and custom taxes during the conception and realization phases of the project, while the private partner is offered a discount on corporate taxes during the operation phase for five years. Sections 7 and 8 of the law leave room for discretion on benefits from custom clearance procedures. This leads to an uneven playing field between projects procured traditionally and those with PPPs. At the minimum, this distinction should be taken into consideration in VfM and public sector comparator analyses.
- The legal framework should include provisions on the financial reporting and accounting treatment, including future costs and contingent liabilities. Ministries, local governments, and

public enterprises should be required to disclose all decisions, which may have an impact on the economic and fiscal outlook. The legal framework should stipulate that the MoF determines what financial data are needed from the private partner to assess fiscal risks arising from PPPs.

- The legal framework should strengthen the provisions for PPP contracts, such as mandatory clauses on how to renegotiate and terminate contracts, dispute resolution mechanisms, events triggering the need for renegotiation, and events triggering the use of escape clauses (external shocks, war, natural disasters).

Institutional framework

- Good international practices indicate the need to establish a system of “gateway” safeguards when managing PPPs. This gateway process empowers the MoF to stop a PPP project if it is deemed unaffordable, or does not offer VfM. Gateways giving oversight to the MoF need to be installed at several stages of the PPP process: planning, preparation, negotiation, and before signing the contract.⁹
- The gateway process in Cameroon is weak. The MoF’s assessment of fiscal affordability of PPP projects is limited to giving advice, following the submission of pre-feasibility studies by public agencies initiating projects, before the CARPA had the opportunity to ensure the VfM of the project. Although the CARPA board has a representative from the MoF, it also has representatives from the private sector, and the MoE has the power to veto its decisions. The gateway process needs to be strengthened by giving veto power to the Minister of Finance over projects at other crucial stages of the process to ensure budget affordability, such as at the procurement stage and before signing the contract. Although in the legislative framework, loan guarantees require the approval of the National Public Debt Committee (CNDP), created in 2008 and presided by the Minister of Finance, PPP contract signatures are not subject to approval by this Committee.
- PPPs should be subject to an ex post independent evaluation. To ensure that PPPs deliver the performance standards set out in the contracts, the oversight role of the Audit Bureau (“*Cour des Comptes*”) should be an integral part of the gateway process. At present, monitoring of PPP projects is done by public agencies, which initiate the project in collaboration with the CARPA. In this regard, there could be a potential conflict of interest in the CARPA, as it combines advisory and monitoring roles.

Budgeting, accounting, and reporting framework

- At present, signed PPP contracts are not integrated in the medium-term budget planning process. PPP proposals that have potential future spending (and balance sheet) implications should not be treated off-budget. Therefore, the assessment of medium-term sustainability of

⁹ See Table 3 for an example of a strong gateway process, similar to the one in South Africa.

projects may bias investment decisions in favor of PPPs compared to traditional public procurement, which involves higher up-front budgetary spending, but lower future commitments. Similar to the recommendation for traditional capital spending, integrating the recurrent, investment, and PPP budgets in the medium-term expenditure framework under the MoF, in collaboration with the CNDP, is necessary to ensure the coherence of the fiscal framework and fiscal sustainability.

- There is a need to ensure that PPPs are undertaken for efficiency reasons, and not solely because they push infrastructure spending off the government's balance sheet, especially when undertaken by local governments and public enterprises. Applying international standards in budgeting, accounting, and reporting would help limit this bias, but given how far off Cameroon is from applying them (since fiscal accounts are on a cash basis), the government may want to start by limiting risk exposure to PPPs by establishing ceilings on the size of PPP operations.¹⁰ The CNDP should also collect information, estimate potential fiscal risks of PPPs, and assess implications for debt-sustainability analysis (firm or contingent liabilities), and transparently disclose this information in budget documents and fiscal statements.

Table 3. An Example of a Good Gateway Process

		Line Ministries / Various committees	PPP Unit of MoF and other public bodies
Project Preparation Period	Phase 1: PLANNING	Prepare feasibility study and PSC (public sector comparator) analysis.	<ul style="list-style-type: none"> • PPP Unit: evaluate initial feasibility study and the PSC analysis, assess VFM and global affordability. • Budget Dpt: evaluate project affordability and ensure consistency with overall fiscal priorities. • PPP Unit: Report to Minister of Finance; advise to turn down project if insufficient VFM or unaffordable.
		GATEWAY 1: Minister of Finance recommends to PPP committee approval/rejection of initial project	
	Phase 2: DESIGN AND PREPARATION OF TENDER	Prepare tender documents.	<ul style="list-style-type: none"> • PPP Unit: Review tender documents for consistency with original project specifications in Phase 1. • PPP Unit: Report to Minister of Finance (MoF).
		GATEWAY 2: Minister of Finance approves/rejects issuance of tender documents	
	Phase 3: BIDDING AND NEGOTIATION	Receive tender bids and select bidder(s).	<ul style="list-style-type: none"> • PPP Unit: Ascertain VFM of the preferred bid. • Budget Dpt: Ascertain fiscal implications of the preferred bid and ensure consistency with fiscal strategy. • PPP Unit: Report to MoF; advise to reject the preferred bid if insufficient VFM or unaffordable.
		GATEWAY 3: Minister of Finance recommends to PPP committee approval/rejection of preferred bid	
Negotiate PPP contract.		<ul style="list-style-type: none"> • PPP unit: Review VFM and the technical committee draft PPP contract. • Budget Dpt: Ascertain implications of PPP contract and ensure consistency with fiscal strategy. • PPP Unit: Report to MoF; advise to reject draft contract if found to offer insufficient VFM or unaffordable. 	
GATEWAY 4: Minister of Finance recommends approval/rejection of contract to Council of Ministers			
PPP contract signed			
Project Implementation Period	Phase 4: CONSTRUCTION AND OPERATION	Supervise and monitor contract regularly.	<ul style="list-style-type: none"> • PPP Unit, Budget Dpt and Audit Bureau follow project implementation based on regular implementation reports by line ministries.
		If needed, renegotiate terms of the initial contract.	<ul style="list-style-type: none"> • PPP Unit: Review VFM of renegotiated draft contract. • Budget Dpt: Check implications of renegotiated contract and ensure consistency with fiscal priorities. • Both: Report to MoF; advise to reject renegotiated contract if insufficient VFM or unaffordable.
GATEWAY 5: Minister of Finance recommends approval/rejection of renegotiated contract to Council of Ministers			

Source: IMF staff.

¹⁰ For example, a ceiling on annual PPP-related payments, complemented with a ceiling on the net present value of all PPP-related commitments (known and contingent) over the lifecycle of the project, would provide a clear budget constraint.

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POVERTY, INCLUSIVENESS, AND THE BUDGET

Poverty in Cameroon has decreased slightly since 2007, but this evolution masks stark divergences between regions, with rural areas in the north showing increases in poverty. Moreover, growth incidence curves point to less inclusive growth patterns. An analysis of budget policy corroborates these findings: it shows declines in allocations to social sectors, an unproductive expenditure mix in education, and a potential crowding out of pro-poor expenditure. The analysis identifies important issues in budgeting and financial management that need to be addressed to make public expenditure more efficient and effective.¹

A. Introduction

1. Developments in poverty and inequality are difficult to track in Cameroon. Cameroon has not had a household survey since 2007.² This paper proposes to fill this gap by imputing poverty figures from a proxy survey carried out in 2011, based on established methodology (Box 1).³ The paper further reviews the evolution of expenditure policy since the last household survey to identify areas where policy adjustments could enhance poverty alleviation and reduce inequality.

Box 1. Cameroon: Poverty Data Imputation

In the absence of household survey data since 2007, poverty incidence data have been imputed from other sources. National household surveys require significant financial and human resources, and many developing countries lack them to maintain the required frequency. In response, poverty analysts have devised a number of alternative poverty estimation techniques. This paper uses three household surveys collected by the *Institut National de Statistiques du Cameroun*, two of which include consumption information and can be used to calculate poverty measures, and a third one (a demographic and health survey, DHS), which requires survey-to-survey imputation to estimate poverty. The details of the imputation methodology can be found in a forthcoming working paper of the World Bank, drawing from literature on poverty measurement imputation (Brick and Kalton, 1996); small area estimation (Rao, 2003); and poverty mapping (Elbers et al., 2002). Similar work can be found in Stidel and Christiaensen (2007), Tarozzi (2007), Grosse et al. (2009), and Doudich et al. (2013). Although there are limitations to the imputed data for 2011, the broad findings are robust.

¹ Prepared by Kristen Himelein (World Bank) and Jean van Houtte.

² A new household survey is expected to be launched in late 2014.

³ The poverty threshold is the adult-equivalent, per person income of CFAF 738, which corresponds to the 2007 price of a basic basket of goods.

B. Poverty Incidence and Developments

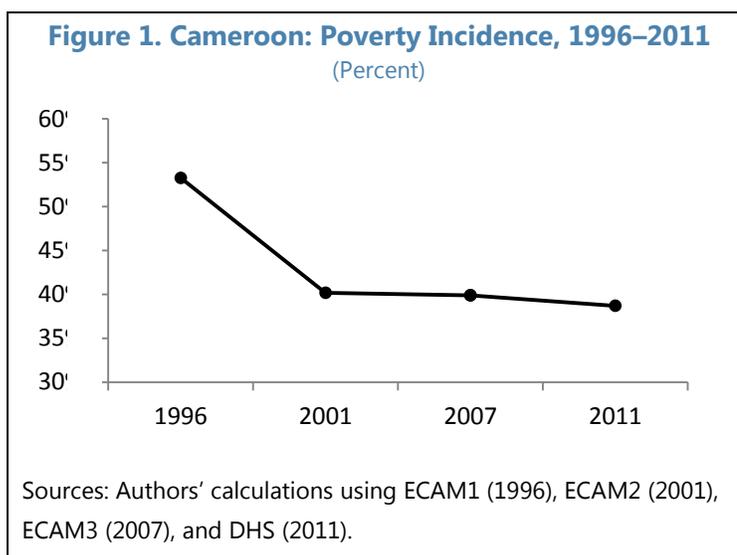
2. Despite a decade of economic growth, poverty rates have remained almost unchanged.

After a large decline between 1996 and 2001, poverty incidence remained broadly constant (Figure 1).

Although poverty decreased from 39.9 percent in 2007 to 38.7 percent in 2011, the rate of decline did not keep up with demographic growth and the number of poor thus increased.

There were net increases in the poor population in both urban and rural areas.⁴ Poverty declined in urban areas from 12.2 percent in 2007 to an

estimated 10.8 percent in 2011. During this period, however, the urban population increased from approximately 8.4 million to 10.0 million mainly because of internal migration, resulting in a small increase in the urban poor population. In rural areas, the percentage of the poor population increased from 55.0 percent in 2007 to 59.2 percent in 2011, which translated into more than one million additional rural poor.



3. The evolution of poverty was consistent with patterns of economic growth. Per capita

growth in non-oil GDP was 1.2 percent on average between 2007 and 2011, which was not sufficient to reduce poverty significantly (Table 1). Moreover, while growth in the primary sector was the most dynamic, it also was the most volatile. The variability of agricultural production was an important obstacle to rural poverty alleviation.

Table 1. Cameroon: Selected Real Sector Indicators, 2007-11
(Year/year percentage change)

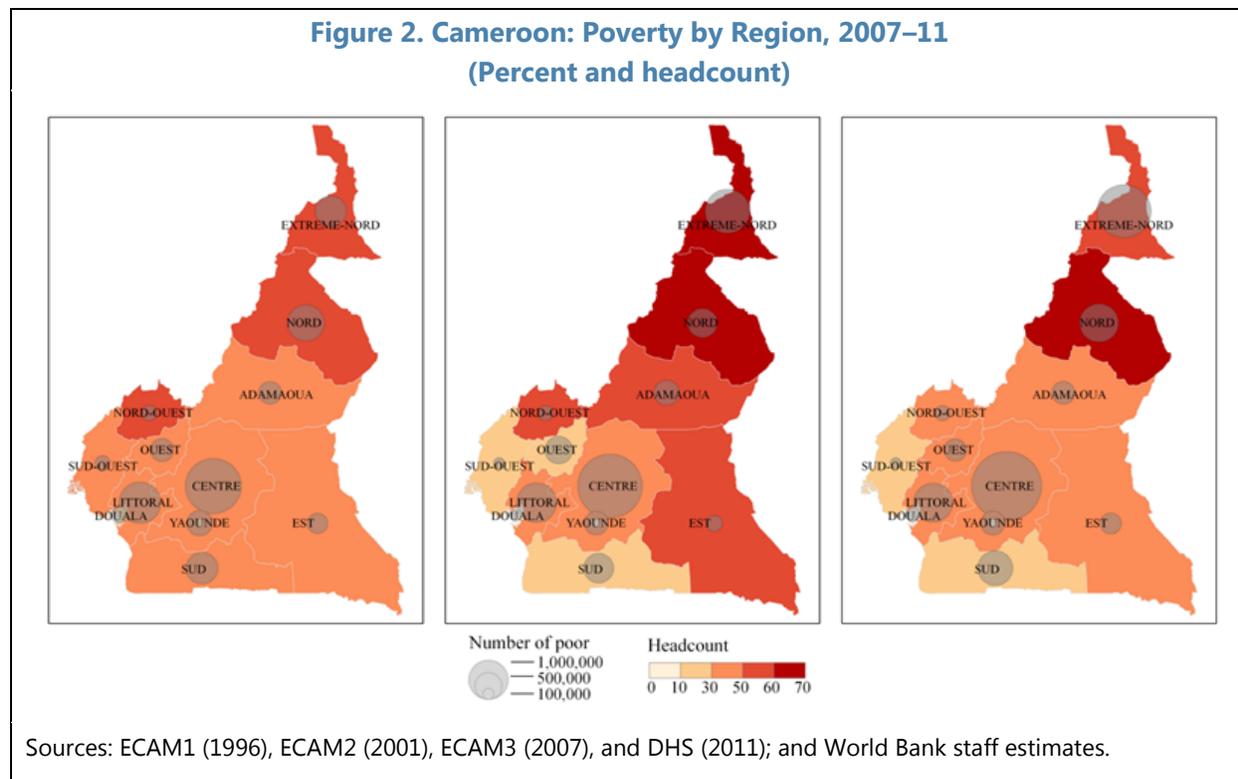
	2007	2008	2009	2010	2011	Ave. 2007-11
Non-oil GDP growth	3.6	4.0	2.8	4.1	4.6	3.8
Primary sector	4.1	9.1	2.6	6.5	3.1	5.1
Secondary sector (non-oil)	0.7	2.1	0.6	3.6	3.3	2.1
Tertiary sector	4.7	1.7	3.5	3.9	5.6	3.9
<i>Memorandum items:</i>						
Population growth	2.7	2.6	2.6	2.5	2.5	2.6
Non-oil GDP growth per capita	0.9	1.4	0.2	1.6	2.1	1.2

Sources: Cameroonian authorities; and IMF and World Bank staff estimates.

⁴ The DHS and the household surveys have different definitions of "urban" and "rural." The sampling frame used in Cameroon divides districts into three types: urban (population more than 50,000 people), semi-urban (population between 10,000 and 50,000), and rural (population below 10,000). The DHS considers urban and semi-urban areas as urban, while the household surveys keep the three categories separate. For comparability, this paper uses the DHS definition, as it is not possible to recover the lower disaggregation of data. This definition yields an urbanized population of 43.0 percent in 2001, 44.0 percent in 2007, and 47.5 percent in 2011. In addition, this paper occasionally separates the urban population into those living in the main cities of Yaoundé and Douala, and those living in other urban areas.

4. Poverty levels varied from region to region in 2001–11. Poverty in the *South-West Region* continuously declined, while it continuously rose in the *North Region*. Poverty rates in 2011 remained the highest in the *North Region*, followed by the *Extreme North Region*. The *North Region*, saw a small decline in the poverty rate in 2007–11, which nonetheless remained elevated at 62 percent. The *Extreme North Region* experienced a 10 percent decline in poverty, but more than half of its population was poor in 2011. The largest declines in poverty occurred in the *East Region*, which experienced a 24 percent decline in poverty (to a poverty level of 38.2 percent); and in the *Adamaoua Region*, where poverty declined by 37 percent (to a poverty level of 33.5 percent). Other regions, with more modest declines in poverty, included the *North-West* and *South West Regions*. There was a substantial increase in poverty in the *West Region* to 35.4 percent, but this was one of the regions that had shown the largest decline in 2001–07. The capital, Yaoundé, showed an increase in poverty from 5.9 percent to 7.3 percent, while poverty in the largest city, Douala, remained unchanged at about 5 percent.

5. Despite a small decrease in poverty as a percentage of the total population, the number of poor living in Cameroon increased in 2007–11. High fertility levels, particularly among poor households, as well as internal migration, meant that certain regions had increases in the population living in poverty even if the percentage of poor declined. For example, despite a percentage decrease of the poor population, there were almost 350,000 and 140,000 net additional individuals living in poverty in the *North* and *Extreme North Regions* in 2011 compared to 2007, respectively (Figure 2).



6. Real per capita consumption growth was close to zero in 2001–07, consistent with the limited progress in poverty alleviation. The annualized real per capita growth rate was essentially flat, at 0.6 percent. However, a more detailed analysis shows a slightly pro-poor development in rural areas and the two major cities. The bottom 10 percent of the country’s population experienced growth rates above the mean, and the top five percent had growth rates slightly below the mean (Box 2; Figure 3). The higher growth rate for the lowest percentiles was driven by growth among the poorest in rural areas. In contrast, the relative decline in growth at the top percentile was driven by lower growth rates in Yaoundé and Douala. The mean growth rates were close to zero in the major cities, other urban areas, and rural areas: 0.3 percent, 0.1 percent, and 0.1 percent, respectively. The median growth rate in Yaoundé and Douala, however, was higher at 3.0 percent.

Box 2. Cameroon: Understanding Growth Incidence Curves

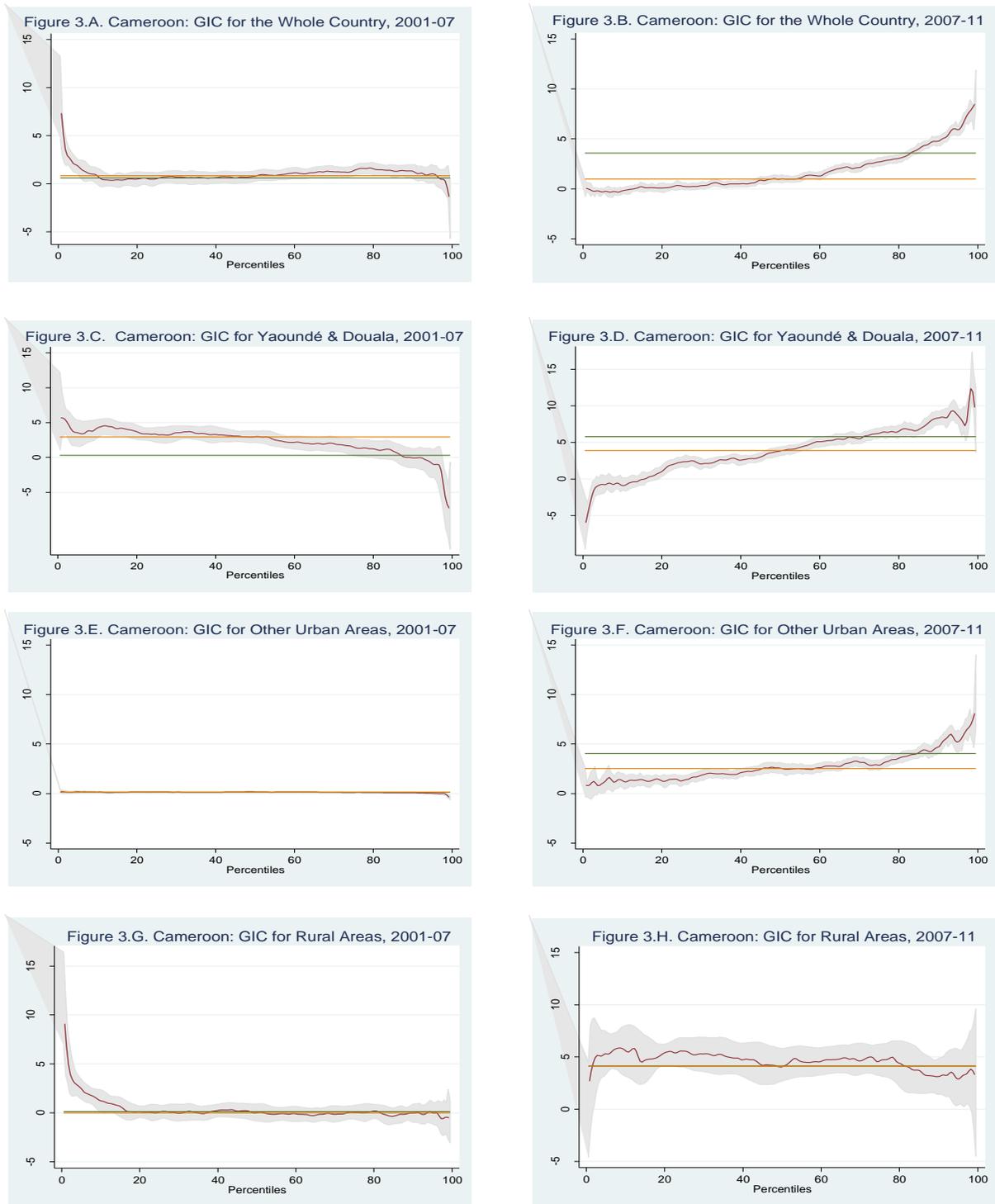
Graphs showing growth incidence curves (GIC) contain three lines. The first, the growth incidence curve itself and its accompanying confidence interval, shows the mean growth rate of real income in a population for different income percentiles. The percentiles are linked to the population at the time of the survey, meaning, for example, that they compare those in the first percentile of the distribution in 2001 to those in the first percentile of the distribution in 2007, rather than tracking the growth of the first percentile in 2001 to their new status in 2007. In addition, there are mean (or “average”) and median growth rates lines. The mean growth rate is defined as the average growth rate across all percentiles of the distribution, while the median growth rate is the growth rate for those households at the 50th percentile. These two statistics have different analytical uses. The mean growth rate is more often used to compare performance between two areas, for example, to say that the average growth rate was higher in urban areas compared to rural areas. The mean growth rate, however, is sensitive to outliers at the tails of the distribution. For example, if the bottom 90 percentiles have a negative growth rate, but the top ten percentile has an extremely high positive growth rate, the mean growth rate may still be positive even though nearly everyone is worse off. The median growth rate represents the growth rate for the percentile in the center of the distribution. In the hypothetical case above, the 50th percentile would be part of the lower 90 percent, which would illustrate the trend of growth with inequality.

7. Growth in 2007–11 was more regressive than in the previous period, with the bulk of the growth dividends accruing to the wealthiest people. The national median growth rate was just below one percent, but the mean rate was at 3.5 percent, indicating higher growth rates for the upper percentiles. Below the 40th percentile, the growth rate was at or just above zero, which indicates that the well-being of the poor hardly changed. The regressive nature of the growth was also evident in the disaggregated analysis. In Yaoundé and Douala, while the bottom quintile had negative overall growth, the top quintile had 5 to 12 percent growth. In other urban areas, the mean and median growth rates, at 4.0 and 2.5 percent respectively, were lower than in the major cities, but growth was positive across the distribution of the population. In rural areas, the median growth rate was -0.25 percent, with net positive growth only for the top quintile. As a result, inequality likely increased substantially in 2007–11, because the national growth rate increased faster for higher percentiles of the distribution.⁵

⁵ The imputation methodology employed here attenuates the extremes of the distribution and therefore it is not possible to calculate the GINI coefficient or other standard measures of inequality.

Figure 3. Cameroon: Growth Incidence Curves, 2001–11

(Percent)

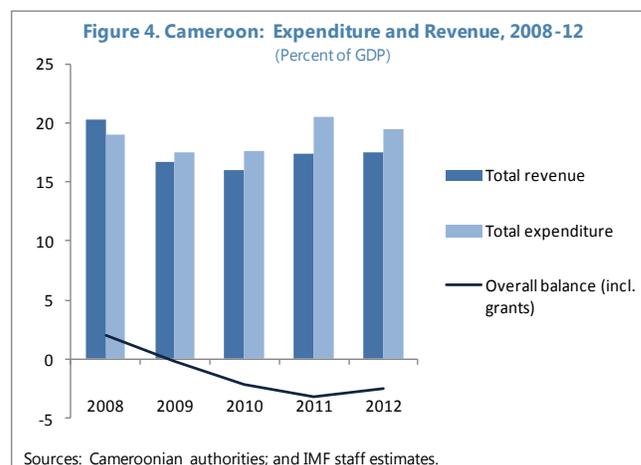


— Median growth rate — GIC — Meangrowth rate

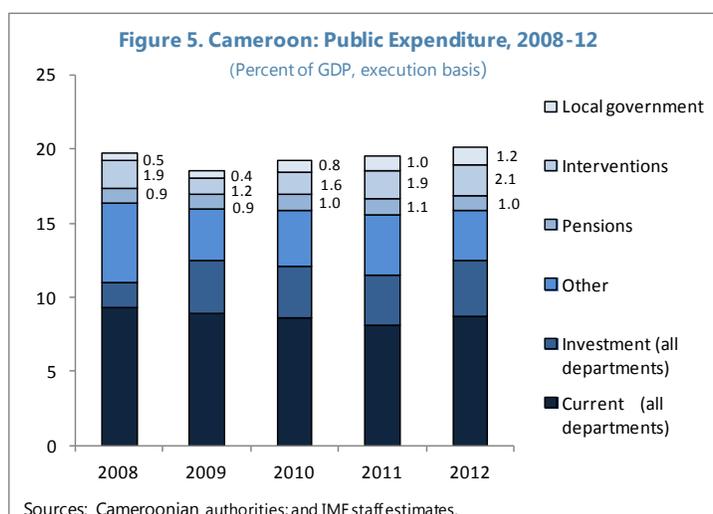
Sources: Cameroonian authorities; and World Bank staff estimates.

C. Budget Policies and Inclusiveness

8. Cameroon's expansionary fiscal stance in 2009–11 did not reduce poverty. The fiscal balance turned negative in 2009, and widened to 3.2 percent of GDP in 2011 (Figure 4). This was the result of falling oil revenue and an expansion in expenditure. The expansionary fiscal stance achieved only a marginal reduction in the percentage of the poor, but did not reduce the headcount of the poor and did not achieve a more equitable wealth distribution, partly because of the composition of public expenditure. Public expenditure is examined below for its strategic consistency with poverty reduction and its sustainability for social spending.



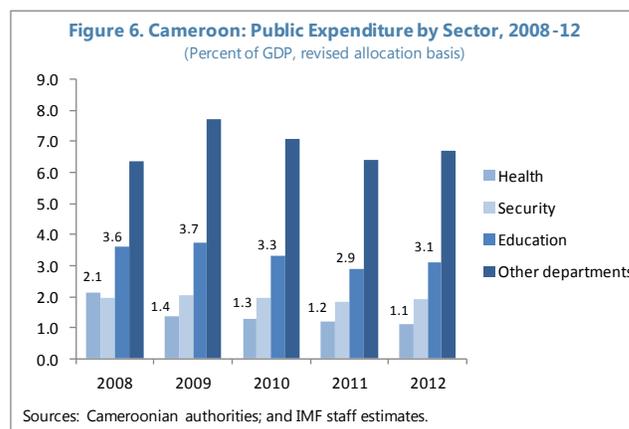
9. The government's poverty reduction strategy⁶ emphasizes infrastructure and human capital development to broaden the participation of the work force in the economy. Budget execution figures for 2008-12 indicate that the decision to develop infrastructure led to an increase in the domestic investment budget (by 2 percentage points of GDP), consistent with the high upfront cost of infrastructure (Figure 5). Current expenditure remained broadly constant at slightly less than 9 percent of GDP.⁷



⁶ *Document Stratégique pour la Croissance et l'Emploi* (Strategic Document for Growth and Employment), 2009.

⁷ Figures may differ from those quoted in the companion staff report owing to limited coverage of externally financed investment in the available data, and a different definition for "current" expenditure.

10. The policy intent to strengthen human capital did not lead to higher public spending in the social sectors. Allocations for education declined somewhat, with some volatility in 2008–12 (Figure 6). Although 7,435 teachers were hired in primary education and 3,896 classrooms were built, spending for education fell from 3.6 percent of GDP in 2008 to 3.1 percent in 2012. Allocations for health suffered a more pronounced decline. Other departmental allocations, excluding security, increased from 6.4 percent of GDP in 2008 to 6.7 percent of GDP in 2012. Additional spending outside ministerial departments (e.g., decentralization, pensions, and transfers to public enterprises, including on fuel subsidies) also increased by more than 1 percentage point of GDP.

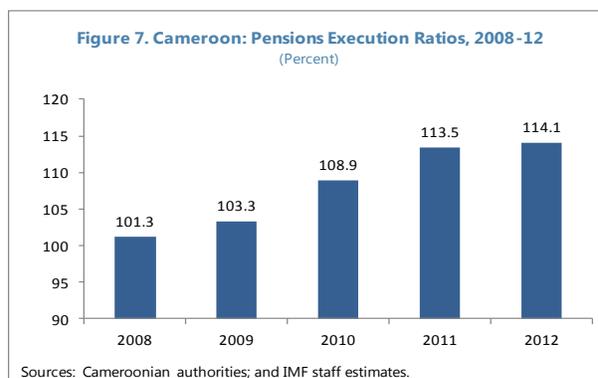


11. Budget allocations are misleading. Spending on fuel subsidies in the budget is understated by around 2 percentage points of GDP at current international oil price levels, because of cross cancellations of subsidies against taxes. Eliminating fuel subsidies could allow social sector funding on par with 2008 levels. Additionally, as the benefits of fuel subsidies largely accrue to vehicle owners, redistribution of this funding could lead to more pro-poor growth outcomes, the more so that the rural poor does not benefit much from this subsidy.

12. Spending on the social sectors was lower than in peer countries by a significant margin. According to the World Development Indicators, Ghana, Senegal, and Tanzania consistently spend more than 5 percent of GDP on education. The same countries allocate a minimum of 2.8 percent of GDP to spending on health, more than twice the amount of Cameroon. One of the leading health policy effectiveness indicators correlates closely with this imbalance: the maternal mortality ratio for Cameroon was 690 for 100,000 births in 2010, whereas it was 350 for Ghana, 360 for Senegal, and 460 for Tanzania.

Social sector spending sustainability could be jeopardized by future pension liabilities.

Pensions are a significant threat to social spending sustainability and could lead to a crowding out of pro-poor expenditure over time. They reflect commitments under a pay-as-you-go (i.e., not capitalized) pension system that has not yet reached demographic maturity. The public wage bill is also set to expand in future years (see Chapter IV). Signs of strain are already showing: every year, budget allocations for the payment of pensions are significantly over-run by an increasingly wide margin (Figure 7).



D. Recommendations

13. An adequate provision of basic social services (e.g., basic education, primary and secondary healthcare) matters for development. While specific technical recommendations in these sectors lie beyond the scope of this report, certain budgetary figures point to imbalances that need to be corrected. A debate about these issues should not be delayed, because meaningful adjustments to the budget are underpinned by policy decisions, the impact of which will take time to materialize. Based on the previous findings, the following recommendations can be made.

- Rebalance expenditure allocations within education, through an increase in non-wage expenditure.
- Given limited resources, strengthen public financial management systems to ensure effective service delivery, especially in rural areas that are more affected by poverty and appear as less attractive for postings.
- Increase allocations to the health sector, with a focus on primary health care, especially in the rural areas.
- Undertake an actuarial study of the pensions system of the civil service; derive recommendations to make pension payments predictable and sustainable.

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FISCAL REGIME OF THE OIL SECTOR

Assumed parameters for the upstream fiscal regime for the oil sector are stylistically modeled and the results show that the government's take encompasses a large share of project net cash flows compared to other sub-Saharan African oil producers. Nonetheless, the regime could be made more attractive to investors and capture a higher share of rents by enhancing its progressivity.¹

A. Introduction and Methodology

1. The purpose of this note is to provide a preliminary account of the upstream oil sector fiscal regime in Cameroon and draw lessons from international good practices in extractive industries. This is done through (i) analyzing the regulatory regime of the oil industry including the oil law, income tax law, model production sharing agreement (PSA), and other relevant regulations; and (ii) providing potential policy reforms to enhance transparency in the oil sector and help the authorities adopt relevant international good practices. The note does not cover Concession Agreements or actual PSAs in Cameroon.

2. The analysis is focused on the upstream section of the oil industry, which generates the highest level of revenues for the government and investors. The upstream section includes exploration, operating oil wells, and extracting oil from the ground. The midstream section deals with transportation and storage. The downstream section covers processing, marketing, and wholesale of the final oil products.

3. The authorities have requested International Monetary Fund's (IMF) Fiscal Affairs Department (FAD) technical assistance in support of their review of extractive industries' fiscal regime in Cameroon. That technical assistance will take up many of the issues raised in this SIP and, in the light of new data and analysis (especially those specific to Cameroon), may revise the approaches and issues for consideration raised here.

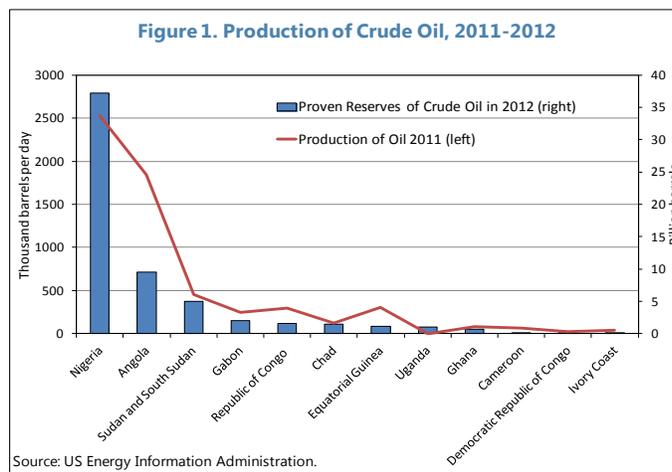
4. Modeling of the oil sector's fiscal regime is based on FAD's Fiscal Analysis of Resource Industries (FARI) model. The model allows a comparative analysis of fiscal regime design and effectiveness. The model requires information on country resources, including oil fields, and concession agreements and production sharing contracts (PSCs) over the lifetime of concerned oil fields. Most of this information is not publicly available in Cameroon and has not been made available for this note. In the absence of access to Cameroon's PSCs and detailed oil data, assumed fiscal terms and a stylized oil project template, based on actual projects in other sub-Saharan African (SSA) countries, are used. The rest of the inputs for the model were either collected from publicly available information on Cameroon's fiscal regime or based on IMF staff assumptions. Accordingly,

¹ Prepared by Jean-Philippe Stijns (formerly IMF) and Ejona Fuli.

the findings and characterizations in this note should be interpreted with more than usual caution and do not pre-empt the findings of any detailed technical assistance review.

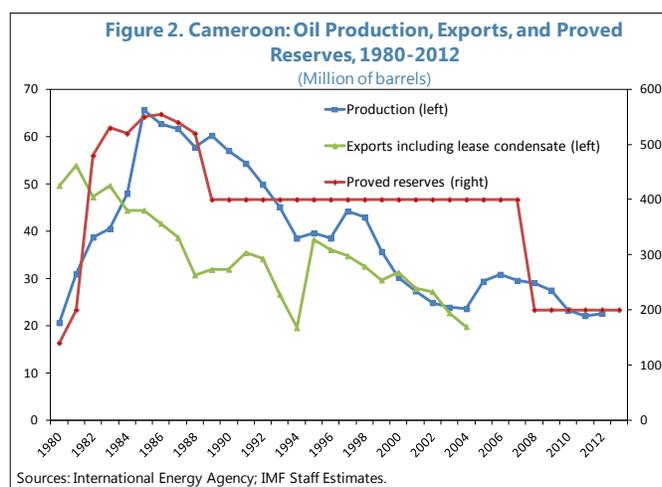
B. Overview of Cameroon's Oil Sector

Cameroon is SSA's tenth largest crude oil producer (Figure 1). Exploration efforts have mostly taken place offshore, but in recent years some exploration activities expanded onshore. Most of Cameroon's oil reserves are located offshore in the Rio del Rey basin, with the rest located in the Douala Basin. Rio del Rey is a mature field covering 7,000 km² in the Niger Delta that generates close to 90 percent of the national crude oil production. The Douala/Kribi-Campo field covers 19,000 km² off Cameroon's western coast, including 7,000 km² onshore.



5. Cameroon is a mature oil producer.

The oil sector is more than 65 years old and the peak of production dates back almost three decades (Figure 2). Exploration began in 1947 and the first commercial discoveries were made in 1972 in the Rio del Rey basin. Annual oil production peaked in 1986 at 63 million barrels (Mbls). In 2013, production totaled about 24 Mbls. Proven reserves declined from a peak of 555 Mbls in 1986 to an estimated 200 Mbls in 2013, primarily because of the exhaustion of mature fields. Some sector analysts² forecast proven oil reserves to fall to 160 Mbls by 2021. However, the authorities believe there are good prospects to discover new oil fields both off- and onshore. In addition, technological progress in drilling and extraction techniques has reduced exploration and production costs making it possible for previously unprofitable discoveries to become commercially viable. Against this backdrop, oil production is projected to rise to around 40 Mbls a year by 2019.³

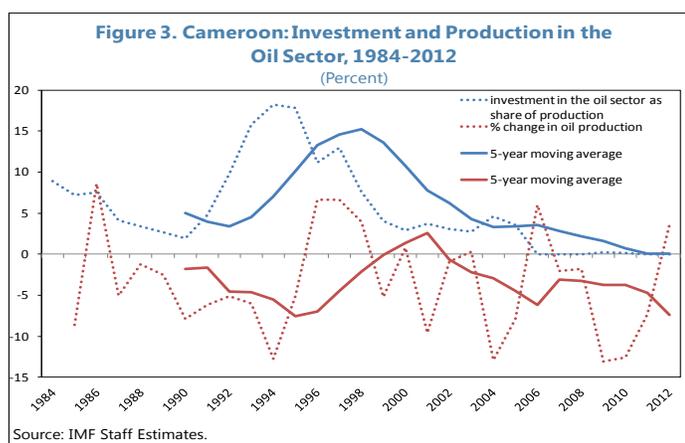


² For example, Business Monitor International (2012).

³ Although not confirmed, the offshore Kribi/Campo oilfield is expected by some market analysts to bring crude oil production potentially back to 100 thousand barrels a day.

6. Investment in the oil sector led to changes in production.

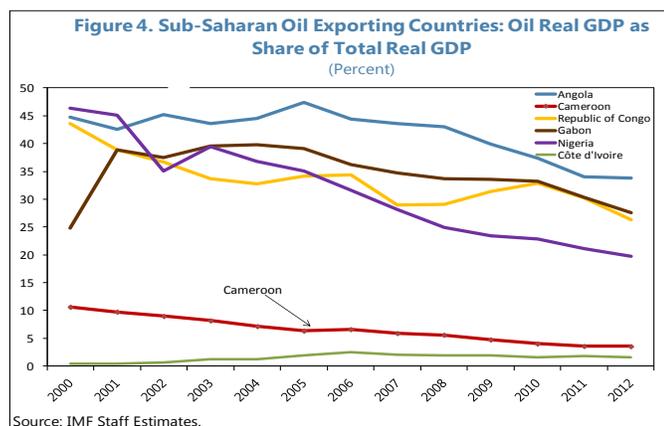
Figure 3 plots the ratio of investment to production in the oil sector and the change in production. The investment rate peaked at 18.4 percent of production in 1994. Since then, it has monotonously declined. Production broadly followed the same trend with a five-year lag. The growth rate of oil production has been somewhat erratic. However, negative growth rates have dominated since the 1980's. Once series are stabilized using five-year moving averages, investment is a fairly robust lead indicator of production. Lack of investment in the oil sector in the last decade may have contributed to the sharp decline in oil production and known reserves. Cameroon is estimated to have attracted a negligible proportion of oil sector investments in the Gulf of Guinea over the past decade (less than 2 percent; KPMG 2013).



Since then, it has monotonously declined. Production broadly followed the same trend with a five-year lag. The growth rate of oil production has been somewhat erratic. However, negative growth rates have dominated since the 1980's. Once series are stabilized using five-year moving averages, investment is a fairly robust lead indicator of production. Lack of investment in the oil sector in the last decade may have contributed to the sharp decline in oil production and known reserves. Cameroon is estimated to have attracted a negligible proportion of oil sector investments in the Gulf of Guinea over the past decade (less than 2 percent; KPMG 2013).

7. Although oil is a relatively small share of overall economic activity, it plays an important role for exports and government revenues

(Figure 4). In 2013, the oil sector represented 3.5 percent of GDP and 52 percent of exports. However, oil revenues decreased to 26 percent of government revenues in 2013 because of rising production costs. Going forward, the significant drop in the contribution of the oil sector to government revenues raises important fiscal concerns.



8. The oil sector is dominated by a single public entity.

The National Hydrocarbons Corporation (*Société Nationale des Hydrocarbures*; SNH), a government owned entity founded in 1980, oversees all companies operating in the oil sector and takes an active part in oil production and refined fuel distribution. The state controls 65 percent of oil production. In comparison, in the other SSA oil producers, governments control 53 percent of oil production on average. Only in Nigeria, the prominent SSA oil producer, does the state have a higher level of control (70 percent; Cossé, 2006).

C. Legal and Tax Framework for the Oil Sector

9. The indicators explained below are used to measure success in government fiscal efficiency in the oil sector.

- *Average effective tax rate (AETR)*, commonly known as the “government’s take” or the share of government oil rents, is the average tax rate that the firm pays on its investment; it is calculated as the ratio of the net present value (NPV) of tax payments to the NPV of the pre-tax net cash flow of the project.
- *Marginal effective tax rate (METR)* is a measure of the tax wedge between pre-tax and after tax rates of return at the margin, where the return on the last dollar invested just covers its cost of capital. This indicator shows the deviation between an optimum level of investment in the extraction of oil, and the forthcoming investment given the fiscal regime in place. The size of this tax wedge depends on a series of factors, such as the rate of profit tax, tax treatment of the financing of the firm, and depreciation provisions.
- *Hurdle or breakeven price* is the price for which the investment would be viable from the investor’s perspective, or a breakeven price given a required rate of return and the tax regime. This indicator is an alternative to the METR.
- *Time profile of revenues* shows the distribution of revenues over the project’s lifetime. Different fiscal regimes will result in different time profiles of government revenues. For example, royalties ensure some government revenues from the start of production, whereas a resource rent tax, based on the rate of return, will generate tax revenues after the project reaches a threshold rate of return.
- *Variance of the NPV* shows how the NPV of the project changes under different circumstances and it is an indicator of government revenues from a given project.
- *Expected monetary value (EMV)* is the NPV of the expected revenues from a project, taking into account the probability of successful resource discovery and the sunk costs in the case of failure. Variations in EMV levels can be used as an indicator of the risk preference of the investor.
- *Payback period* of a project is the time required for the investor to recoup all the invested capital. The investor uses it to decide whether to undertake a project or not. It is used as a proxy to estimate investor’s risk preference.
- *Government share of total benefits* is the ratio between overall government revenues from the project and net project revenues excluding initial capital investments. This indicator, when used in conjunction with the rate of return of the project, reflects the progressivity of an oil fiscal regime, i.e., the regime’s ability to capture increases in project profitability.

A discussion on the principles and design of oil fiscal regimes is presented in Box 1.

Box 1. Principles and Design of Oil Fiscal Regimes

The key objectives of an oil fiscal regime include: neutrality, revenue raising capacity, government risk, investor risk, adaptability, and progressivity (Daniel et al., 2010, IMF 2012).

Neutrality: a neutral regulatory framework is one that does not generate, or at least minimizes, distortions in economic decisions that operators would make in the absence of regulation.

Revenue raising capacity: in an oil-rich country, a large share of government revenues comes from the taxation of the oil industry. One of the key goals of oil regulation is therefore to contribute toward maximizing government revenues on a sustainable basis.

Government risk preference: the ability and willingness of the government to take on fiscal risk in the context of an oil project typically is a function of the country's income level, the ability of the government to access capital markets, the size and the diversity of the portfolio of current and future oil projects, and the relative size of individual projects

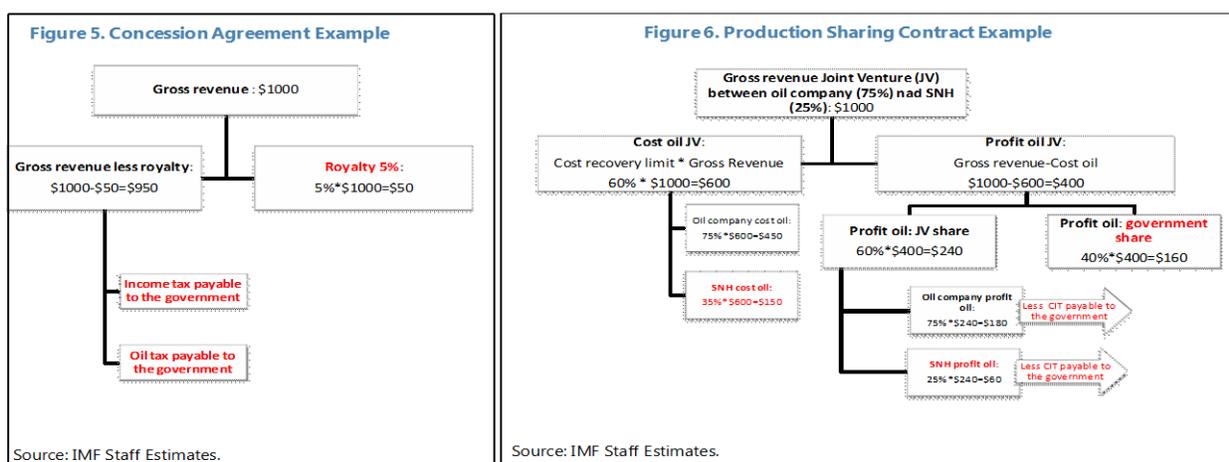
Investor risk preference: the perception of risk by oil operators is typically a function of the political risk associated with the host-country and of the neutrality and revenue raising capacity of the regulatory framework. A framework that has fiscal stability clauses is more attractive to investors and also ensures more sustainable government revenues, all else being equal.

Adaptability and progressivity: a fiscal regime is adaptable if it is able to respond to changes in industry standards and the economics of individual projects, such as production levels, cost structure, prices, and internal rate of return. Although it is better to incorporate the backbone of the regulatory framework in the legislation, typically an oil code, some elements may be left to negotiation to increase competition within the industry and to allow the government to maximize its share of economic rents. Biddable fiscal elements could include bonuses, tiers in the case of production sharing contracts, or profit tax rates in the case of concession agreements. A fiscal regime is progressive if the government captures a higher portion of profits when projects become more profitable, including when the sale price of oil increases or extraction costs decrease.

Fiscal Regime Objectives	Indicators
<i>Neutrality</i>	Average effective tax rate (AETR); marginal effective tax rate (METR); hurdle price.
<i>Revenue Raising Capacity</i>	AETR; time profile of revenues.
<i>Government Risk Preference</i>	Variance of the NPV of revenues; revenues in the first n years.
<i>Investor Risk Preference</i>	Expected monetary value (EMV); payback; dispersion of internal rate of return (IRR); value of negative returns.
<i>Adaptability/Progressivity</i>	Government's share of total benefits versus project IRR; sliding-scale tax based on project rate of return (ROR).

D. Cameroon's Oil Fiscal Regime

10. The legal and fiscal framework for the upstream oil sector is governed by a comprehensive set of legislation. These include the General Tax Code; the Oil Law of 1999; the Oil Law Application Decree 2000/465; concession agreements (CAs); and PSCs. A CA gives the oil company the exclusive right to the resource and to explore, develop, produce, and market oil at its own risk and expense. In exchange for the concession, the contractor is obligated to pay the appropriate royalties and taxes (Figure 5). Under a PSC, the government retains the ownership right to oil resources in the ground. The agreement between the government and the oil company stipulates that the latter bears all costs of exploration and development in exchange for a share of production, but gives the oil company the right to explore, develop, and produce oil, which is equivalent to owning a share of the reserves (Figure 6). Therefore, PSC rights can be viewed as similar to concession rights. With the right fiscal tools, both CAs and PSCs can yield similar streams of government revenues.



11. The authorities have negotiated advantageous oil contracts over the years (Ongba, 2011). The main fiscal instruments applicable to the Cameroonian oil industry include: royalty; corporate income tax; cost recovery provisions; economic rent capture mechanisms; and duties.

12. The following fiscal elements play an important role in the production sharing fiscal regime as represented by the Model PSA.⁴

- *Bonuses.* The model PSC requires oil companies to pay signature and production bonuses. The signature bonus is payable at the signing of the PSC, whereas production bonuses are determined on the basis of total production levels. Bonuses are not considered recoverable costs. They are common practice in PSCs and thus they need no revision.

⁴ The model PSC was provided by the Cameroonian authorities.

- *Production royalties.* CA holders are liable for production royalties, which are payable monthly either in nature or in kind. The specific rate and base for the production royalty are subject to negotiation and specified in the CA. (CAs are not further discussed in this note.) Royalties ensure an immediate stream of revenues for the government, once production starts. It is important to specify clear guidelines for the calculation of the royalty “tax base.” Data provided by the authorities show, in some instances, a royalty flow from the SNH to the oil company.⁵ It is unclear from the legislation what the underlining methodology for this flow is. Conversely, the model PSC does not include a royalty on oil production. In Cameroon, royalties are not necessary in PSCs because the cost recovery limit, coupled with a minimum production share, ensures an immediate stream of revenues for the government when production starts (see below).
- *Surface fees.* All oil contractors are required to pay an annual surface fee specified in their CA or PSC. Surface fees are levied on the surface of the contract area. The model PSC specifies different rates for the first three years of the project and the later years. Revenues from surface fees contribute minimally to government revenues once oil production starts.
- *Cost recovery.* This element is specific to PSCs. Oil companies holding a PSC bear all the financial and exploration risks, while the government holds the rights to the oil resource. Therefore, to compensate the oil company for the risks, part of the oil revenues may be used by the company to recover its operational and capital costs—this is often referred to as “cost oil.” The remainder of oil revenues, known as “profit oil,” is shared between the oil company and the government through terms defined in the PSC. The limit on cost recovery and the government’s minimum production share ensure some revenues for the government from production start. As per standard practice, PSC holders are entitled to cost recovery in any accounting period, expressed as a percentage of total production. The terms and limit for cost recovery are negotiated in the PSC and vary from contract to contract. Terms of reference for several licensing biddings, through which the government issues new oil exploration licenses (CAs or PSCs), specify a maximum cost recovery of 60 percent.⁶
- *Profit oil.* According to the model PSA, profit oil is shared between the oil company and the government using either the daily rate of production (DROP) or the R-factor as benchmarks. The DROP system determines the government share of profit oil based on the average daily rate of production for the latest quarter. The R-factor is calculated as the ratio of net accumulated revenues over accumulated investment and it is used as a benchmark to determine government’s share of profit oil. The different tiers of the DROP rates or the R-factor benchmarks and the respective government share of profit oil are established in PSAs.

⁵ Prior to 1999, the rules for corporate income tax (CIT) were different. The state guaranteed a 13 percent minimum rent (“*rente minière nette garantie*”) for the oil companies. When the rent was below the 13 percent threshold, the state paid an adjustment to the company to reach the threshold level.

⁶ Published on the SNH’s website: www.snh.cm.

- *Corporate income tax.* Oil contractors pay CIT based on a rate varying from 35 to 50 percent, as determined in the CA or PSC. Although CITs are standard practice, it is important that all legislation and technical rules on CITs be consistent across different legislations.
- *Ring-fencing.* When a project is treated in isolation for tax purposes, it is considered “ring-fenced.” This imposes limitations on income consolidation and deductions for tax purposes across different projects undertaken by the same contractor. Ring-fencing prevents the erosion of the tax base. In Cameroon, there may be an inconsistency on multiple oil project taxation. The General Tax Code allows consolidation of businesses for the same tax payer, while the Oil Law explicitly foresees project ring-fencing.
- *Depreciation for income tax.* The General Tax Code gives priority to the straight line method, and states rates for specific assets varying from 5 to 33 percent. However, there is flexibility for oil contracts to provide project-specific depreciation terms.
- *Carry forward of losses.* In general, losses may be carried forward for up to four years following the year in which the loss is incurred. However, the PSC may provide different terms on the carry forward of losses.
- *Special tax on revenues.* Payments from companies operating in Cameroon to nonresidents are subject to a 15 percent special tax, except when there is a treaty of no double-taxation between Cameroon and the company’s home country. The oil sector is exempted from this tax during the exploration and the development phases. This tax has the features of a services withholding tax, which is common practice in the industry. This implicitly assumes a 37.5 percent profit margin.⁷ Given the large amounts spent on drilling services, this withholding tax rate may be a disincentive to oil exploration in Cameroon.
- *Decommissioning.* Virtually all oil fiscal regimes require contractors to decommission oil fields at the end of their production life and to restore the production site in a manner consistent with good environmental practice. Both the Oil Law and the model PSC give consideration to decommissioning. The model PSC requires the oil company to start a decommissioning fund, and depositing annual payments in an escrow account, within the first six months of the start of production. This is at par with international good practices.
- *Tax exemptions and incentives.* The oil sector is exempted from value-added tax (VAT), import duties, and dividend withholding taxes. According to the Oil Law, two pieces of legislation, Law 91/018 of December 12, 1991 and Law 95/19 of August 8, 1995, have specific incentive measures and provisions for the promotion of oil exploration and production. These exemptions vary considerably from country to country.

⁷ Assuming a corporate income tax rate of 40 percent, for the special tax on revenues to yield the desired rate of 15 percent = 40 percent (CIT) * 37.5 percent (profit margin).

- *State participation.* According to the model PSC, the government participates in oil joint ventures through the SNH. It is unclear from the available legislation and regulations whether the state participates in a joint venture in the case of a CA. Although the model PSC specifies a minimum 5 percent government participation, several licensing biddings have established this share at 25 percent. State participation takes the form of paid equity and it starts from the development phase of the project. All costs associated with SNH's share are paid to the partners in the joint venture when SNH decides to exercise its rights of participation. An equity participation of about 10–15 percent by the government should not deter investors. However, there are potential financing implications for the government, as SNH will be responsible for funding its share of development costs, which may be sizable and required to be met before any revenue is received from a project.

E. Fiscal Regime Modeling

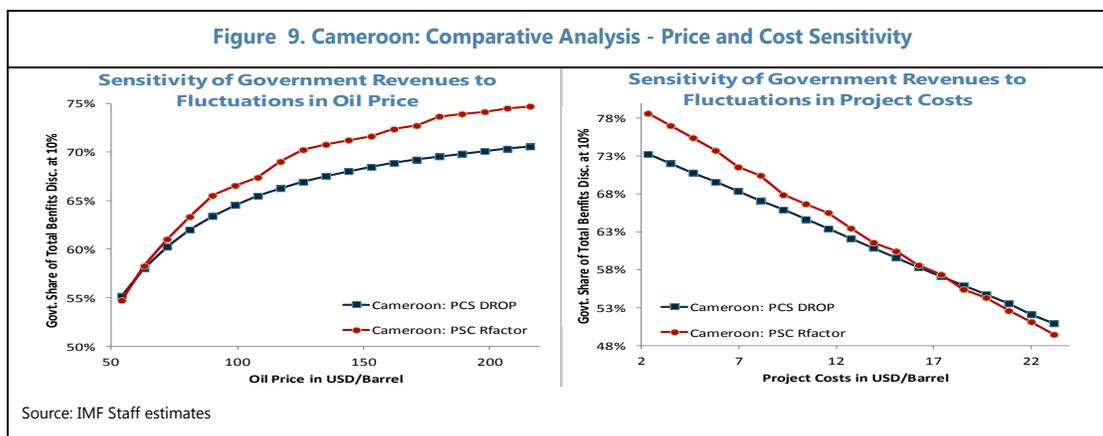
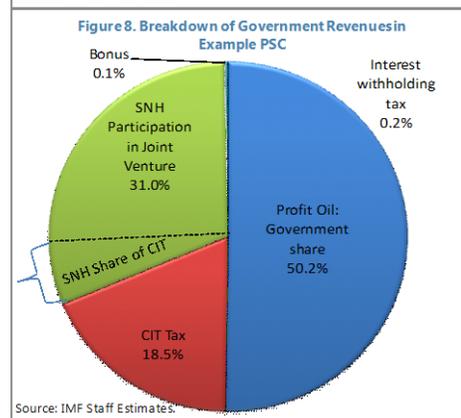
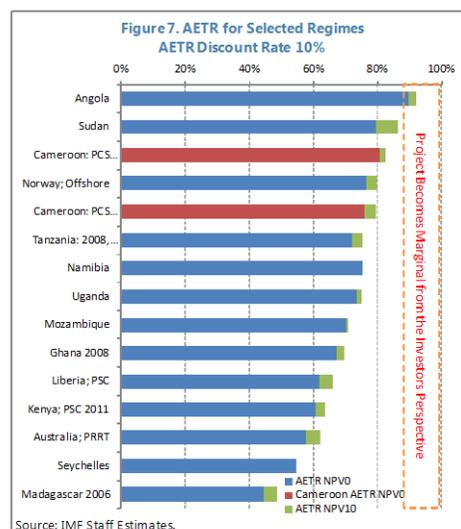
13. Cameroon's upstream oil fiscal regime is modeled using a stylized project that reflects production and cost profiles similar to other fields in the region. A stylized 450 million barrels (Mbl) oil project and several oil production scenarios were evaluated using the FARI model. The project examples were initially generated from the IHS Que\$tor⁸ tool, which enables detailed production, capital, development, and operating cost estimations for new oil and gas projects in most oil basins worldwide. The Que\$tor estimates are then compared and modified in line with other data sources, providing estimates of expected oil development costs in peer SSA countries.

14. The modeling includes a number of important assumptions: no international tax issues, such as tax evasion by multinational contractors; perfect tax collection mechanism and full and timely tax payments; and all foreign-sourced debt. To simplify the calculations of withholding taxes, the model assumes that oil companies procure their debt financing in the international financial markets rather than in the domestic banking market. Owing to lack of information, Cameroon's baseline regime includes assumptions on production sharing tiers; DROPT tiers; "R-factor" (the ratio of project revenues and project costs) tiers; and royalty rates. Fiscal parameters used in the model are presented in Appendix 1.

⁸ QUE\$TOR is a project modeling and evaluation system for global application in the oil and gas industry. For more information, see: www.ihs.com.

15. The FARI model shows that Cameroon's take, under the assumed parameters described in Appendix 1, represents a large share of project net cash flows compared to other SSA oil producers. The AETR is used to compare the baseline oil fiscal regimes to other international oil regimes. In calculating the AETR, government revenues and pre-tax net cash flows are discounted at 10 percent. Two PSC examples are evaluated. The first example defines the production sharing tiers based on the R-factor. The second example defines the production sharing tier, based on the average daily rate of production (DROP). The model yields an AETR of 82 percent for the R-factor approach and 80 percent for the DROP approach, capturing a share at the top of the range of peers (Figure 7; the figure also shows results for a 0 percent discount rate) Figure 8 illustrates the breakdown of government revenues in a stylized PSC.

16. A fiscal regime that uses the R-factor responds better to fluctuations in oil prices and project costs than a regime using the DROP. Scenario analysis of government revenues shows that the R-factor regime captures a higher share of revenues as oil prices increase and as project costs decrease (Figure 9). The share of project benefits is used as a proxy for government revenues. The higher the slope of the government share, the higher the increase in government revenues. Sensitivity of government revenues to oil prices is measured by evaluating the government share of project total benefits to oil prices ranging from US\$50/bl to US\$220/bl. The cost sensitivity is carried out for project costs varying from US\$2/bl to US\$24/bl. Using the R-factor to determine production sharing makes the regime more progressive, i.e., it captures a higher share of net cash flows when oil prices increase.



F. Issues for Consideration

17. The assumed Cameroonian oil fiscal regime could be improved through the following:

Fiscal Regime

- The corporate income tax rate for the oil sector should not be negotiable.
- Consider with planned technical assistance including a separate section in the General Tax Code on all tax features of the oil industry and ensure consistency of the Oil Law with them.
- Set depreciation rules in legislation.

The Role of the State

- *The role of SNH.* SNH has a double mandate, serving as both an industry regulator on behalf of the state and as the national oil company (NOC). Although the motivations for this double role are understandable, international experience suggests that too often, NOCs fail to meet expectations. In the case of Nigeria, for instance, the government's concern to exercise direct political control resulted in the NOC having no governing board of any kind for ten years. Another example of the state failing to keep a transparent and efficient NOC is Venezuela (IMF, 2003). The government replaced a highly professional board and management team at Venezuela's NOC with a handpicked political team. Until recently, a similar situation prevailed in Mexico, where the government used taxes to capture a very high proportion of NOC's net income. This leads to continuous budget negotiations with the ministry of finance, often under non-transparent circumstances. Box 2 lists successful reform initiatives undertaken by NOCs in several countries. *In Cameroon, the government should ensure that the SNH regulator and commercial roles are separated and clear and separate institutional responsibilities are assigned accordingly. The SNH should become a strictly commercial company. In addition, all government fiscal revenues, with the exception of payments to the SNH for its participation in joint ventures, should be transferred directly to the budget.*
- *Fiscal transparency.* According to the model PSC, when the SNH participates in a joint oil venture, it is proportionally liable for CIT payments. However, the SNH's reporting of its income tax payments does not break down these by project and it is not possible to distinguish CIT stemming from oil operations from other type of CIT owed by the SNH to the state. Moreover, projects are ring-fenced, which implies separate accounting and financial reporting for tax purposes. Improvement of the reporting of CIT payments by the SNH is a good candidate for improving fiscal transparency in the oil sector in Cameroon.

Box 2. Selected National Oil Company Reforms

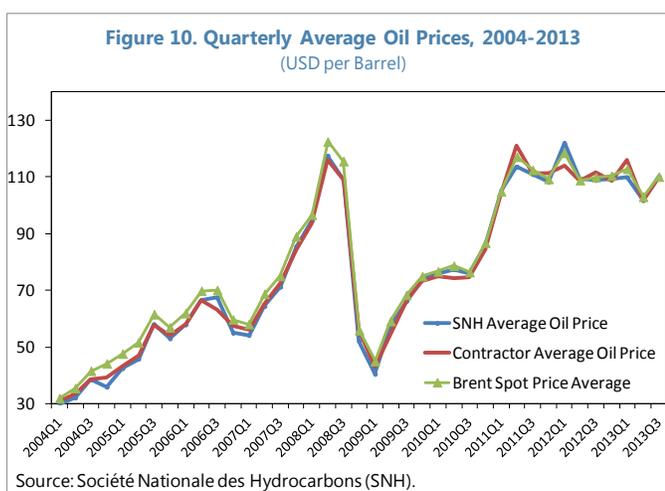
Algeria	<p>Divestiture of policy and regulatory roles from Sonatrach.</p> <p>Commercialization of Sonatrach (i.e., profit-oriented, internal restructuring that ensures adequate funds, independence, and accountability).</p> <p>Private sector entry into all phases of the business cycle.</p> <p>Downstream price deregulation.</p>
Brazil	<p>Partial privatization of Petrobras and creation the National Petroleum Agency in 1997, which assumed all the regulatory powers previously in the hands of Petrobras.</p> <p>Commercialization of Petrobras.</p> <p>Promotion of private sector participation.</p>
China	<p>Partial privatization of national oil companies through the sale of shares.</p> <p>Creation of three competing national oil companies.</p>
Indonesia	<p>Withdrawal of Pertamina's monopoly.</p> <p>Commercialization of Pertamina and creation of MIGAS agency, within the ministry of energy and mines, which assumed all regulatory and administrative functions previously in the hands of Pertamina.</p> <p>Promotion of private sector participation.</p> <p>End to downstream price distortions.</p>
Nigeria	<p>Planned privatization of downstream activities.</p> <p>Commercialization of Nigerian National Petroleum Corporation.</p>

Sources: Charles McPherson et al. 2003 and 2012.

18. Cameroon's valuation guidelines for crude oil pricing provide appropriate protection against abuse.

Valuation is the process by which tax authorities determine in advance what prices companies must use for valuing their oil production for computing their taxes. This advance pricing procedure is adopted because of transfer pricing risks prevalent in extractive industries. Abusive transfer pricing involves the underpricing (in the case of sales) or overpricing (in the case of purchases) of

transactions to lower taxable profits or sharable production. With respect to possible over-pricing of purchases, the model PSC requires procurement on an arm's-length basis, a transaction in which



both the buyer and seller act independently and in their best interests. According to the guidelines specified in Decree 2000/465, the authorities use the five-month average Brent oil market prices as benchmark for oil valuation for fiscal purposes. In addition, they subtract/add a discount/premium amount that accounts for the quality of oil and transportation costs in Cameroon. This methodology ensures that the oil prices used for valuation purposes in Cameroon follow international market prices and protect the government from under-pricing. However, the magnitude of the discount factor may impact the final oil price used in valuation. According to information provided by the authorities, the discount/premium is subject to negotiation between the government and the oil companies. Historically, the government has secured favorable average oil prices on its crude oil sales through SNH, as shown in Figure 10. Despite the mixed quality of Cameroon's crude oil, sale prices have closely followed the trend in Brent crude oil prices and the discount factor is minimal.

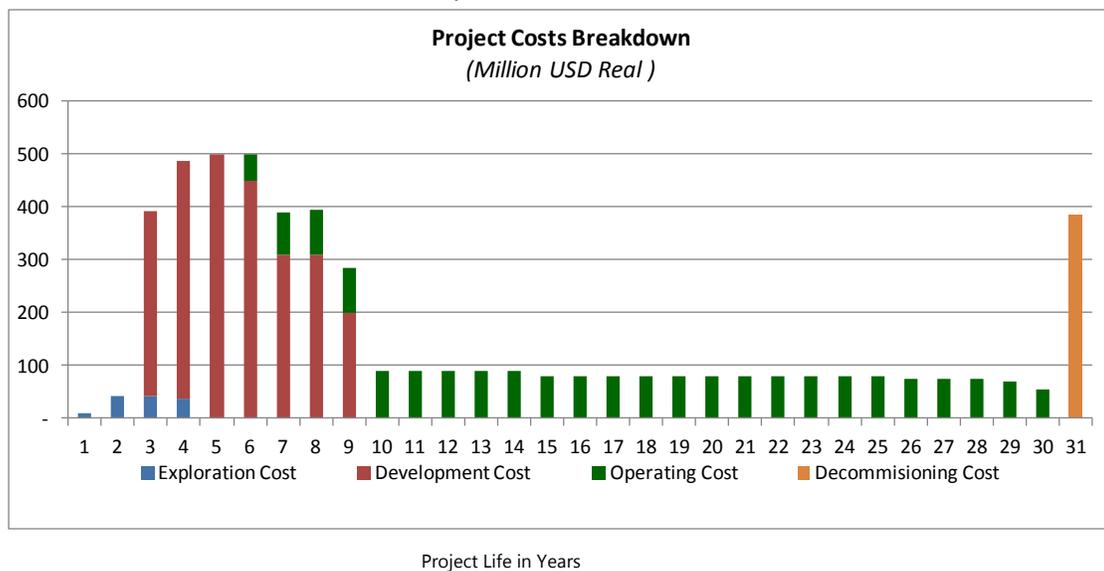
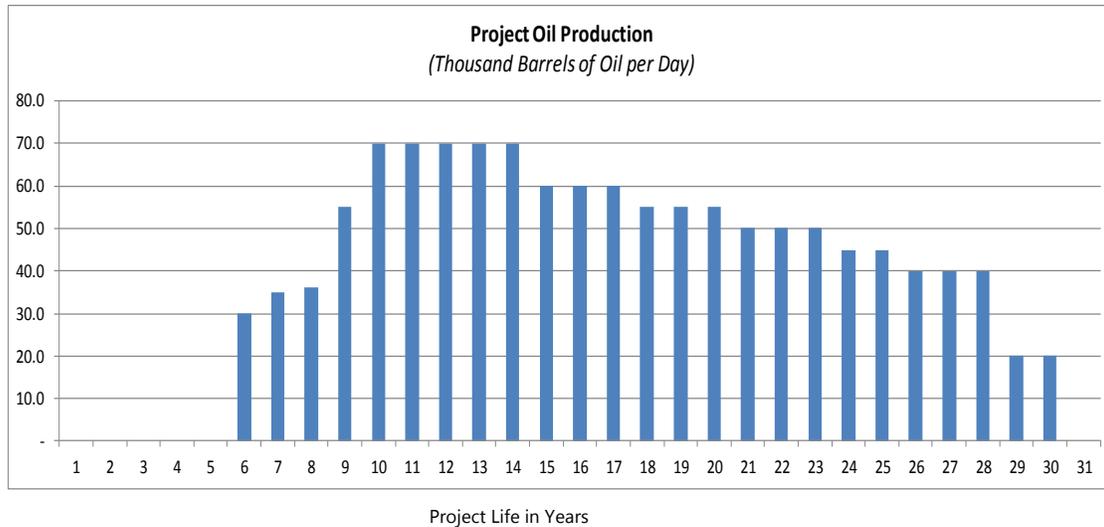
19. Despite improvements since 2005, fiscal transparency remains an area for improvement (Akitoby et al. 2012). By law, the Minister of Finance may request external audits of public enterprises. In the case of the SNH, auditors from a local audit office carry out annual audits, the results of which are published in SNH's annual reports and on its website. The government's Audit Office also undertook an audit of the SNH. However, tax issues in the oil industry are complex and need thorough knowledge of the industry structure and auditing practices. It is not clear whether local audits follow Generally Accepted Accounting Principles. The SNH is not subject to external audits by an internationally reputable auditing firm (IMF, 2010). The only independent exercise to reconcile the financial flows related to oil revenue was conducted by the Extractive Industries Transparency Initiative's Committee. For 2011 that exercise found only minor discrepancies (EITI, 2013). Another important element of fiscal transparency relates to the secrecy surrounding oil contracts. *The government should consider requesting annual audits of the SNH's accounts by international reputable auditing firms. In accordance with EITI recommendations on next steps, EITI new requirements,⁹ and the IMF Guide on Resource Revenue Transparency,¹⁰ the government should consider making PSCs and CAs available to the general public, following the example of Liberia which has published all its mining and oil contracts on the EITI website.*

⁹ Requirement 2.13 refers to publication of oil contracts. For a detailed list of the new requirements, see: [EITI New Requirements 2013](#).

¹⁰ The case for publication of contracts is addressed in detail in the "IMF, *Guide on Resource Revenue Transparency*," 2007.

Appendix I.

Appendix Figure 1. Stylized Oil Project Data



Source: IMF staff estimates.

Appendix Table 1. Cameroon: Assumptions for the Benchmark Fiscal Oil Regime
(Concluded)

Fiscal Terms Used for the Baseline Regime	Units	PSC DROP	PSC R-factor
Signature bonus (assumed not cost recoverable or tax deductible; 100 percent equity financed)	<i>\$mm</i>	3.50	3.50
Production bonus 1	<i>\$mm</i>	1.00	1.00
Production bonus 2	<i>\$mm</i>	2.00	2.00
Production bonus 1 production rate	<i>Mbl</i>	50.00	50.00
Production bonus 2 production rate	<i>Mbl</i>	100.00	100.00
Royalty method (incremental or flat rate)		Flat Rate	Flat Rate
Royalty on millions of barrels per day production rate tier 1 (and for flat rate)	<i>% oil revenue</i>	0%	0%
Decommissioning provision	<i>Switch</i>	yes	yes
Commencement of decommissioning provision	<i>% reserves</i>	0.50	0.50
Decommissioning provision earns interest	<i>Switch</i>	yes	yes
Decommissioning interest rate margin, LIBOR +		0.00	0.00
Cost recovery limit	<i>% oil revenue</i>	0.60	0.60
Development cost depreciation for cost recovery	<i>Years</i>	1.00	1.00
Finance costs recoverable under PSC	<i>Switch</i>	no	no
Exploration cost uplift for cost recovery	<i>%</i>		0.00
Development cost uplift for cost recovery	<i>%</i>		0.00
Profit oil sharing method	<i>Switch</i>	DROP	R-factor
Daily production rate based on profit sharing tiers			
Oil production tier 1	<i>Mbpd</i>	10.00	
Oil production tier 2	<i>Mbpd</i>	20.00	
Oil production tier 3	<i>Mbpd</i>	50.00	
Oil production tier 4	<i>Mbpd</i>	100.00	
Oil production tier 5	<i>Mbpd</i>	100.00	
Government shares applying at each tier			
Government share oil tier 1	<i>% revenue</i>	30%	
Government share oil tier 2	<i>% revenue</i>	40%	
Government share oil tier 3	<i>% revenue</i>	50%	
Government share oil tier 4	<i>% revenue</i>	60%	
Government share oil tier 5	<i>% revenue</i>	60%	
Rate of return and R-Factor pre or post tax	<i>Switch</i>	pre-tax	pre-tax
Profit Oil Share return tier 1	<i>R-factor</i>		1.0
Profit Oil Share return tier 2	<i>R-factor</i>		1.5
Profit Oil Share return tier 3	<i>R-factor</i>		2.0
Profit Oil Share return tier 4	<i>R-factor</i>		2.5
Government shares applying at each tier			
Government share tier 1	<i>% revenue</i>		10%
Government share tier 2	<i>% revenue</i>		20%

Government share tier 3	% revenue		40%
Government share tier 4	% revenue		60%
Government share tier 5	% revenue		60%
Corporate income tax (CIT) rate	%	40%	60%
Tax loss carry forward for 4 years	Years	4	4
Exploration cost depreciation ("deferred" or "immediate")	Switch	immediate	Immediate
Straight line depreciation over 4 years	Years	4	4
Dividend withholding tax	%	0%	0%
Interest withholding tax	%	17%	17%
State participation in joint venture	% oil revenue	25%	25%

Appendix Table 2. Example 450 Million Barrel Baseline Project

The project has a 25-year lifetime, with first production starting in 2021. The overall capital investment is assumed to amount to US\$2.7 billion, with an operating cost of US\$4.5/bbl. At oil prices set to World Economic Outlook forecasts, the model yields a 35 percent real rate of return (before production-sharing and tax), and US\$4.33 billion in net cash flows (discounting net present value at 10 percent).

Project Indicator

Production oil	450	Millions of barrels
Years of production	25	
<i>Constant 2010 US dollars</i>	US\$ millions	\$/bl
Exploration costs	135	0.3
Development costs	2,569	5.9
Operating costs	1,980	4.5
Decommissioning	385	0.9

Source: IMF staff estimates.

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PUBLIC WAGE BILL DETERMINANTS

Although the wage bill is not particularly high, its sectoral composition has changed significantly, and recent hiring is likely to add pressure to public expenditure. The growing size of the civil service could threaten a sustainable wage bill and effective public service delivery.¹

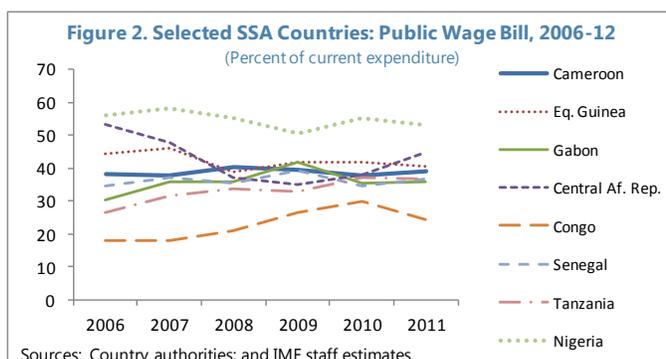
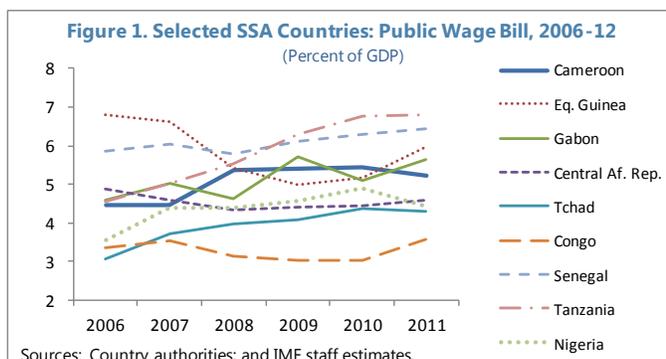
A. Introduction

1. The public wage bill and the civil service framework provide valuable insights into the options and constraints to effective public service delivery. The hard-to-reverse nature of decisions related to the civil service, and recent hiring plans have motivated this analysis. Among the developments are the Government's decision in 2012 to hire 25,000 as part of its job creation plan, and a planned security personnel expansion.

B. Determinants of the Public Wage Bill and Civil Service

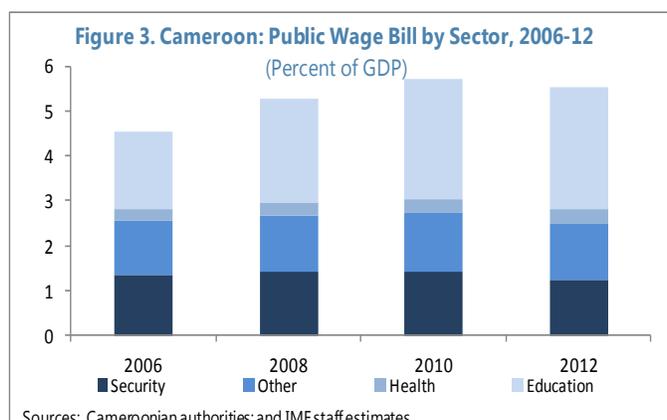
Size and Composition of the Public Wage Bill

2. The wage bill grew steadily between 2006 and 2012. It rose from 4.5 percent of GDP in 2006 to 5.2 percent of GDP in 2012. It ranked among the highest for the Central Africa Economic and Monetary Community (CEMAC), but is not particularly high compared to other sub-Saharan African (SSA) peer countries (Figure 1). Moreover, it hovered around 40 percent of current expenditure (Figure 2), comparable to the average weight of the wage bill in peer countries.



¹ Prepared by Jean van Houtte and Du Prince Tchakoté.

Education had become dominant in the wage bill since 2006.² Education held the largest share in 2006 with 1.7 percent of GDP, or 40 percent of the wage bill (Figure 3). By 2012, education sector wages accounted for 2.7 percent of GDP, or 50 percent of the wage bill. By comparison, the wage bill for health had remained broadly constant at 0.3 percent of GDP, and about 6 percent of the wage bill. The share of security fell from 1.3 percent of GDP in 2006 to 1.2 percent of GDP in 2012; this represented a decline from 31 percent to 23 percent of the wage bill, which almost offset the increase in education. The wage bill for other sectors taken together showed a small increase of 0.1 percentage point of GDP, but nonetheless shrank as a percentage of the overall wage bill (by more than 3 percentage points). Table 1 confirms the relative importance of the education sector wage bill, and the relatively small size of the health sector wage bill. The structure of the civil service is described in Box 1.



	Education Wage Bill (Percent of total wage bill)	Health Wage Bill (Percent of total wage bill)	Total Wage Bill (Percent of GDP)
Africa	66.7	40.6	6.5
Cameroon ²	83.9	28.1	5.2
Low income countries	69.2	45.6	5.2

¹ Central government.
² 2012.
Sources: IMF Government Finance Statistics; OECD; World Bank; Eurostat; and IMF staff estimates.

² Education covers the Ministries of basic education (MINEDUB), secondary education (MINESEC), tertiary education (MINESUP), and employment and training (MINEFOP). Health covers the Ministry of health (MINSANTE); and security covers the Ministries of Defense (MINDEF) and national security (*Délégation générale à la sûreté nationale*; DGSN).

Box 1. Cameroon: Structure of the Civil Service

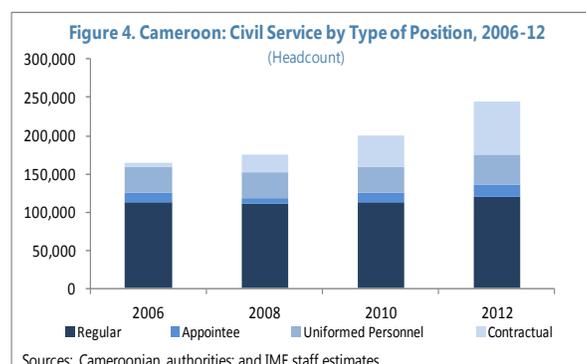
The civil service in Cameroon comprises four categories.

- Civil servants are hired through competitive, country-wide examinations (“*concours*”). They are meant to staff the critical positions in the civil service on a permanent basis, as reflected in their distinct grade and salary scale, and terms of employment, which include an accrued pension. Civil servants are classified under four sub-categories: A for senior staff; B for middle staff; C for executives; and D for subordinates.
- Contract employees are hired directly by the ministry in charge of the civil service (except for temporary teachers who were recruited in the mid-2000s by the ministries in charge of primary and secondary education). They are divided into twelve sub-categories: sub-categories 1-6 (“appointees”) with skills corresponding broadly to sub-categories C and D in the permanent civil service; and sub-categories 7-12 (“contractuals”).
- Uniformed personnel are hired under distinct, open-ended employment frameworks. They are found mostly in the ministries of defense and national security, but also in other ministries in lesser numbers. Conversely, civil servants are also found in the ministries of defense and national security.
- Judges and diplomats make up the fourth category, with distinct salary scales and structures, and with a profile comparable to that of civil servants.

The first category of government employees is regulated by the General Statute of the Civil Service; the second falls under the Labor Code; and the last two are governed by special statutes related to their trades.

Size of the Civil Service

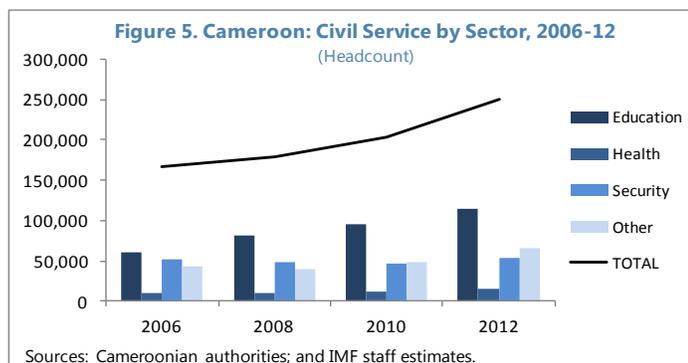
3. The size of the civil service increased at a brisk pace between 2006 and 2012. The number of civil servants grew from 167,000 to 250,000, equivalent to a 6.9 percent yearly increase, while the population is estimated to have grown on average by 2.5 percent (Box 2). This trend accelerated in recent years (Figure 4). The bulk of the civil service increase happened through positions filled by contractual workers (79.5 percent). These contractual workers comprised mostly (i) locally hired teachers who were incorporated into the civil service; and (ii) part of the 25,000 young people recruited between 2011 and 2012 under a program to promote youth employment. By comparison, regular civil servants contributed 8.5 percent of the overall increase, and uniformed personnel, 6.5 percent. Appointees contributed the remaining 5.5 percent. By 2012, regular appointments comprised less than half of all civil servants.



All sectors contributed to the staffing increase, but education was the most important driver.

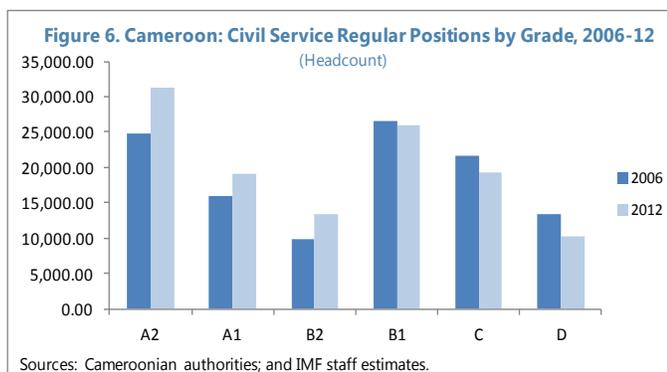
The number of positions in education rose from 37 percent of all positions to 46 percent (Figure 5).

Most new positions in education were for teachers hired as contractuels in primary education.³ In health, the number of positions grew at 6.8 percent a year (close to the civil service average) from an initial low level of 10,363 to 15,399. Staffing in security grew modestly by less than 1 percent a year, albeit from a base of 51,551 positions in 2006. In relative terms, the share of security shrank from 31 percent of the civil service in 2006 to under 22 percent in 2012. There has been a shift toward more uniformed personnel, who now comprise almost three quarters of all security staff.



4. There was significant grade inflation for regular civil servants.

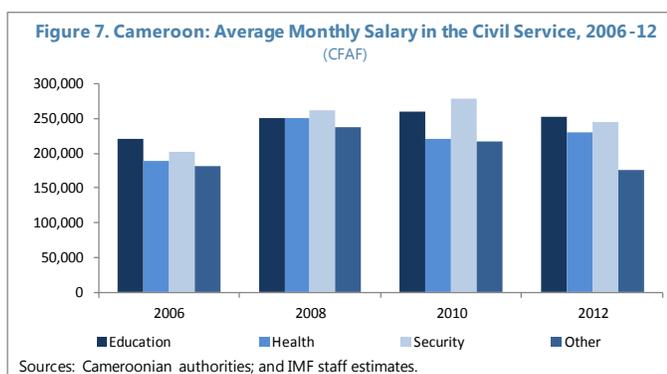
While the ranks of the lowest categories of civil servants (i.e., categories B1, C, and D) shrank significantly, the ranks of higher categories (i.e., categories A2, A1, and B2) swell. The top category (A2) is now the largest, with more than a quarter of all regular civil servants (Figure 6).



Compensation

5. The average salary grew moderately between 2006 and 2012.

The salary scales have been frozen since the late 1990's. Accordingly, salary progression came only from automatic promotions, based on time in grade (Box 3). For the civil service as a whole, the increase was 2.3 percent a year on average, which is less than the average rate of inflation of 3 percent a year over the same period; the average wage increase was about 3 percent a year in the social and security sectors (Figure 7).



³ The ranks of contractuels in education swelled, as teachers previously financed under a specific French debt forgiveness scheme were integrated into the civil service in 2008.

6. The ratio between highest and lowest⁴ individual wage is relatively low (around 6), but adequate to establish a meaningful incentive structure. Such a “compression ratio” should typically be higher than 4 to help contain corruption in the civil service, but not higher than 14.⁵

Box 2. Cameroon: Civil Service Flows

Competitive examinations (“*concours*”) are launched almost every year for non-contractual civil servants, based on predefined recruitment plans. Eligible candidates must be between 17 and 35 years of age. Successful candidates undergo one to seven years of training in the government’s specialized higher schools. A newly recruited staff member is subject to a probationary period of one year during which he or she must confirm his or her professional ability to perform the assigned duties. In case of an unsatisfactory internship, the civil servant is dismissed after notice. A civil servant can also be fired by the Disciplinary Board of the Civil Service for insufficient results or a disciplinary offense, although this is rare.

Movements between civil service categories are infrequent by design, as each employee is expected, in principle, to stay in his trade. However, line ministers can decide to transfer employees under their authority in the ministry’s various offices throughout the country. The positions of director general, secretary general of ministries, and equivalent positions are appointed by presidential decree, while the Prime Minister appoints directors and technical advisors to ministers. Ministers appoint heads of services and lower positions. Promotions are based on staff qualifications and results, although there remains scope for patronage.

Exit from the civil service can happen through dismissal, revocation, retirement, death, or resignation. A decree of 1974 set the retirement age in the non-uniformed civil service at 50 years for sub-categories C-D and 1-6; and 55 years for sub-categories A-B and 7-12. Several adjustments have occurred since, setting different thresholds for specific sectors. As a result, retirement age is much higher for judges and academics (60-65 years) and teachers (55-60 years). Since 2012, in the uniformed service, retirement age varies between 48 years (soldier) and 60 years (colonel).

⁴ The lowest wage (for Category 1) was not used for this comparison, since it applied only to about 500 civil servants. The next lowest wage, by comparison, applied to about 5,000 civil servants.

⁵ IMF, 1991, “*Public Expenditure Handbook*.”

Box 3. Cameroon: Compensation in the Civil Service

Salaries are based on scales for the different categories of government employees. Base salary increases every two years on a time-in-grade basis, provided performance is satisfactory. A civil servant is also eligible for a step increase, as a result of a specific achievement, as documented by two letters recognizing high performance from the minister.

Salaries for judges and diplomats evolve broadly in line with those of regular civil servants, but are more generous. Salaries for the uniformed civil service are also higher than those of the regular civil service. Base salaries of contractual employees are fixed by presidential decree and are lower.

Four main types of allowances are granted on top of base salary, including (i) a category or trade-based allowance; (ii) those related to administrative function (director, head of department); (iii) housing allowance (except for categories 1-6); and (iv) other various bonuses (technicality, risk, teaching, etc.). Total allowances represent on average 32 percent of the base salary, with differences across trades. Allowances are higher in the uniformed services, magistracy, and higher education (up to 90 percent of base salary in these sectors). In addition, specific allowances apply to selected categories (e.g., allowances for technical ability, water, electricity, and telephone).

C. Wage Bill Projections

7. Two scenarios are presented going forward. The baseline scenario assumes no reform in the public service (Table 2). It further assumes (i) a continued freeze in the wage scales and, accordingly, an average compensation that increases by little more than inflation; (ii) an increase in staffing at about 10 percent a year; (iii) a large increase in the number of regular civil servants and a zero increase in the numbers of contractuels, because as primary schoolchildren graduate, they generate demands on the secondary education system, in which teachers occupy mostly tenured positions, and where the ratio of teachers to students is much lower; (iv) a 50 percent increase in the size of

Table 2. Cameroon: Determinants of Public Wage Bill Scenarios, 2013-19
(Percent, year/ year increase)

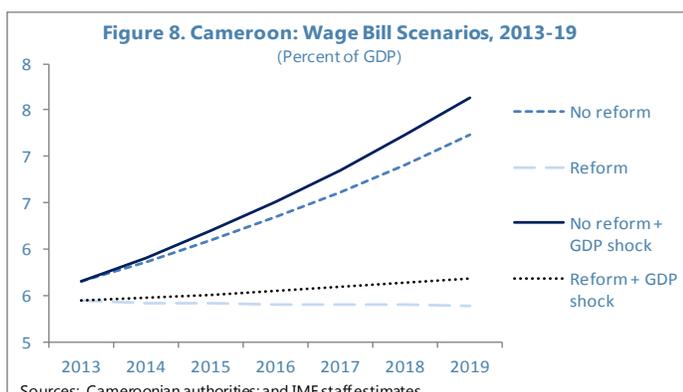
	Civil Servants	Appointees	Contractual	Mil. + Police
Scenario 1: no reform				
<i>Civil service growth rate</i>	12.0	5.0	0.0	6.0
<i>Nominal salary growth rate</i>	3.0	3.0	3.0	3.0
Scenario 2: reform				
<i>Civil service growth rate</i>	6.0	3.0	0.0	5.0
<i>Nominal salary growth rate</i>	2.5	2.5	2.5	2.5

Sources: Cameroonian authorities; and IMF staff estimates.

the uniformed personnel rosters by 2019, owing to regional security concerns. Under this baseline scenario, the wage bill rises from over 5.5 percent of GDP in 2013 to 7.2 percent of GDP in 2019—a trend that would put considerable stress on the budget. Under a “reform” scenario, salary increases are somewhat tempered, and significant efforts are undertaken to limit the number of new positions in the regular civil service, while uniformed personnel rosters grow at a slower pace than in the baseline scenario. The reform scenario is consistent with the stable, sustainable wage bill of 5.5 percent of GDP contemplated in the macroeconomic framework of the 2014 consultation.

8. A sensitivity analysis indicates that a one percentage point decrease in the projected economic growth rate has a significant impact on the sustainability of the wage bill. The

magnitude of this impact is proportional to the size of the wage bill. Over the medium term, this “shock” increases the share of the wage bill by up to 0.5 percentage point of GDP for the baseline scenario, and by 0.3 percentage point for the reform scenario (Figure 8). This argues for continued vigilance in the management of the civil service and the wage bill.



D. Issues and Options

Fiscal Issues

9. Fiscal sustainability could be jeopardized by a rising wage bill. This is slated to happen if new positions are created at the current pace, and if wages increase faster than inflation, which is more likely after the recent spate of young hires into the civil service.

10. Flexible management of the workforce has been improved by the shift toward hiring more contractuels. However, the size of the contractual contingent has become large and concentrated in one sector (i.e., education), which will require careful management given its importance.

11. The increase in the size of the public service has created new pension claims. While these claims may not result in an immediate expenditure, they are an incurred contingent liability that deserves close monitoring to ensure that the budget steers clear of unprovisioned liabilities in the long term.

Service Delivery Issues

12. In the absence of improved revenue performance, a growing wage bill may crowd out other expenditure, such as goods and services. The resulting imbalances in the expenditure mix could compromise the quality of public service delivery. This will be especially important for education, where a growing enrollment in secondary education will test the ability of the government to provide high-quality facilities and teaching equipment.

13. The quality of public service delivery remains a question open to debate. The rapid increase in the number of civil servants does not guarantee that service delivery will meet the expectations of beneficiaries. Specifically, the vast expansion in primary education teachers must meet clear, measurable, and time-bound objectives; requires training of new teachers to contribute

to these objectives; and calls for testing to ensure that outcomes are satisfactory. Higher staffing raises expectations of better service delivery that need to be approached methodically.

14. Management of the expanded civil service, especially in education, poses new managerial challenges to ensure effective service delivery. Civil servants need to report for duty, including in less attractive field assignments; absenteeism needs to be monitored and reined in as needed; and the payroll needs to be updated efficiently and effectively to eliminate ghost workers. The drift toward the higher grades of the civil service limits the scope for career progression and may increase frustration and affect motivation.

Options

15. The recent evolution of the civil service calls for closer monitoring of civil service and wage bill developments. While there are no immediate concerns about the sustainability of the wage bill, high and competing demands on government make it an opportune time to consider how to improve the civil service's contribution to service delivery. It would be useful to launch a task force to assess civil service issues and consider reforms to the civil service framework for better service delivery under the constraint of fiscal sustainability. Options to consider include the development of a medium-term expenditure framework to model the effects of decisions on wages and staffing on public expenditure; the identification of critical positions in ministries, consistent with the efforts of the government to implement results-based program budgeting; the clear association of specific grade levels with certain types of positions to avoid excessive promotions; a continued emphasis on salary increases through merit rather than seniority; and the possibility of creating new grade levels to alleviate pressure in certain grade levels.

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FINANCIAL SECTOR REVIEW

The banking system appears to be undercapitalized, but profitable and liquid. Three small banks remain troubled. Equity participation of the state in the financial sector raises concerns about a level playing field, besides implying large contingent liabilities. Financial access and depth have improved, but remain constrained by structural bottlenecks. The main hurdles are informational asymmetries; poor judicial environment; lack of property and creditor rights; and regulatory and supervisory issues. The financial system could gain from reforms that foster financial stability and development.¹

Financial Sector Profile

- 1. Cameroon's financial system is the largest in the Economic Community of Central African States (CEMAC), accounting for about half of this region's financial assets.** At end-December 2013, the Cameroonian financial sector consisted of 13 commercial banks with a network of 231 branches; a postal savings network (CAMPOST); 24 insurance companies, 1 pension fund, and 407 microfinance institutions. Total financial system assets were estimated at about 39 percent of GDP in 2012, up by nearly 3 percentage points since 2010.
- 2. The banking system accounted for about 70 percent of total financial sector assets and 27 percent of GDP at end-2013.** Most banks' core business consists in collecting deposits, lending to bigger firms, including subsidiaries of multinational companies, and holding government securities. Between 2010 and 2013, banks' total assets expanded by about 31 percent and contributed to about 68 percent to the increase in financial system total assets (Table 1 and Figure 1).
- 3. The microfinance sector plays a vital role in Cameroon by providing credit to the poor.** Because of low capitalization, microfinance institutions cannot expand and are vulnerable. Their operating costs are high and their profit margins are low. At end-2013, the sector employed about 10,000 people directly and an estimated 5,000 indirectly (as agents) and had some 1.5 million clients. Over 50 percent of deposits are lent to members.
- 4. The insurance industry is underdeveloped but offers lucrative growth prospects.** The market is competitive and fragmented, with 24 companies: 16 are non-life insurers and 8 are life insurers. Total employment in this sector stood at about 1,350 people at end-2012. Vehicle and transport insurance dominates the sector with 75 percent share of the market, while fire and other hazards insurance accounts for the remainder. The insurance penetration rate (number of insured people to total population) for life insurance stood at about 2 percent at end-2012 and did not improve much over the three previous years. Total turnover of the industry was estimated at about CFAF 159 billion (1 percent of GDP) at end-2013 (Figure 2).

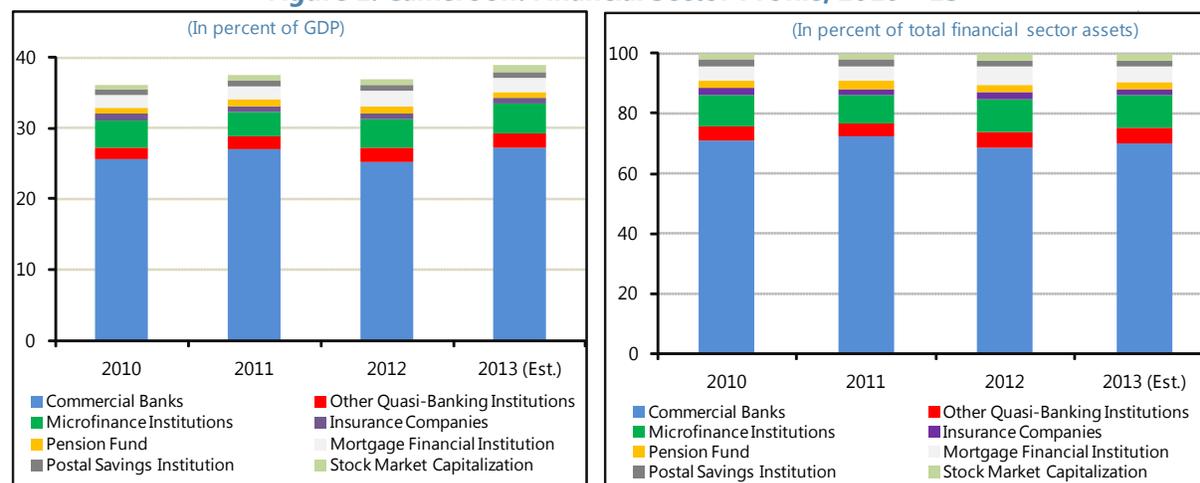
¹ Prepared by Jitendra Bissessur.

Table 1. Cameroon: Financial Sector Assets, 2010 – 13

(CFAF millions)

	2010	2011	2012	2013 (Est.)
Commercial Banks	2,998,902	3,399,209	3,420,198	3,937,312
Other Quasi-Banking Institutions	194,759	209,040	251,038	300,546
Microfinance Institutions	449,450	431,490	558,580	600,475
Insurance Companies	100,612	105,907	110,513	116,179
Pension Fund	110,747	119,267	122,897	127,032
Mortgage Financial Institution	200,000	230,000	300,000	300,000
Postal Savings Institution	89,957	110,510	104,327	104,327
Stock Market Capitalization	87,419	92,652	111,854	133,719
Total Financial System	4,231,846	4,698,075	4,979,406	5,619,589
Financial System (in percent of GDP)	36.2	37.5	36.8	38.9

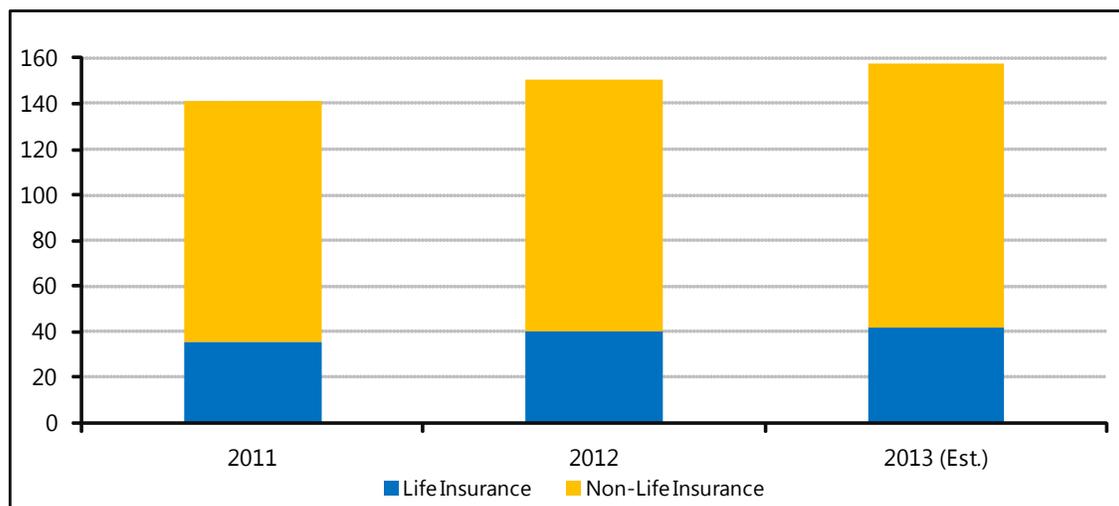
Sources: Cameroonian authorities; and IMF staff estimates.

Figure 1. Cameroon: Financial Sector Profile, 2010 – 13

Sources: Cameroonian authorities; and IMF staff estimates.

Figure 2. Cameroon: Insurance Companies' Total Assets, 2011 – 13

(CFAF billions)



Sources: Cameroonian authorities; and IMF staff estimates.

5. The insurance sector is regulated by the Inter-African Conference on Insurance Markets (CIMA), which is the central insurance supervisory authority in French-speaking sub-Saharan African (SSA) countries. The Regional Insurance Control Commission licenses insurance companies and imposes penalties. Moreover, the National Director of Insurance can withhold licenses approved by the Regional Insurance Control Commission. The insurance sector poses certain challenges on account of the lack of enforcement of mandatory vehicle insurance.

6. The state has an equity stake in the capital of three foreign-controlled banks and lately recapitalized one troubled bank. This makes it a prime actor in the financial sector, as it also has controlling interests in the country's mortgage financial institution, the public pension scheme, and postal savings institution. Recently, the regional supervisor (*Commission Bancaire, COBAC*) authorized the setting up of a new bank for small and medium enterprises (SMEs; Box 1).

7. The state-run pension fund provides pension services to employees in the private sector and in public enterprises (*Caisse Nationale de Prévoyance Sociale, CNPS*). The state also manages the pension services for civil servants. Some private insurance companies have started offering pension products lately. Employers typically contribute 4.2 percent and employees, 2.8 percent of their salary. The employee base is nearly 1 million and total assets of the CNPS stood at an estimated CFAF 127 billion at end-2013. The collected contributions are deemed insufficient by the CNPS to cover its pension obligations. In addition, the state has some long-standing financial obligations vis-à-vis the CNPS (estimated at about CFAF 146 billion). There is an actuarial review underway at the CNPS, which will chart a path for possible reforms.

Box 1. The Bank for Small and Medium Enterprises

The Bank for Small and Medium Enterprises (SME) is set to start operations in late 2014 and its capital of CFAF 10 billion was totally subscribed by the state. The bank would initially employ 55 people and will be located in Yaoundé, with a branch in Douala. In the short term, the Bank will tap the network of existing banks and microfinance institutions to finance its operations. In the medium term, the state plans to divest its shares to the private sector. The Bank aims to build up to 0.5 percent of market share for both deposits and loans in its first year of operation. Currently, the state is setting up the board of directors, the majority of whom will be public officials, along with a few independent directors.

It is claimed that the creation of the Bank is warranted on the premise that the SME sector is denied access to credit by existing banks. Political intervention in credit allocation, which artificially depresses lending rates in attempts to “assist” the ultimate clients, often generates misallocation of resources. The setting up of a risk mechanism to assess the creditworthiness of borrowers should be the first-order principle of the Bank. The financing practices of the Bank should be considered along with a strategy of pursuing fiscal discipline.

Ratnovski and Narain (2007) argue that more stringent oversight is required for public financial institutions, as they are (i) likely to have higher risks—the volatility of the SME sector is typically above economy average—and the higher risks are amplified by the low diversification and low profitability of the public financial institutions; (ii) likely to have worse managerial incentives on account of the bureaucratic environment that accommodates low transparency, under-reporting of risks, and concealment of losses; (iii) subject to limited market discipline owing to government guarantees, thus paving the way for low-quality, politically driven, connected lending; and (iv) likely to create contingent liabilities for the state.

8. The domestic capital market remains a negligible source of funding and is largely illiquid.

The Douala Stock Exchange (DSX) started operations in 2006 with one listed company. Since then, there have been only two new listings. The DSX had a capitalization of CFAF 133.7 billion (0.9 percent of GDP) at end-December 2013, and little trading. The development of this market is constrained by the high listing costs and administrative hurdles. Companies prefer to borrow from banks.

9. The Cameroonian postal service (CAMPOST) also provides banking and savings services.

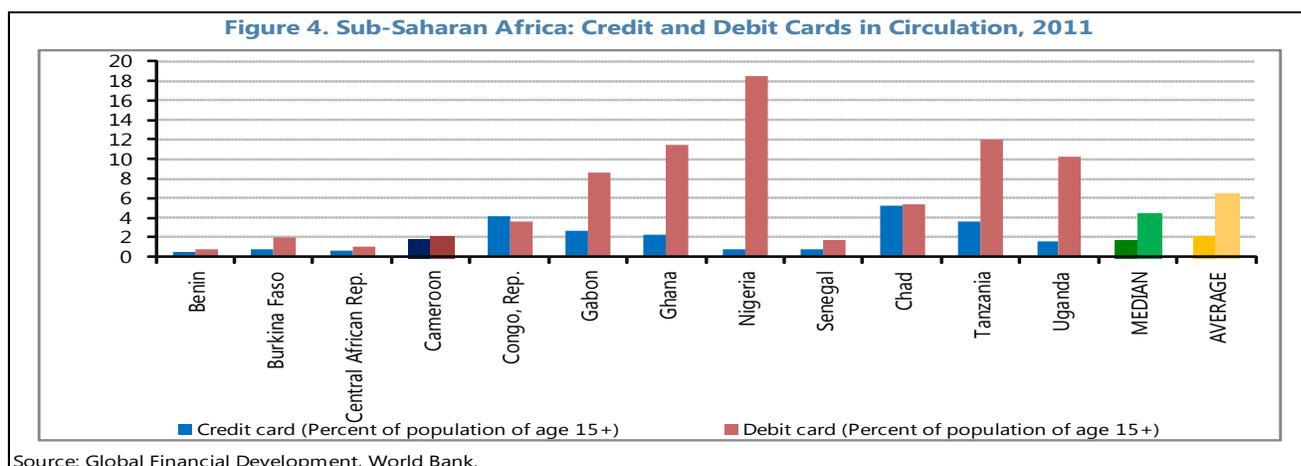
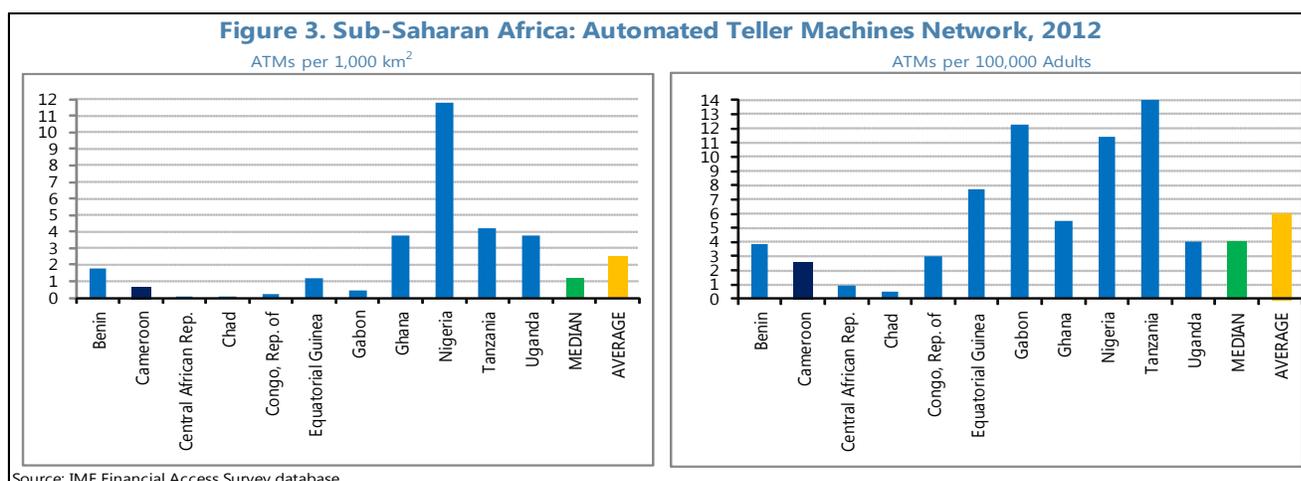
It offers postal checking accounts; postal savings accounts; and postal money orders. At end-2013, it owed some CFAF 87 billion (0.6 percent of GDP) to its small depositors. However, this figure is subject to an ongoing audit. CAMPOST is contemplating the setting-up of a postal savings bank, which would be fully state-owned. In doing this, it hopes to leverage its nation-wide network to reach out to clients outside the traditional banking system.

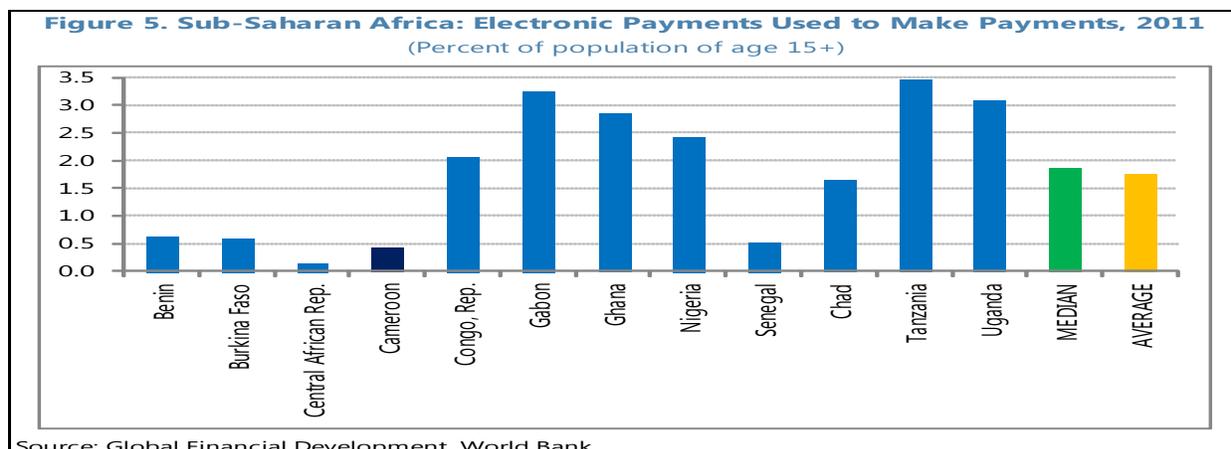
10. The *Crédit Foncier du Cameroun* (CFC) is the only mortgage finance institution, with the purpose of promoting housing. The government owns 75 percent of its capital and the rest is held by the CNPS (20 percent) and CAMPOST (5 percent). The CFC is funded by all employees, who contribute 2.5 percent of their salary. It also collects deposits from the public, who intends to borrow from the institution later. CFC’s total assets were estimated at about CFAF 300 billion (2 percent of

GDP) at end-2013. However, its financial situation is marred by its high level of nonperforming loans (NPLs), estimated at CFAF 80 billion. Furthermore, the CFC has yet to finalize its accounts for 2012 and 2013. The state's outstanding obligations vis-à-vis the CFC were estimated at about CFAF 300 billion at end-2013.

11. A regional framework for a deposit insurance fund (FOGADAC) was launched in 2004. Banks contribute 0.2 percent of their outstanding deposit liabilities into this fund; deposits collected are held at the central bank. Deposits collected amounted to CFAF 40 billion at end-2013.

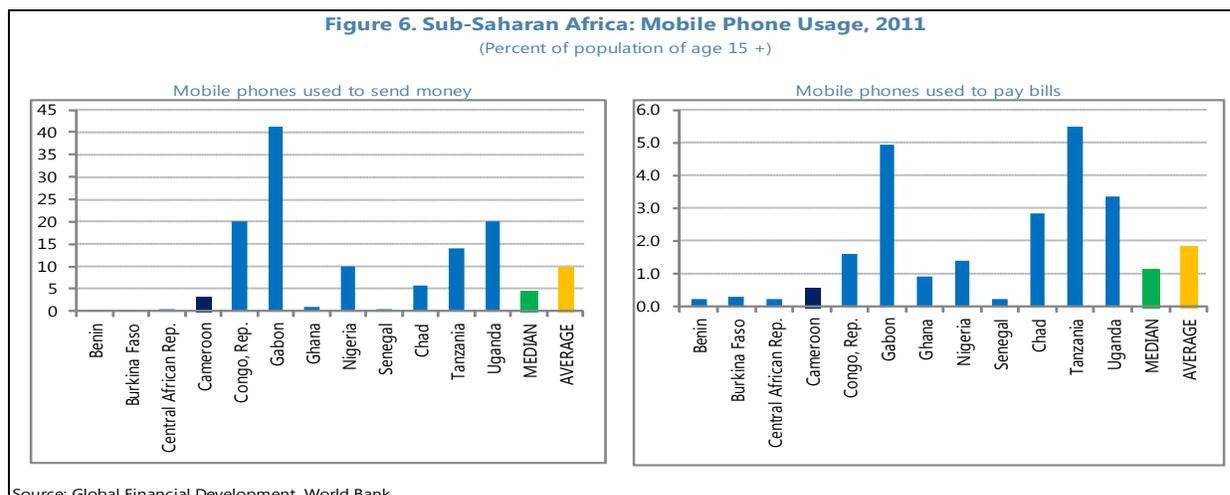
12. Electronic banking is still in its infancy. Banks offer electronic access to account balances and recent operations, and provide various alerts. The number of automated teller machines (ATMs) has been on the rise and is estimated at about a hundred (Figure 3). Internet banking is still new in Cameroon and one of the central issues is low internet penetration (6.5 percent in 2013 according to Internet Worldstats, 2014; Figures 4–5).





13. Mobile banking offers an opportunity to serve the “unbanked.” The limited access to financial services stems particularly from deficient infrastructure, geographical isolation, financial illiteracy, all of which result in very high cost of providing banking services. Cameroon lags its peers in mobile banking (Figure 6). Mobile banking costs are lower² than in West Africa, but significantly more expensive than in East Africa. There is scope for improving these costs to increase mobile phone penetration and thus, boost mobile phone transactions.

14. There were 26 registered foreign exchange bureaus at end-2013, mostly in Douala and Yaoundé. This sector is supervised by the Ministry of Finance, which licenses the bureaus and undertakes periodical inspections. However, there are no recent data on their operations for lack of adequate supervision.



² See Box II.1, Financial Sector Review, Cameroon Country Report 13/279, 2013.

15. The interbank market is largely inoperative in spite of development efforts at the national and regional levels. Interbank operations are limited to bilateral relationships with a counterpart deemed reliable, based on subjective criteria, or within a group, based on similar considerations. Banks are reluctant to lend to each other because they do not have access to recent and reliable financial information, necessary to evaluate counterparty risks. The excess liquidity of some banks hinders the development of this market.

Financial Deepening and Inclusion

16. Improving access to financial services is essential for enhancing economic growth and reducing poverty. An efficient financial system boosts economic development by: (i) providing payment services and reducing transaction costs; (ii) pooling savings; (iii) economizing on screening and monitoring costs to finance investment and improve resource allocation; and (iv) lowering liquidity risk to enable long-term investment through maturity transformation.

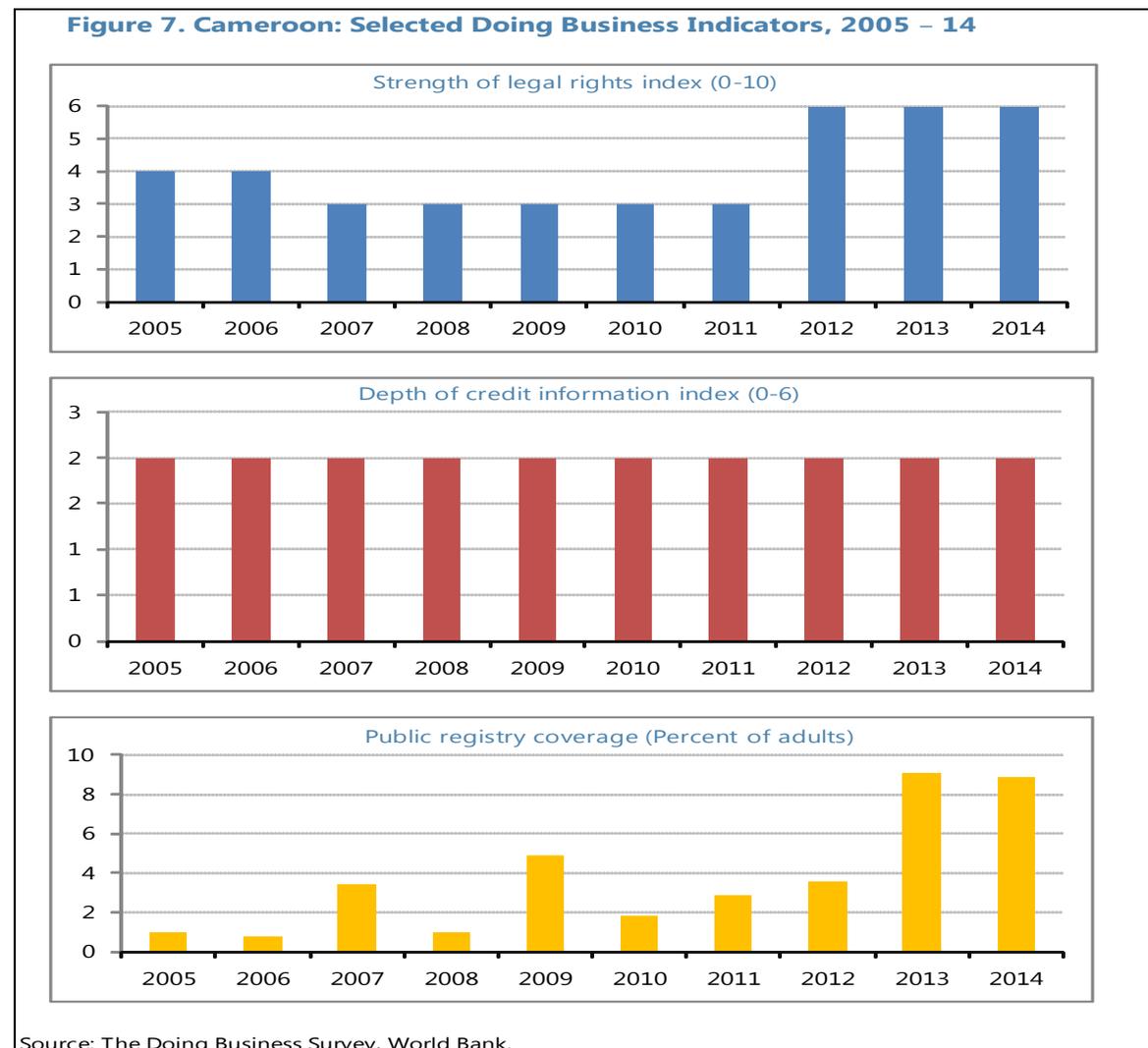
17. The literature lists the following obstacles to financial deepening: (i) *informational asymmetries*—lack of information on borrowers owing to the limited size of the formal sector, the limited availability of audited company statements, and the absence of credit bureaus, which increases adverse selection and moral hazard issues leading to credit rationing; (ii) *business and judicial environment*—the absence of formalized property rights increases the difficulty of using land as a collateral and the inability to recoup losses at a reasonable cost discourages lending; (iii) *tax regime*—the relatively high taxes and fees on banking and stock exchange operations raise the costs of financial services and reduce demand for them; (iv) *regulatory and supervisory framework*—some regulatory ratios, such as the transformation ratio, are perceived to be excessively constraining and curbing the development of medium- and long-term credit; and (v) *skills*—the quality of human capital is critical to provide the necessary risk-management expertise and the ability to design and sell the products that customers need.

18. Strengthening the financial infrastructure is thus considered crucial to address structural and institutional challenges in the financial sector. The prerequisites include (i) strengthening the regulatory frameworks and supervisory capacity; and (ii) improving corporate governance, by enhancing transparency and accountability, improving information and disclosure requirements, promoting investor education and financial literacy, and encouraging accounting and auditing standards in line with international good practices.

19. Enhancing financial inclusion and deepening financial intermediation are priorities for the government, as stated in the National Strategy for Financial Inclusion. Economy-wide bottlenecks that hamper financial deepening comprise (i) the institutional framework that hinders risk-taking by banks; (ii) difficulties faced by banks in obtaining robust loan guarantees and enforcing them in cases of default; (iii) the small size of the formal sector; and (iv) the high operational costs in rural areas. In the microfinance sector, impediments include (i) lack of suitable management information systems; (ii) lack of long-term funds for same horizon lending; and (iii) a degree of public distrust in the wake of negative depositor experiences.

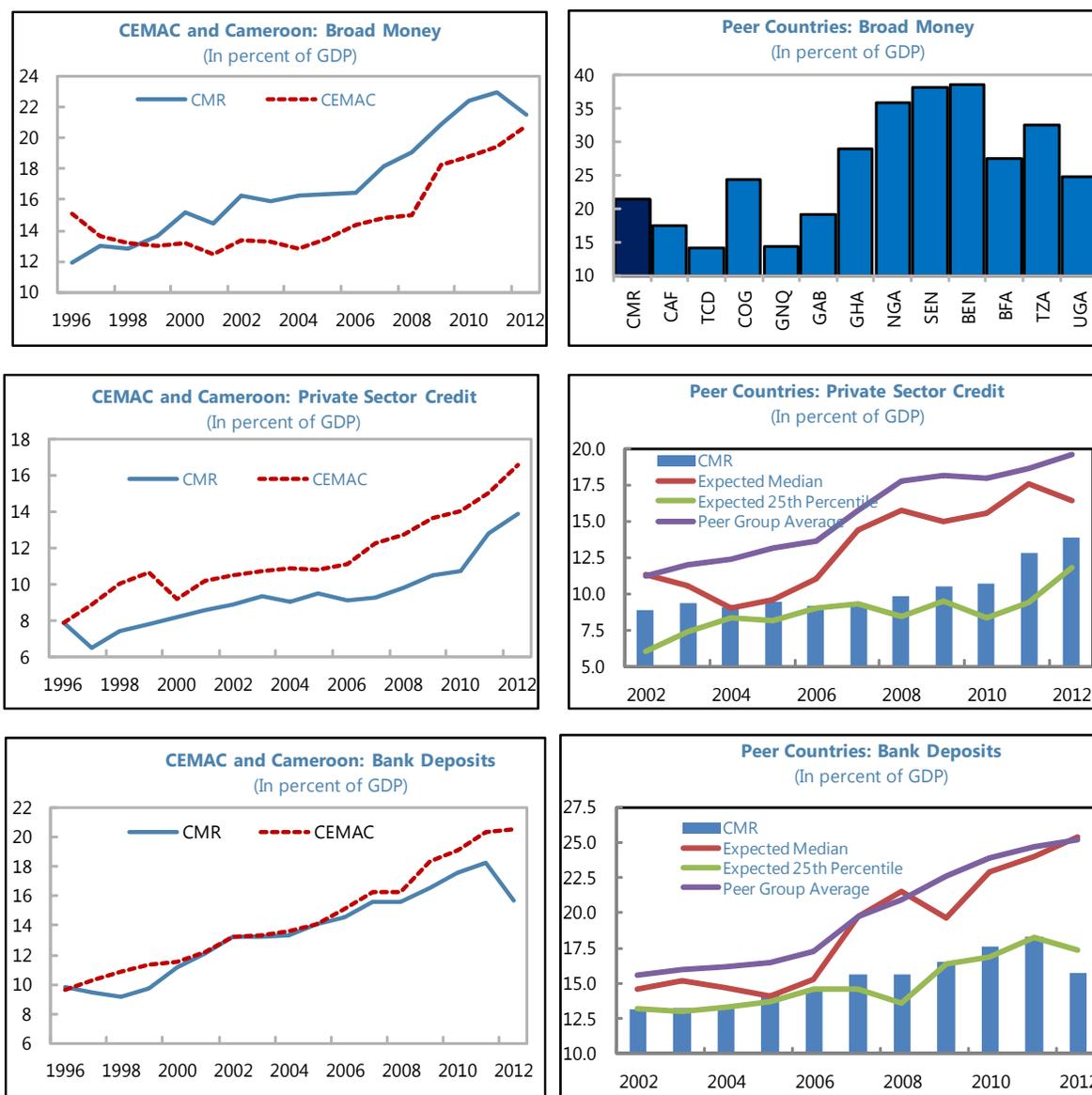
20. The 2013–14 World Economic Forum report on global competitiveness ranks Cameroon 107th out of 148 countries in terms of financial market development, with a score of 3.6 out of 7. Access to financing is viewed as the second most problematic factor for doing business. The World Bank's *Doing Business Surveys* show that the credit information index had not improved and the public coverage registry index remained low (Figure 7). The authorities have pledged to address these issues with background work starting on the establishment of a private credit bureau. In addition, the National Credit Council has come forward with a number of initiatives to improve credit quality and sensitize borrowers to repay loans. The authorities have lately put in place the necessary infrastructure for enhancing new financing options for businesses, such as venture capital and factoring.

21. Against this backdrop, the benchmarking exercise carried out in last year's country report is extended to compare Cameroon's financial system to peer countries in SSA, using the World Bank's FinStat database. The peer countries are defined as other CEMAC member states, Benin, Burkina Faso, Ghana, Nigeria, Senegal, Tanzania, and Uganda.



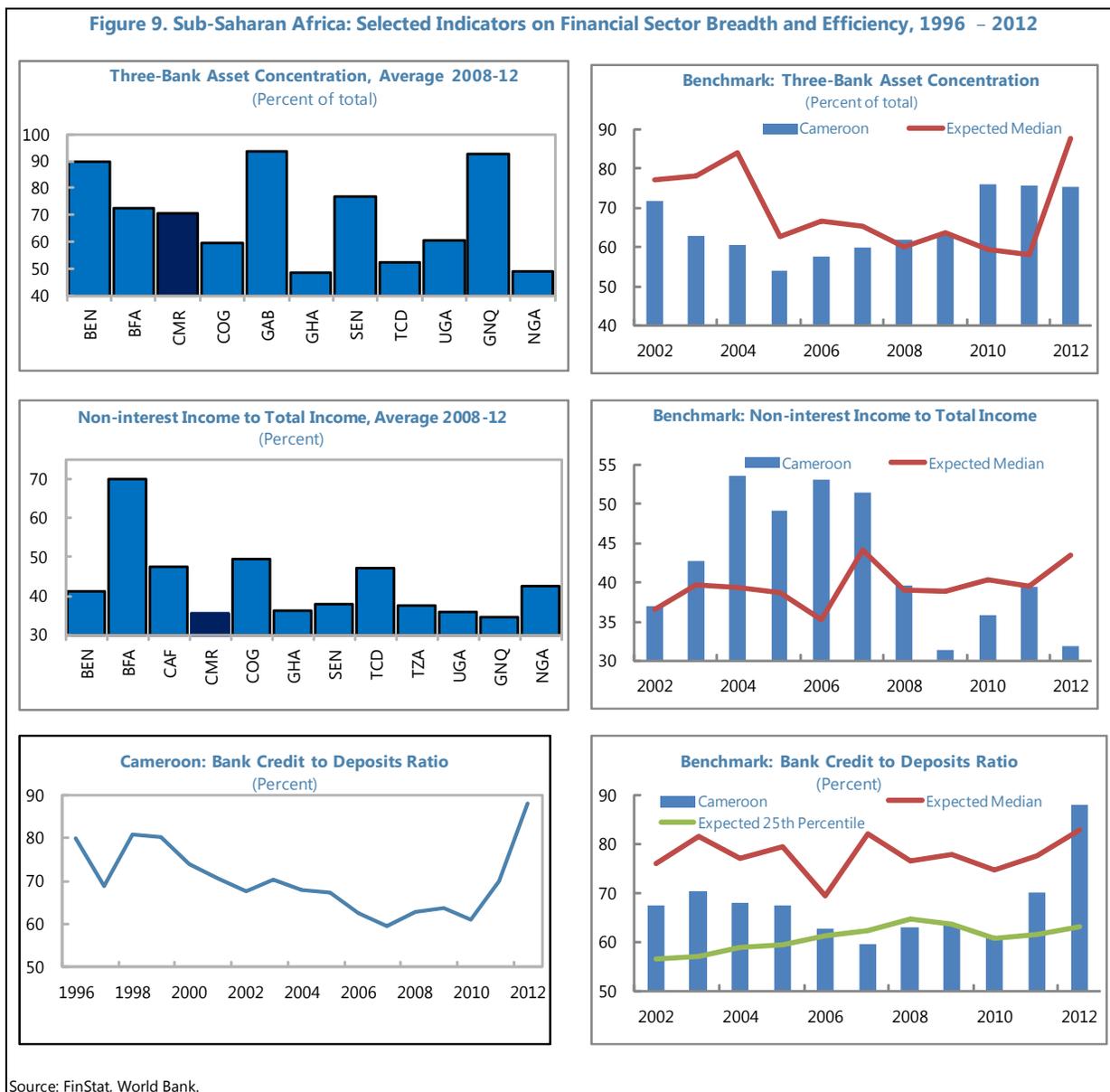
22. Depth. Despite the uptrend noted in the past fifteen years, the banking system remains shallow. The updated analysis shows that Cameroon's banking depth indicators have not improved in 2012 when compared to their benchmarks. Cameroon underperforms the benchmarks for private sector credit and deposits to GDP, lying near the 25th percentile frontier (Figure 8).

Figure 8. Sub-Saharan Africa: Selected Indicators on Financial Sector Depth, 1996 – 2012

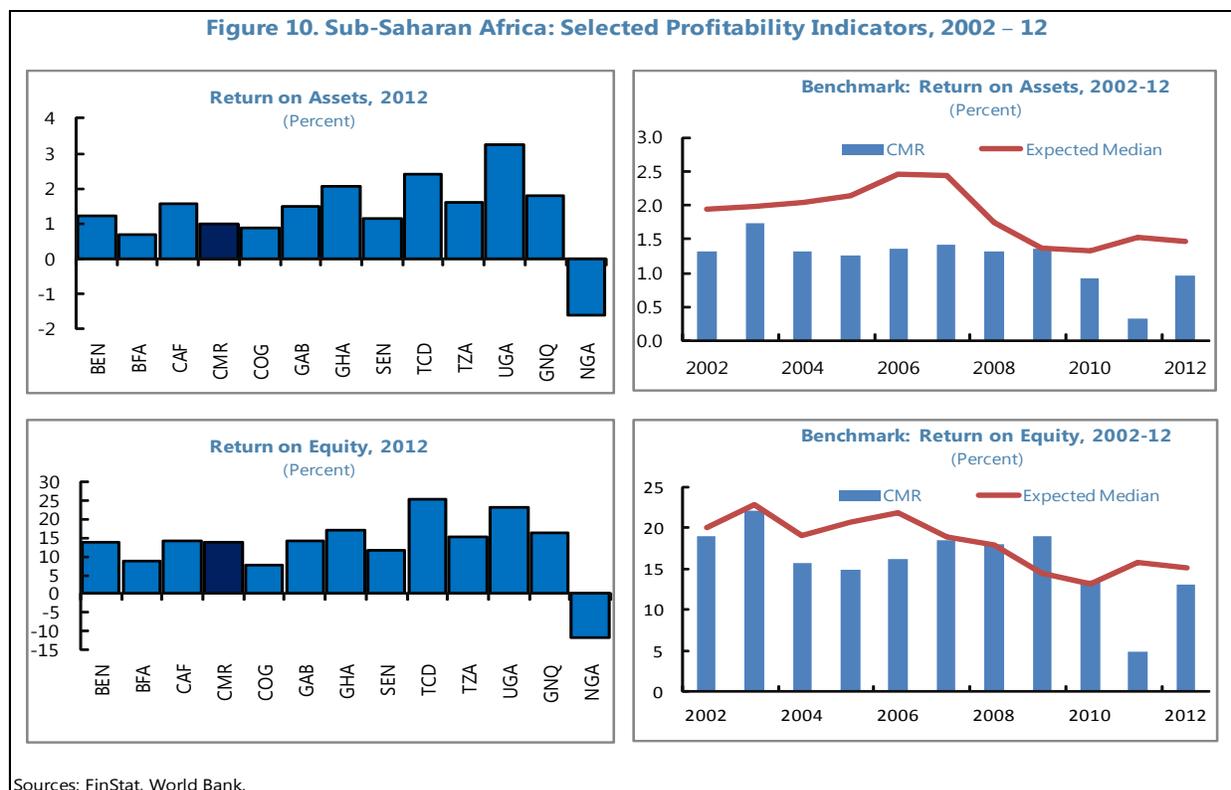


Sources: World Development Indicators, World Bank; and FinStat.

23. Breadth and efficiency. The banking sector remains concentrated and competition is relatively low, as evinced by the asset concentration of the three largest banks, which have maintained a share of about 70 percent of total assets of all commercial banks (Figure 9). These three banks continue to dominate the banking landscape and could be seen as market setters in terms of pricing of financial products and services.



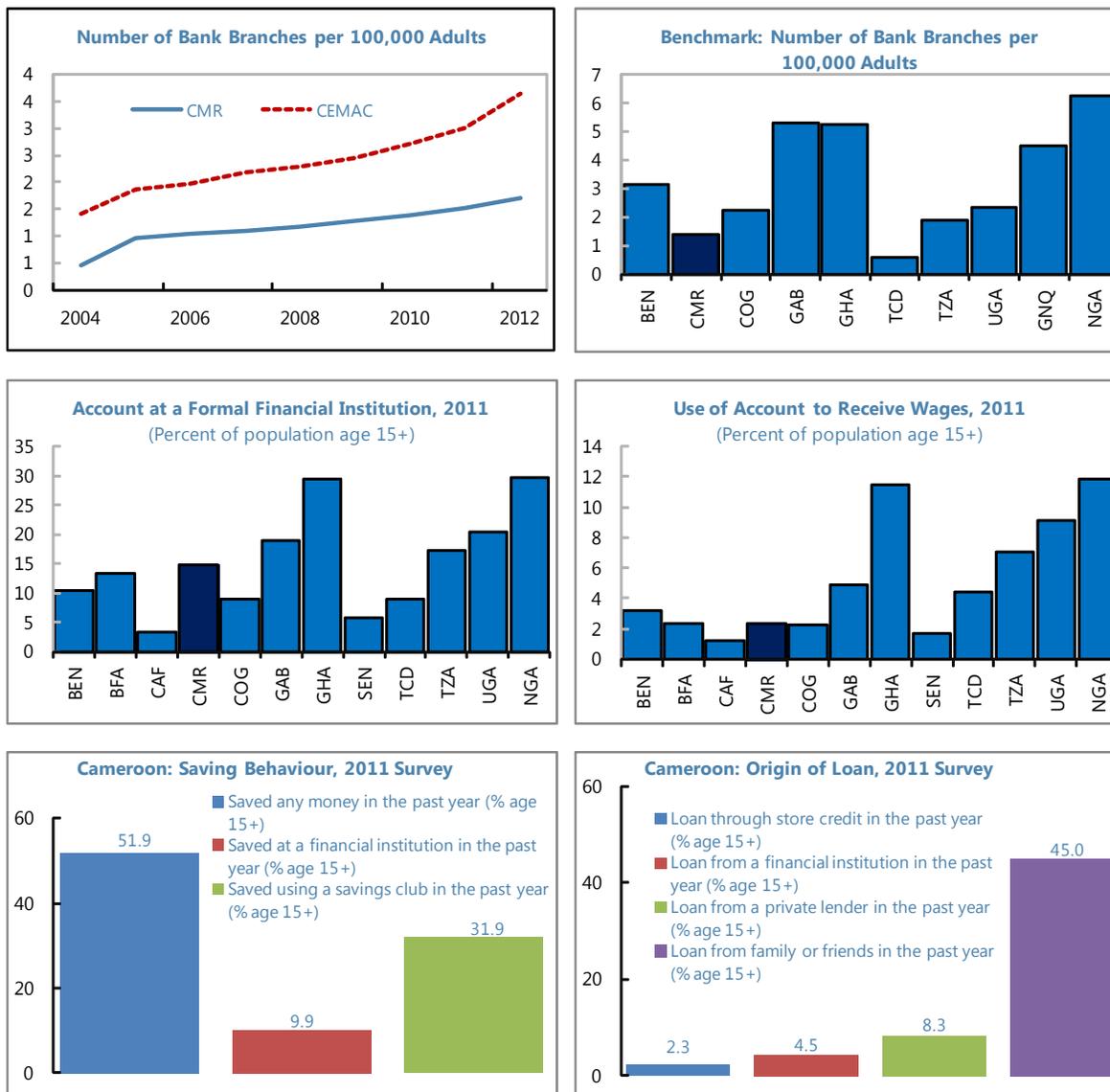
24. Profitability. Two usual indicators, return on assets (ROA) and return on equity (ROE) show comfortable rates of return over the past five years, broadly matching those of CEMAC countries. However, both indicators mask the frailties of the problem banks in Cameroon (Figure 10).



25. Inclusiveness. Household access to banking services is low. Only 13.5 percent of the population in 2013 was estimated to hold bank accounts. The authorities prescribed some minimum banking services that banks ought to provide at minimal or no cost. Customers with bank accounts are generally in the upper income brackets. The average size of bank accounts is about CFAF 3 million (about US\$6,000), which represents about four times per capita income. The number of deposit accounts in banks relative to the active population confirms the relatively low level of access to banking services. Conversely, after including the number of deposit accounts at microfinance institutions and postal services, Cameroon's inclusiveness reaches 20 percent of the population (Figure 11).

26. Consumers have limited access to credit and face high financing costs. Bank credit to the private sector in 2013 was just 15.0 percent of GDP. Real lending rates are high, with maximum rates averaging 15 percent. The main reasons for high lending costs are the lack of competition and the risks associated with the high cost of doing business. Credit information about borrowers' financial status is inadequate. The availability of collateral is limited, and there is no up-to-date property registry. The process of enforcing contracts and recovering losses is hampered by an inadequate legal system.

Figure 11. Cameroon: Selected Indicators on Financial Sector Inclusiveness, 2004 – 12

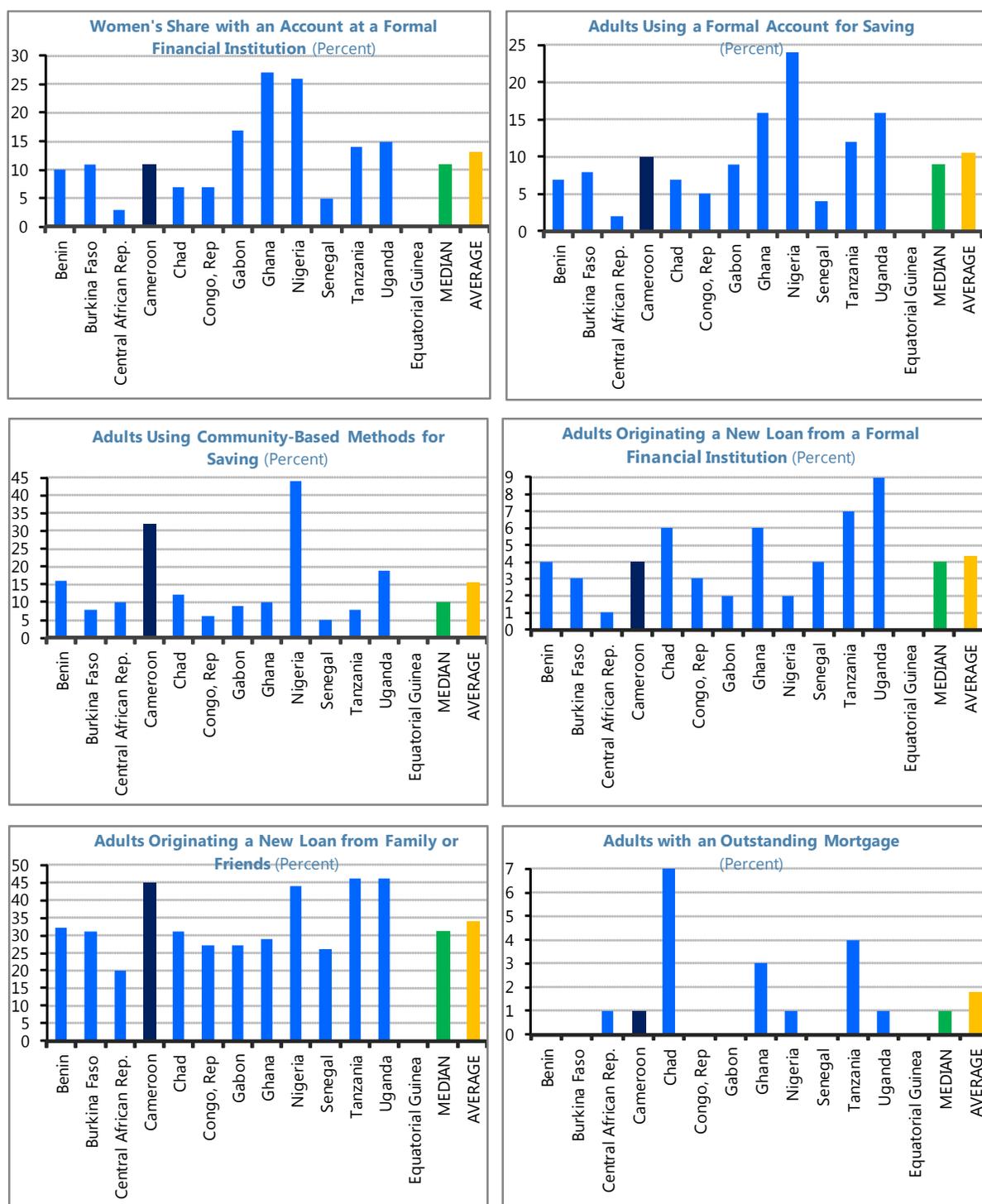


Source: Global Findex, World Bank.

27. Inclusiveness has also been assessed using the World Bank's Enterprise Surveys, which show how firms finance their operations. Excessive reliance on internal funds is a sign of potentially inefficient financial intermediation. Figures 12–14 illustrate various enterprise-level indicators of financial inclusiveness in Cameroon and peer countries.

28. Cameroon is broadly in the middle of its peers when financial deepening and financial inclusiveness are combined. Financial deepening, measured by the ratio of credit to GDP, is plotted against financial inclusion, measured by the percent of the adult population holding an account in a formal institution (Figure 15). The plot shows that in both dimensions Cameroon has room for progress.

Figure 12. Sub-Saharan Africa: Relative Use of Various Sources to Finance Investment, 2011



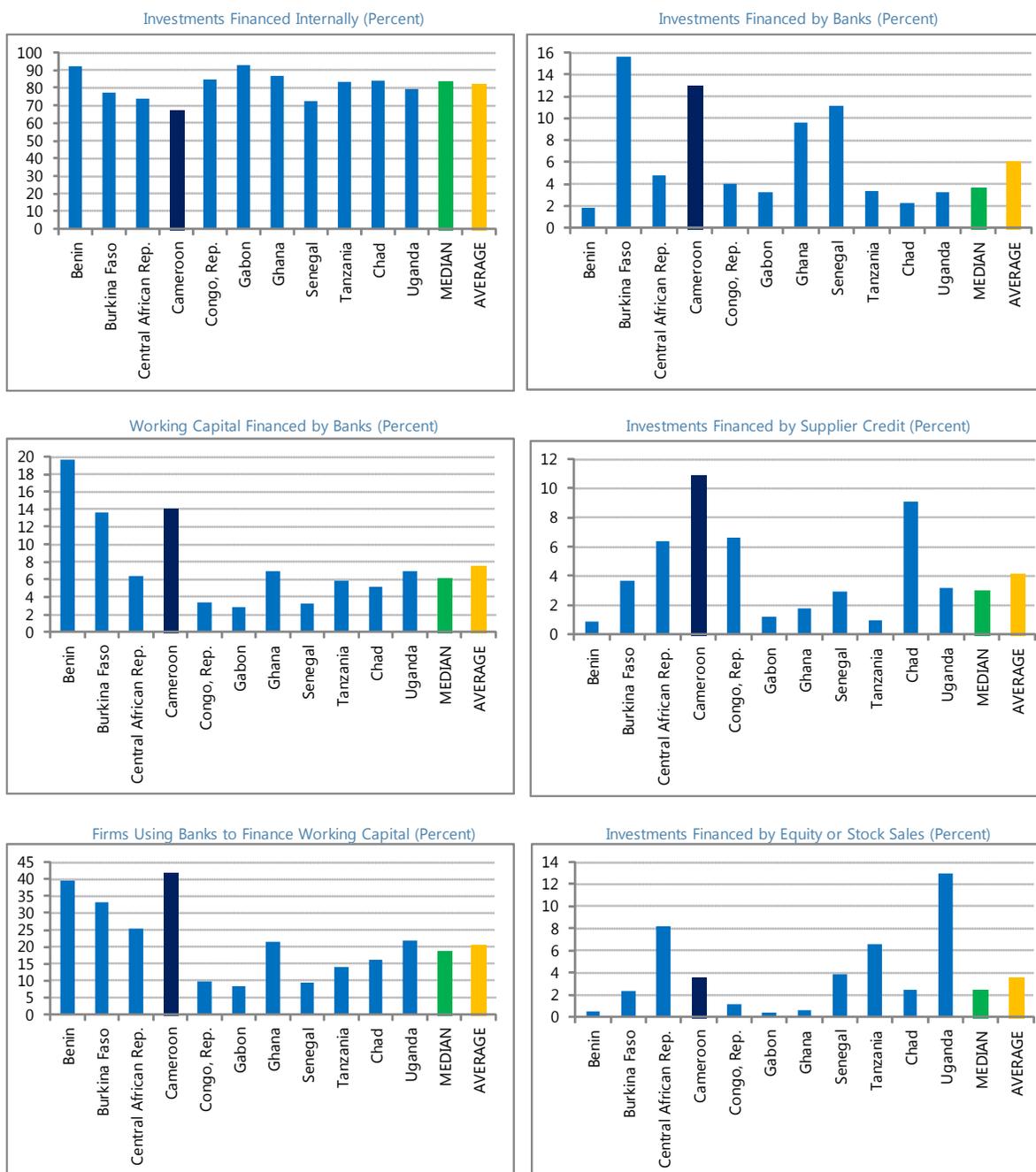
Source: Global Findex Database, World Bank.

Figure 13. Sub-Saharan Africa: Use of Various Sources to Finance Investment, 2011



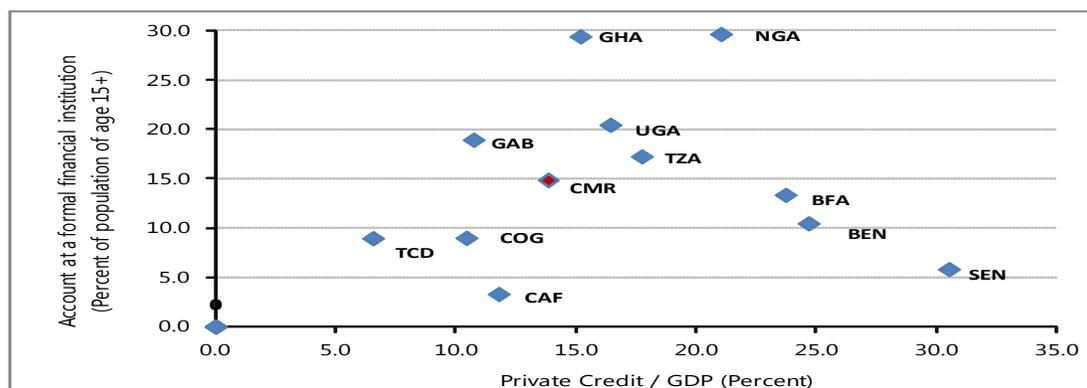
Source: Global Index Database, World Bank.

Figure 14. Sub-Saharan Africa: Use of Financial Markets by Firms, 2007-13



Source: Global Index Database, World Bank.

Figure 15. Sub-Saharan Africa: Financial Access and Deepening, 2012



Source: Global Findex Database, World Bank.

A. Banking Sector Soundness

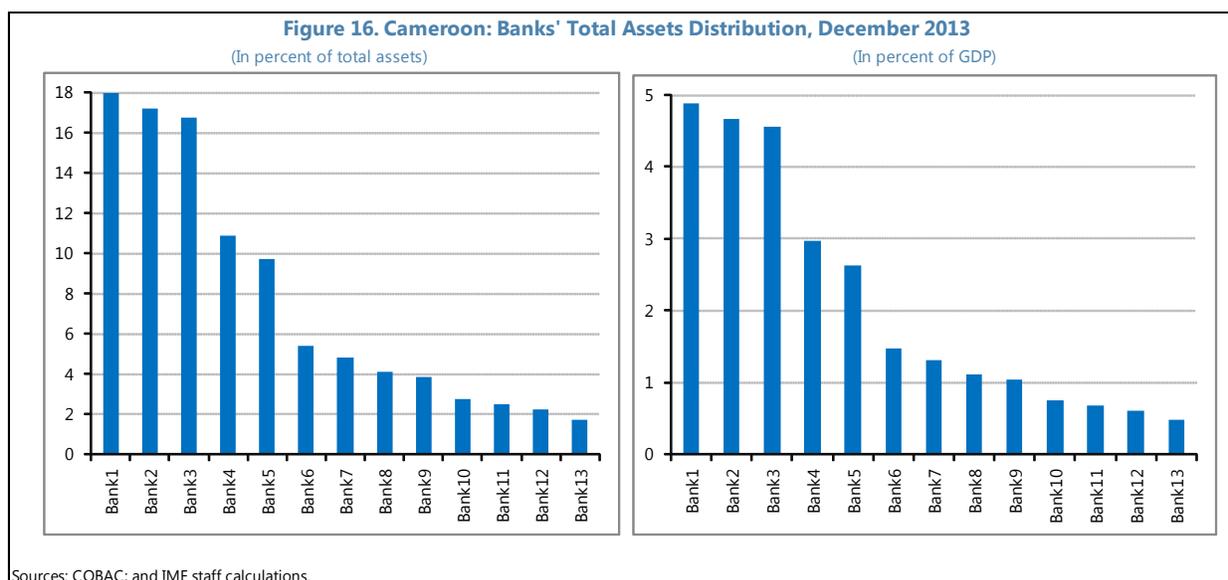
This note is presented against the background of a forthcoming Financial Sector Assessment Program (FSAP) mission for the CEMAC, which will dwell deeper in the issues covered and present a broader list of policy recommendations.

29. The banking system dominates the financial sector. The five largest banks account for about three-quarters of the system's total assets; collecting more or less the same proportion of deposits and extending a similar share of loans to the private sector (Table 2 and Figure 16). Banks have excess liquidity; rely on short-term deposits; and prefer to deal with large corporations and a few high-net-worth individuals, considered to be less risky.

Table 2. Cameroon: Banking System Structure, 2013

Group	Controlled by		Controlling Share at end-April 2014 (Percent)	Ownership Participation by Cameroon Government (Percent)	Share in Total Credit in Cameroon end-2013 (Percent)	Share in Total Deposits in Cameroon end-2013 (Percent)
	Country of headquarters					
Domestically controlled						
Afriland First Bank	SBF et Co.	Cameroon	80.7		17.0	18.6
CBC	Allianz Assurance et Vie	Cameroon	1.8	98.2	5.8	4.6
NFC	Various	Cameroon	100.0		2.5	1.8
Subtotal:					25.3	25.0
Foreign controlled - regional						
Ecobank	Ecobank	Togo	79.6		11.5	10.1
UBC	Ecobank	Togo	54.0		1.3	1.7
BAC	AFG C ET EA	Togo	54.5		2.1	2.5
UBA	UBA Plc	Nigeria	100.0		3.4	4.2
BGFI	BGFI	Gabon	70.7		4.9	3.3
Subtotal:					23.1	21.9
Foreign controlled - other						
BICEC	Banque Populaire	France	61.2	17.5	16.7	16.9
SGBC	Société Générale	France	58.1	25.6	18.3	17.0
SCB	Attijariwafa	Morocco	51.0	49.0	11.0	11.5
SCBC	Standard Chartered	UK	100.0		4.2	5.7
Citibank	Citibank N.A.	US	100.0		1.4	2.1
Subtotal:					51.6	53.1
Total (in percent)					100.0	100.0

Sources: COBAC; and IMF staff estimates.



30. Overall, the system-wide³ capital adequacy ratio (CAR) remains below the minimum regulatory requirement of 8 percent at end-December 2013 (Figure 17). Excluding the troubled banks which were carrying negative equity, the remaining banks are sound. Financial soundness indicators point to the banking system, as a whole, as being undercapitalized, but profitable and liquid. Deposit liabilities are the main source of financing for banks—at end-2013, deposits represented 78 percent of the banking system’s balance sheet. Nearly 50 percent of deposits were short-term, although they tend to remain in the banks for relatively long periods. The transformation ratio imposed by the regulator hinders maturity transformation. The ratio of non-interest income to total income, approximately 40 percent, provides an indication of the importance of bank commissions and fees in generating income.

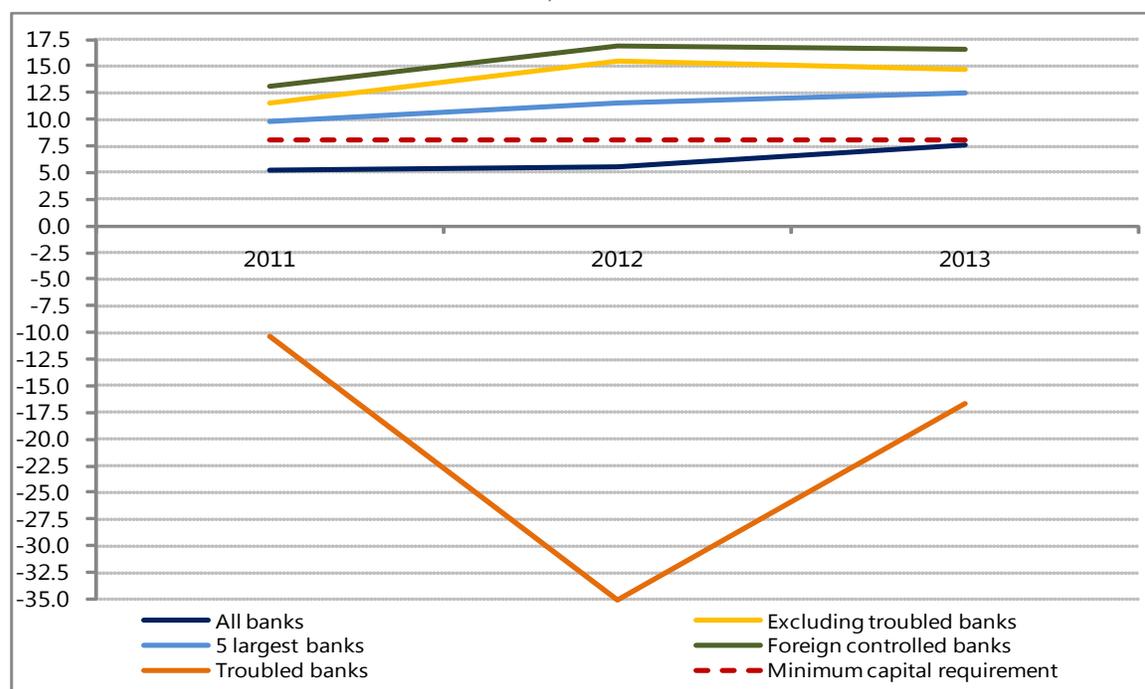
31. The aggregate CAR masks wide disparities among banks. The foreign-controlled banks maintained a CAR almost twice as much as the minimum required level. Conversely, three banks were undercapitalized, but they are small and do not pose a systemic risk. A forthcoming change to the regulatory environment, scheduled for end-June 2014, will mandate a minimum capital of CFAF 10 billion—this will require further re-capitalization of the three distressed banks.

32. Asset quality has not shown much improvement lately. Although the ratio of gross NPLs to total loans has dropped for the entire banking sector, from 11.6 percent at end-2012 to 10.3 percent at end-2013, this decline masks significant variations at individual banks. Exposures have to be monitored closely, as the macroeconomic outlook exposes the banking sector to credit risks, warranting a strengthening of crisis prevention and management capabilities.

³ Derived using a simple aggregation measure.

Figure 17. Cameroon: Capital Adequacy Ratios, 2011 - 13

(In percent)



Sources: COBAC; and IMF staff calculations.

33. High, although declining, NPLs have been a persisting problem. The recent reductions in the ratio of NPLs to total loans reflect in part the sector's rapid credit expansion, as well as the transfer of one commercial bank's NPLs to an asset recovery company, as part of its restructuring. Credit quality is broadly an issue, with an NPL ratio⁴ of 13.9 percent of gross loans at end-2013 (Figure 18). Provision for NPLs stood at 60 percent and thus was deemed insufficient. In all, banks would need to inject an additional CFAF 58 billion (0.4 percent of GDP) to provision NPLs fully. The provisions-to-loans ratio shows the importance of credit growth in reducing NPLs (Table 3). It would be appropriate for the regulator to monitor NPLs by business activity to detect vulnerabilities in particular sectors (e.g., the public enterprise sector).

⁴ This is a broad ratio which includes past due receivables, over three months, whose final recovery cannot be ascertained yet.

Table 3. Cameroon: Financial Soundness Indicators, 2011 – 13

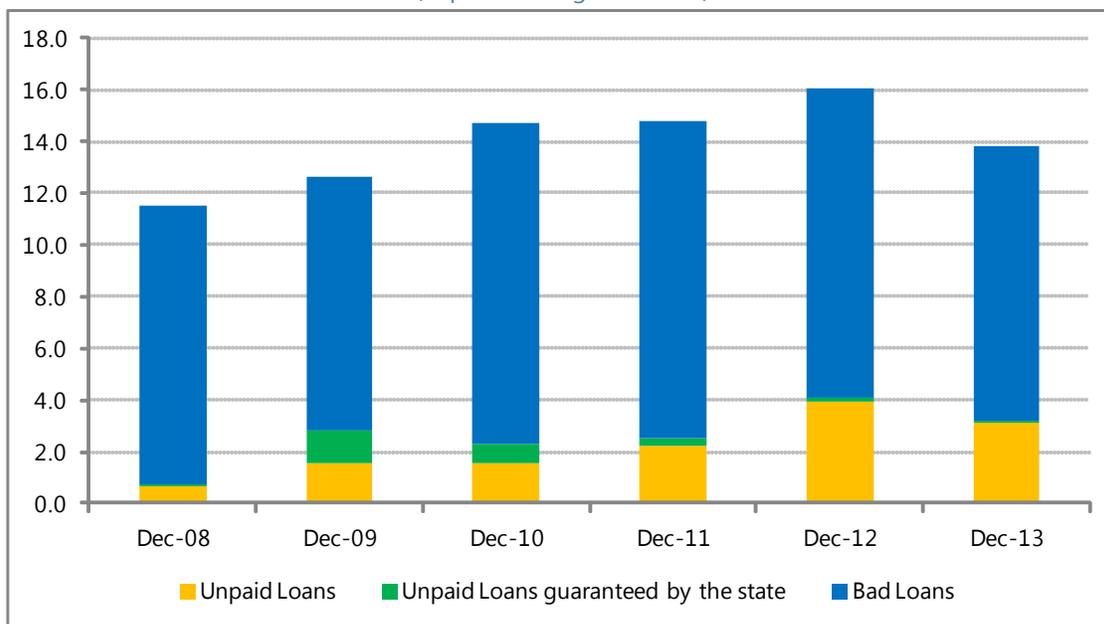
	Dec-11	Dec-12	Dec-13
	(In percent unless otherwise indicated)		
Capital Adequacy			
Capital to Risk-Weighted Assets	11.4	14.4	11.9
Regulatory Capital to Risk-Weighted Assets	5.5	6.3	7.9
Regulatory Tier 1 Capital to Risk-Weighted Assets	5.3	5.7	6.3
Capital to Assets ¹	2.9	2.5	3.6
Asset Quality and Composition			
Non-Performing Loans Net of Provisions to Capital	6.4	26.4	n.a.
Non-Performing Loans to Total Gross Loans	11.4	11.6	10.3
Large Exposures to Capital	582.9	506.3	354.3
Sectoral Distribution of Total Loans: Residents	91.5	93.6	90.4
<i>Sectoral Distribution of Total Loans: Deposit-takers</i>	<i>1.0</i>	<i>0.6</i>	<i>0.5</i>
<i>Sectoral Distribution of Total Loans: Central Bank</i>	<i>6.5</i>	<i>4.8</i>	<i>4.0</i>
<i>Sectoral Distribution of Total Loans: Other Financial Corporations</i>	<i>0.9</i>	<i>1.0</i>	<i>2.1</i>
<i>Sectoral Distribution of Total Loans: General Government</i>	<i>0.1</i>	<i>1.9</i>	<i>1.4</i>
<i>Sectoral Distribution of Total Loans: Nonfinancial Corporations</i>	<i>64.5</i>	<i>63.4</i>	<i>63.3</i>
<i>Sectoral Distribution of Total Loans: Other Domestic Sectors</i>	<i>18.5</i>	<i>21.9</i>	<i>19.2</i>
Sectoral Distribution of Total Loans: Nonresidents	8.5	6.4	9.6
Earnings and Profitability			
Return on Assets	0.5	0.6	1.5
Return on Equity	18.9	25.0	55.0
Interest Margin to Gross Income	37.7	16.2	14.2
Non-Interest Expenses to Gross Income	77.5	86.3	86.6
Trading Income to Total Income	7.9	4.2	4.0
Personnel Expenses to Non-Interest Expenses	25.0	9.5	8.4
Liquidity			
Liquid Assets to Total Assets (Liquid Asset Ratio)	13.1	10.2	9.4
Liquid Assets to Short-Term Liabilities	164.1	161.8	127.6
Customer Deposits to Total (Non-Interbank) Loans	126.4	118.7	114.6

¹Defined as the ratio of capital to total assets

Source: IMF's Financial Soundness Indicators (FSI) Database.

Figure 18. Cameroon: Non-Performing Loans, 2008 - 13

(In percent of gross loans)

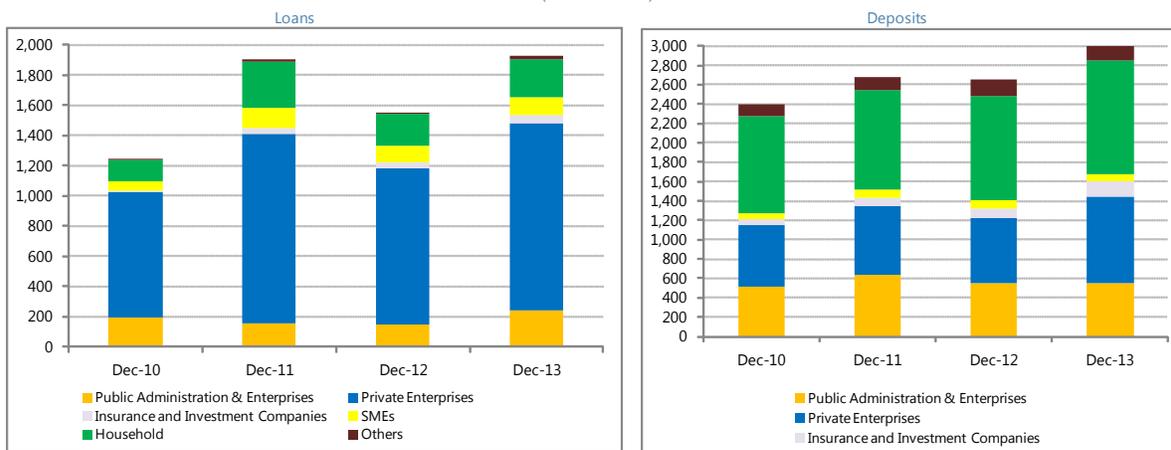


Source: COBAC.

34. Nearly two-thirds of banks loan portfolios are directed to private enterprises while 12 percent of loans are channeled to public enterprises. Household credit makes up 13 percent of total loans. With regards to banks' deposit base, household deposits represent 38 percent of the total deposits, while private enterprises account for about 29 percent (Figure 19).

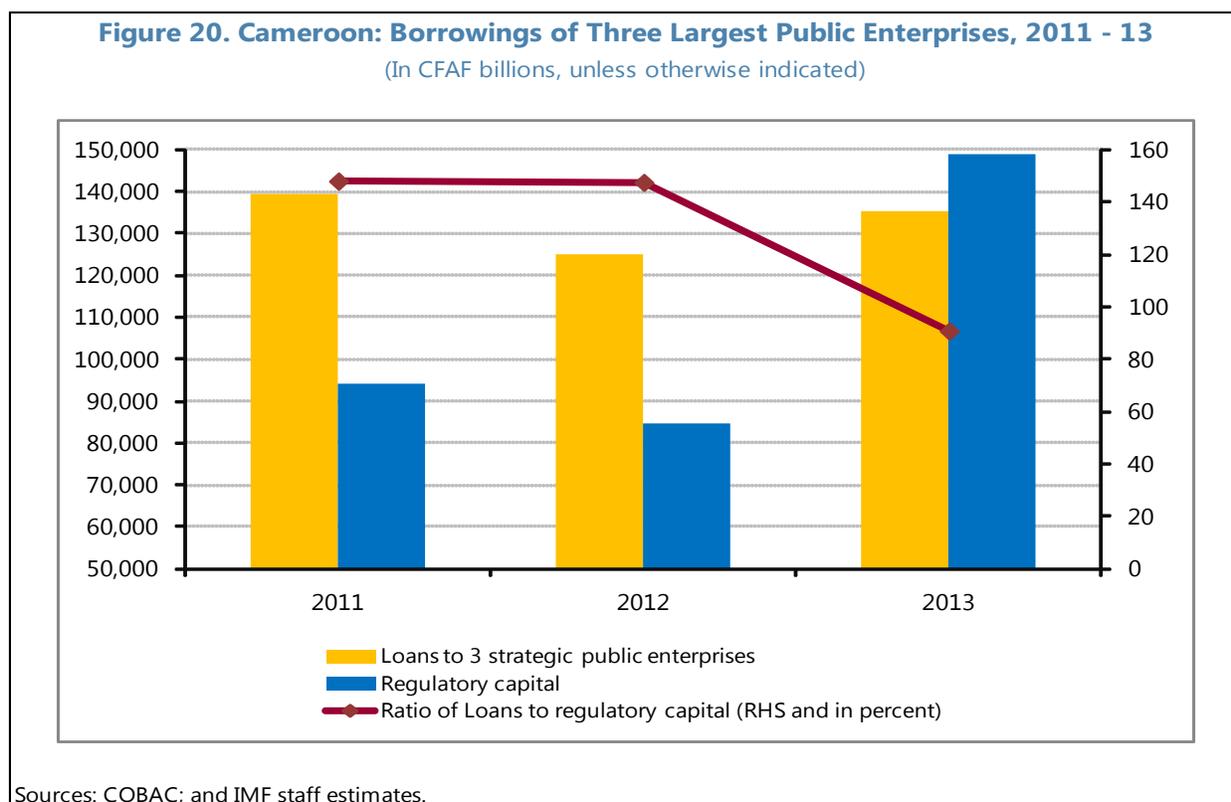
Figure 19: Cameroon: Sectorwise Distribution of Bank Loans and Deposits, 2010 - 13

(In CFAF billions)



Sources: COBAC; and IMF staff estimates.

35. The major risks to the sector emanate from loan concentration and asset quality. Single obligor credit concentration is a serious risk in the banking system. Credit exposure to “strategic” public enterprises represents a risk that requires close monitoring. Borrowings of the three largest public enterprises are shown in Figure 20. Their borrowing accounted for over 100 percent of banks’ regulatory capital in 2011 and 2012; it declined to 90 percent in 2013.



36. The banking industry is profitable, as evidenced by returns on asset and equity. The largest banks exhibit the highest profitability ratios, reaping the benefits of economies of scale and being price setters in some segments. These banks typically focus on lending to strategic companies and major oil and export-oriented enterprises with low-to-moderate risk profiles.

37. Liquid assets⁵ represent 27 percent of banks’ assets. The low level of credit relative to bank resources reflects (i) weak economic activity in the non-oil sector, which limits lending opportunities; (ii) the high cost of credit stemming, in part, from limited competition among banks; and (iii) unfavorable legal and judiciary procedures, which make it hard for banks to recover delinquent loans and foreclose on collateral. Such conditions make banks reluctant to extend long-term loans; not surprisingly, short-term loans account for the bulk of their lending.

⁵ Liquid assets are defined as a broad measure to comprise cash in hand, deposits at the central bank, and holding of government papers.

38. Stress testing has been applied to gauge the resilience of banks to adverse events arising from the concentration of exposures. The stress tests covered all banks in Cameroon. Solvency and liquidity tests followed a bottom-up approach using end-2013 balance sheet data. Banks' capital needs were assessed against the regulatory requirement of 8 percent of risk-weighted assets. The tests also examined the impact of shocks due to fiscal slippages and to a sudden drop in confidence and a deposit run on the banking system (Appendix I, Tables 1-3).

39. Although the stress test results call for caution given data quality concerns, they show that system-wide capitalization is vulnerable to credit shocks and credit concentration.

Solvency stress tests were based on sensitivity analysis of shocks using end-2013 as the baseline. Tests were run to assess the implications of a default by the top obligor of banks. Such a default would reduce the capital adequacy ratio by about two-thirds for the banking sector as a whole; and by about 27 percent for foreign banks and 37 percent for the five largest banks, respectively.

40. The banking system is also vulnerable to liquidity shocks. The testing simulated the implications of a run down in deposits on banks by the public sector (fiscal slippage) and a loss in confidence in the economy. Private demand deposits made up about 55 percent of total deposits at end-December 2013. The tests were calibrated with reference to changes in deposits at end-2013 and assumed a 10 percent decline in demand deposits on a daily basis. The analysis considered "cash and deposits at the BEAC" as liquid assets.

41. The banking system was found to withstand a daily withdrawal of 10 percent of public sector deposits over a five-day period, but it is vulnerable to a run on demand deposits from the private sector. By day five, four banks (of which three are the troubled banks) would be faced with liquidity problems. The banking system as a whole would nonetheless withstand liquidity risk over the five-day period. This result is not surprising given the high liquidity levels at most banks.

B. The Microfinance Sector⁶

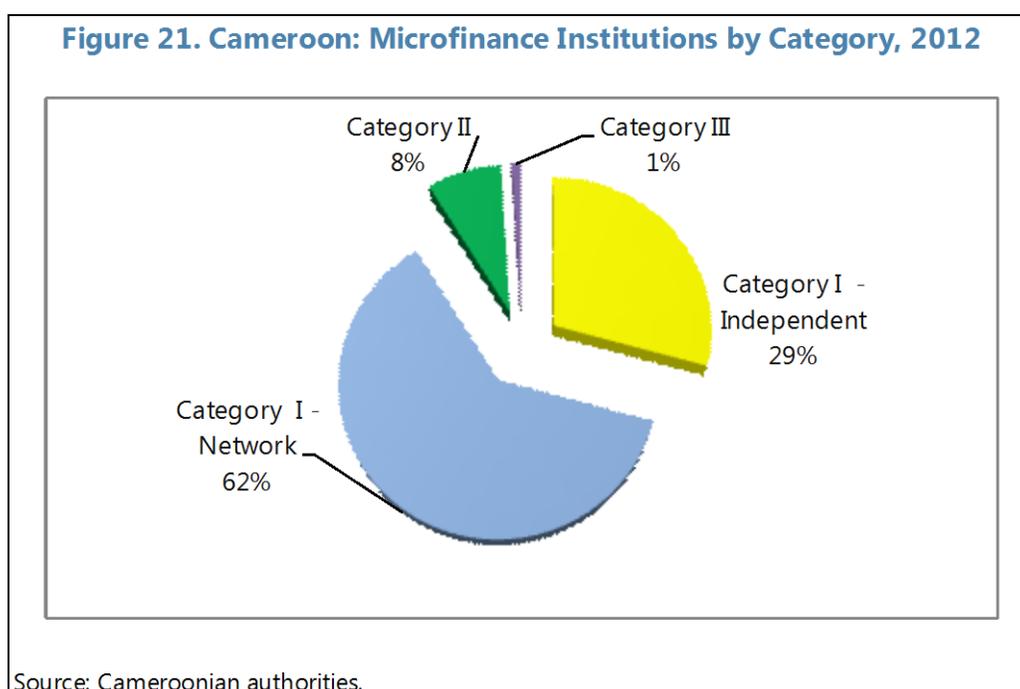
42. Microfinance is culturally rooted in Cameroon. The microfinance movement can be traced back to the 1960s with the creation of the first cooperative by a Dutch missionary in the *North-West* region. This cooperative was the precursor to the Cameroon Cooperative Credit Union League (CAMCCUL). Traditional microfinance institutions (MFIs) continue to provide access to credit and to some basic micro-insurance for the rural and urban communities. They are mainly informal self-help groups or rotating savings and credit associations, commonly known as *tontines*. In 1998, a law was passed to recognize MFIs as unique entities in the financial sector. Under this law, MFIs were placed under the control of the Ministry of Finance, but the regional bank supervisor (COBAC) was also entrusted with supervisory role. The distribution of MFI branches is disparate, with three of the ten regions—the *North-West*, *Littoral* and *Centre* regions—accounting for 60 percent. MFIs are also concentrated in the largest cities.

⁶ A forthcoming FSAP mission for the CEMAC will review this sector and offer more specific recommendations.

43. MFIs are regulated by the 2002 “master framework.” It is known as Standard n° 01/02/CEMAC/UMAC/COBAC Organization and Supervision of Microfinance Activities in the CEMAC. The framework defines microfinance as “*activities undertaken by authorized entities that are neither banks nor financial institutions, but take savings or deposits, give out credit or loans and offer specific financial products to those generally excluded from banking networks.*” There are three categories of microfinance institutions (Figure 21).

- Category I MFIs collect savings and deposits from their members and lend them on exclusively to their members. This category includes credit associations, cooperatives, and unions, and is further subdivided into independent and network MFIs.
- Category II MFIs collect savings and deposits and lend them on to third parties. This category comprises limited liability companies that function more like quasi-banks.

Category III MFIs do not collect savings and deposits. They include micro-credit and project finance institutions.



44. MFIs are also regulated by three legal provisions: (i) national law; (ii) CEMAC law established through COBAC; and (iii) OHADA. A MFI is supposed to follow the COBAC guidelines, especially with regards to basic prudential norms. However, these guidelines have been hardly enforced until lately, when COBAC rolled out a reporting framework for Category II MFIs. The Cameroonian authorities have set up a unit within the Ministry of Finance to monitor the activities of MFIs, which they hope will help professionalize the sector; develop and monitor products and services to be offered by MFIs; and propose a pricing policy for services. The framework for analyzing the performance of this sector is based on five criteria: (i) asset quality; (ii) efficiency and

productivity; (iii) financial management; (iv) profitability; and (v) management. The multiple challenges faced by the microfinance sector also prompted the authorities to adopt a national strategy for the microfinance sector in 2013 (Box 2).

45. The microfinance sector experienced strong growth, with concomitant consolidation in 2012. The number of agencies, clients, deposits, and loans all grew, while the number of MFIs decreased. This drop illustrates the fragility in the sector, but also efforts in closing out non-viable MFIs. There were 371 Category I MFIs; 32 Category II MFIs and 4 Category III MFIs. Category II MFIs accounted for nearly half of market share with respect to deposits mobilized and loans extended (Table 4). Twelve MFIs, irrespective of their categories, account for over 77 percent of MFI total assets, thereby showing concentration in this sector. CAMCCUL, which is the MFI of a network of affiliated Category I institutions, accounts for about 29 percent of total MFI assets. MC², which can be considered as a rural development micro-bank, is the next largest MFI; six Category II MFIs make up nearly 29 percent of total assets (Figures 22–23).

Box 2. National Strategy for Financial Inclusion

A national strategy for financial inclusion was launched in 2013 to consolidate and develop the microfinance sector in Cameroon. The strategy aims to: (i) reinforce training of promoters, officers, and employees of MFIs; (ii) establish a first level of supervision and control of MFIs by COBAC, consistent with CEMAC regulations; and (iii) further strengthen the monetization of the economy, including the expansion of automated payment systems to MFIs.

The strategy notes the need to improve the regulation and taxation of the microfinance sector, in the face of constraints, such as (i) insufficient and ineffective monitoring; (ii) low capacity to mobilize long-term resources; (iii) inadequacy between traditional collateral guaranties and the realities of MFIs; (iv) the absence of standardized prudential ratios for MFIs thereby rendering assessment difficult; (v) the vagueness of the tax system applied to MFIs; (vi) administrative rigidities confronting the sector; and (vii) the lack of consideration in the regulation of the use of technology in microfinance. In light of these findings, the strategy recommended to: (i) establish a fund for security deposits for the microfinance sector to ensure coverage of risks; (ii) strengthen the monitoring by involving key stakeholders, including the COBAC, the Ministry of Finance, the Professional Association of Microfinance Institutions; (iii) facilitate the mobilization of long-term resources to meet the coverage ratios; and (iv) revisit the prudential ratios to adapt them to different types of MFIs.

The strategy identified four strategic axes for 2013-18: (i) improving the legal, regulatory and institutional environment for the microfinance sector to make it more inclusive; supporting a viable and sustainable supply of diversified and innovative products adapted to the needs of all segments of the population; (iii) developing partnerships for the efficient mobilization of financial and technical resources adapted to the specific needs of the sector; and (iv) evaluating the social impact of MFIs.

Table 4. Cameroon: Microfinance Institutions Selected Data, 2006 – 12

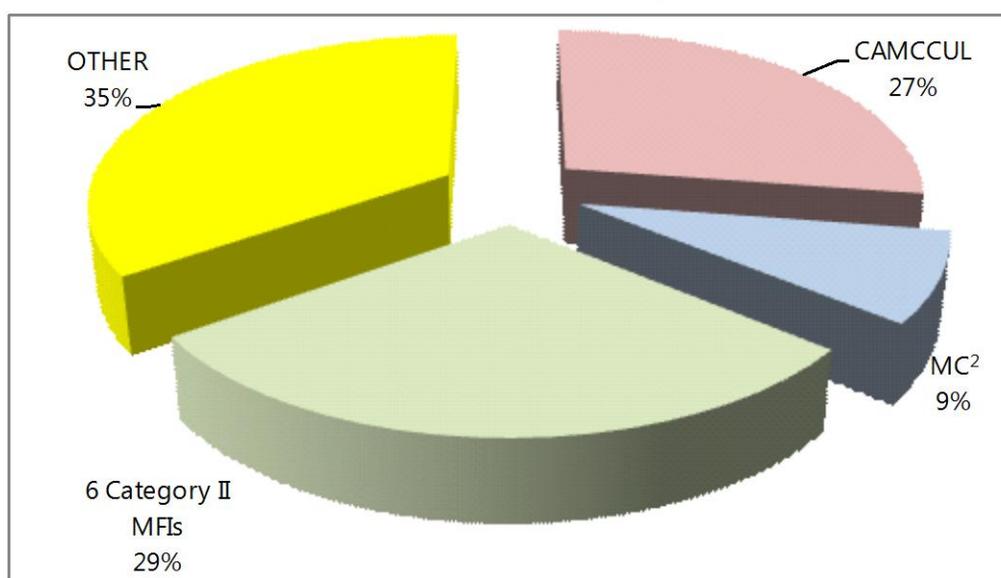
(Units as indicated)

	2006	2008	2010	2012
Number of microfinance institutions	453	470	490	407
Number of agencies	1,052	983	1,000	1,087
Number of clients	849,030	1,073,620	1,360,000	1,500,000
Total deposits (CFAF billions)	162.4	258.2	373.9	454.6
Total loans (CFAF billions)	104.2	138.5	221.4	239.8
Share capital (CFAF billions)	20.0	22.2	42.3	63.5

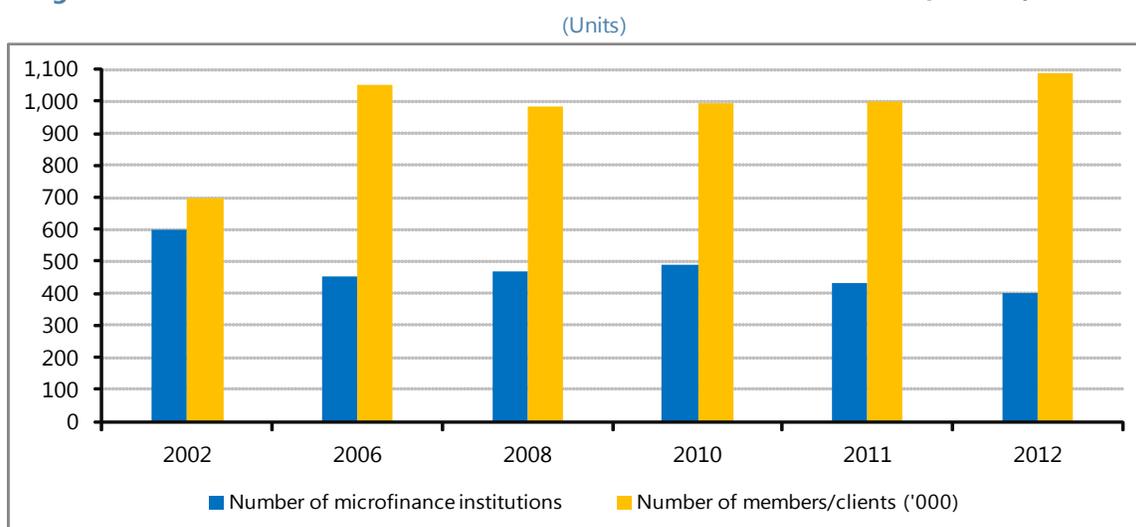
Source: Cameroonian authorities.

Figure 22. Cameroon: Main Microfinance Institutions, 2012

(In percent of total assets)

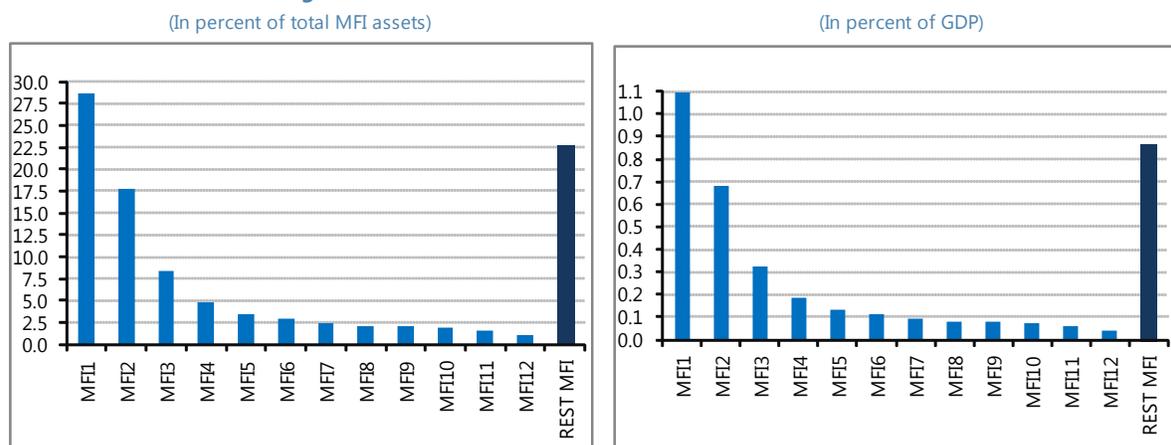


Sources: Cameroonian authorities and IMF staff estimates.

Figure 23. Cameroon: Number of Microfinance Institutions and Members/Clients, 2002 - 12

Source: Cameroonian authorities.

46. The distribution of the twelve largest MFIs by asset size and as a share of GDP is shown in Figure 24. Total MFI assets have been hovering around 4 percent of GDP for the past few years and the total assets of the largest MFI represented 1.1 percent of GDP at end-2012.

Figure 24. Cameroon: Microfinance Institutions Assets, 2012

Source: Cameroonian authorities.

47. A stylized balance sheet for the MFI sector was prepared for end 2012 using the extrapolation method (Table 5). This was done using selected data made available by the authorities and using balance sheet information for the twelve largest MFIs. The balance sheet shows that deposits of concerned MFIs accounted for 81 percent of their total liabilities. Loans as a share of total assets were estimated at 43 percent, while liquid assets, defined as cash in hand and balances with banks, stood at 35.5 percent. The high liquidity ratio is not surprising given that MFIs are to meet cash withdrawals at very short notice.

Table 5. Cameroon: Microfinance Institutions Stylized Balance Sheet, 2012

(CFAF millions)

Liabilities		Assets	
1. Capital and Reserves	63,475	1. Liquid Assets	198,330
2. Total Deposits and Contributions	454,560	2. Loans	239,825
3. Long-Term Borrowings	10,700	3. Fixed Assets	61,430
4. Current Liabilities	24,315	4. Current Assets	30,855
5. Other Liabilities	5,530	5. Other Assets	28,140
Total Liabilities	558,580	Total Assets	558,580

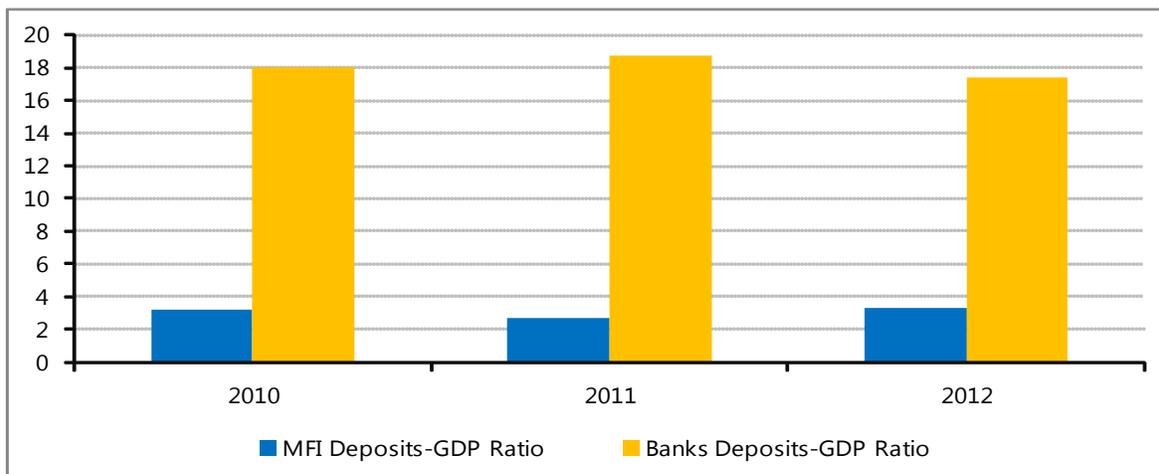
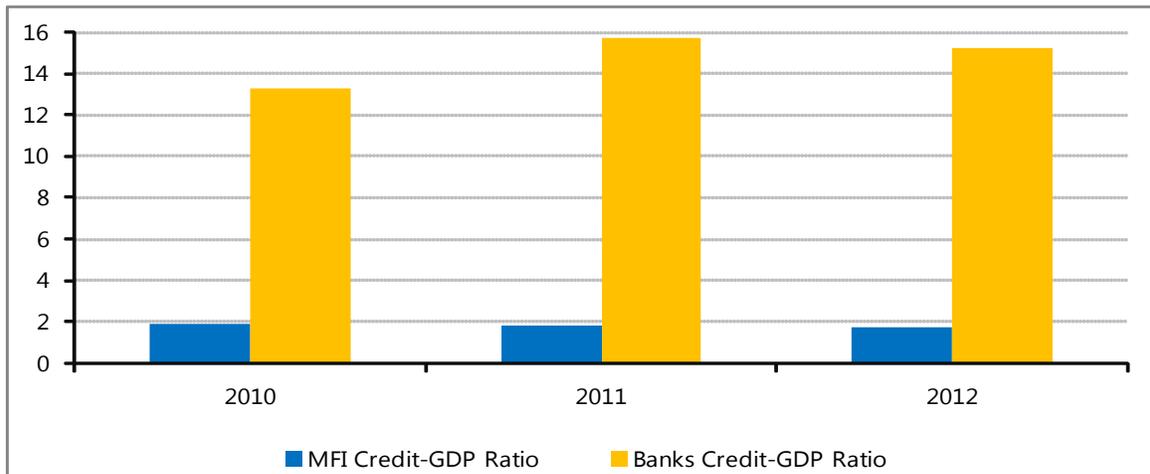
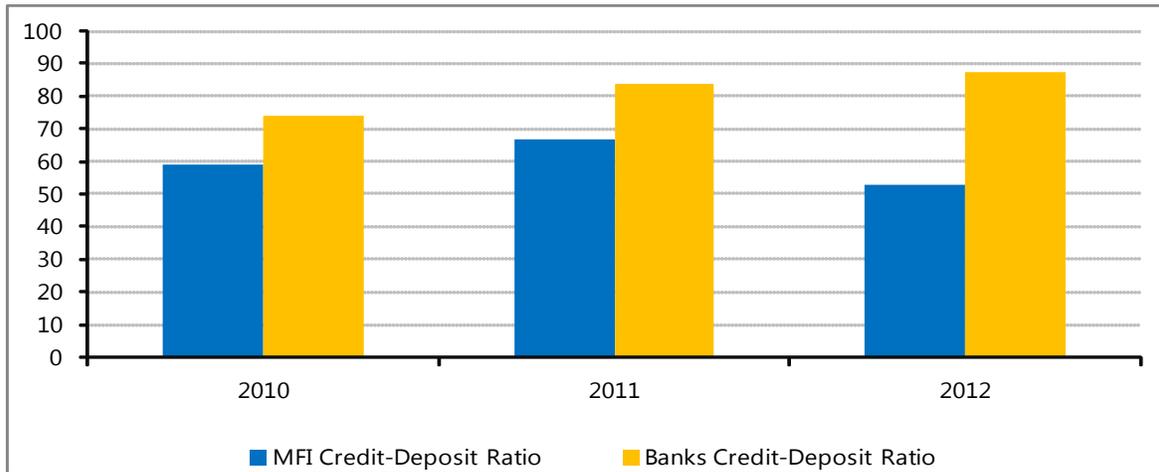
Sources: Cameroon Ministry of Finance; and IMF staff estimates.

48. Relations between banks and the largest MFIs are increasingly complex. On the one hand, the largest MFIs compete with banks. The assets of the biggest MFI is at par with those of the ninth largest bank (Figure 25). MFIs enjoy certain advantages that may improve their competitive position relative to commercial banks (i) they are structured as cooperatives, benefitting from tax exemptions not applicable to banks, that were originally justified by their social mandate and not-for-profit motive; (ii) there is no cap on interest charged by MFIs for loans, unlike for banks; and (iii) some MFIs receive public or donor support via cheap funds, guaranties, or training of staff. On the other hand, several banks are operating in the microfinance sector—six banks have created MFIs that they partially finance.

49. The regulation and supervision of MFIs should be an integral part of a strategy to develop a market-based financial system. Microfinance is not limited to borrowing, but also includes other financial services such as savings, insurance, transfer facilities, etc. A clear and transparent regulatory framework is necessary because MFIs' traditional fund sources cannot keep pace with their lending growth, and thus MFIs need to have access to external finance to complement their own resources. The systemic importance of about 1.5 million depositors requires adequate measures to preserve the stability of the microfinance sector. There have been calls from the MFIs' professional association (APECCAM) to extend the bank deposit insurance scheme to deposits mobilized by MFIs.

50. Cameroon's microfinance services are inadequately diversified to satisfy the financing needs of the economy. Only the largest MFIs are able to offer a wider range of savings products (e.g., current and savings accounts and term deposits at different maturities) and of loan products. Other basic products, like micro-insurance and mobile money transfer, are not common.

Figure 25. Cameroon: Banks and Microfinance Institutions Credit and Deposits, 2010 - 12
(Percent)



Sources: Cameroonian authorities; and IMF staff estimates.

51. Some MFIs are in financial distress, mostly because of governance problems, lack of proper internal controls, and inadequate management information systems. Experiences of fraudulent financial schemes have undermined confidence in the microfinance sector. Against this background, it is important that distressed MFIs be either restructured or liquidated rapidly. This would send a strong signal to the whole sector.

C. Recommendations

Banking sector

52. The cost of financial services should be reduced through stronger competition. A more competitive environment is needed to incite financial institutions to improve services and lower prices. It is necessary to enhance the quality, coverage, and dissemination of information on banks' operating fees. Customers are entitled to information on the strengths and weaknesses of the bank to which they entrust their deposits. Providing financial information to the general public and to the media is one way of developing healthy competition and a "financial culture," and promoting modernization of financial instruments. State participation in banks should be phased out gradually.

53. Habit formation in consumption of financial services must be enhanced to broaden the use of banking services. The authorities could use public awareness campaigns to promote the concepts of saving and credit, and the role of financial institutions. Promoting financial literacy is a prerequisite.

54. Better infrastructure would broaden access to financial services. Better infrastructure, involving financial technologies (e.g., ATMs, point-of-sale machines, electronic bank cards) would reduce transaction costs. Ensuring reliable power supply is vital to the functioning of the payments system. Improved transportation would make financial institutions more willing to open branches in rural areas.

55. Innovative forms of banking could be contemplated. Introducing mobile payments on a large scale will require enhanced provision of public infrastructure (in particular telecommunications) to reduce the cost of new services and the expansion of financial services to reach underserved areas.

56. Contract enforcement is needed to expand bank lending. Banks need reliable credit information, suitable collateral, efficient property registry system, and a strong judicial system that enforces contracts. Financial institutions find it difficult to assess creditworthiness, in particular because information from the payments incidents data base run by the central bank (*Centrale des Risques*) is limited and out of date.

57. An effective credit bureau would also help to promote lending. Credit information should include not only default history but also standardized ratings of creditworthiness for individuals and companies, based on a basic rating system.

58. Consolidated supervision needs to be developed. A few banks in Cameroon are controlled by holding companies incorporated in other CEMAC countries and one bank operates as a branch of a bank incorporated in another union country. Cross-border information sharing and supervision remains generally limited. It is noted that the COBAC is in the process of drafting new regulations on this issue and the authorities are encouraged to cooperate with the COBAC and support it in its mission of implementing consolidated supervision.

59. The development of capital markets can widen access to financial services. Capital markets provide savers with a variety of investment choices with long maturities. Companies can raise long-term funds from capital markets at a lower cost than from banks. Pension funds and insurance companies can invest part of their portfolios in capital markets. Developing capital markets requires appropriate sequencing and a sound macroeconomic environment, transparent institutions, and good governance. A first step could be the merging of the Douala, Cameroun, and Libreville, Gabon, stock exchanges; and the respective authorities are invited to work together to achieve this for the benefit of the whole region.

60. Nonbank finance has not been tapped in Cameroon, but has potential. Bond finance is an interesting substitute to bank finance, but the necessary legislative and business frameworks need to be adopted. The emergence of a large market in equity requires strong investor rights.

Microfinance sector

61. Ensuring an adequate balance of prudential supervision and financial inclusion will require increased supervisory resources. Given the importance of this sector in terms of exposure to the low-income population, and the needs to minimize risks to financial stability and sustain public confidence, it is important to put in place an effective supervisory mechanism which includes both prudential and market conduct supervision. This applies to all MFIs, not just the largest ones, as small players with a poor reputation can lead low-income consumers to abandon the industry entirely, harming financial inclusion. As a complement to the regulatory framework, efforts should be made to disseminate basic principles guiding specific aspects of microfinance activities, accompanied by financial literacy, complaint handling, and consumer protection initiatives. Properly designed standards and guidelines may also provide a set of basic principles facilitating good practices, but attention has to be paid to avoid the risk of limiting product innovation, which is a key characteristic of the microfinance industry.

62. Long-run goals for supervision should include improving the quality of licensing and training, and stepping up information sharing. Improvements will have to be undertaken given limited resources, but MFIs should be able to collect accurate and timely information for their own management and internal control purposes, as well as for transmission to the supervisory authorities, and also keep pace with innovations relating to other stakeholders, such as mobile phone companies and post offices. Supervisors also need to set up proportionate approaches for licensing MFI personnel to ensure that they have the necessary skills sets for microfinance operations. MFI personnel should have basic banking knowledge, and fit and proper requirements, augmented by specific skills tuned to the peculiarities of microfinance operations. Supervisory

oversight, including comprehension of the controls mechanisms of MFIs, are important for consumer protection and to maintain trust in the system.

63. To improve financial inclusion objectives, governments often collaborate with public-private partnerships to offer appropriate incentives to MFIs to reach out to underserved rural areas. These incentives sometimes have taken the form of participation in (i) the lease or construction of the necessary infrastructure; and (ii) the lease/purchase of equipment (computers, safe deposit boxes, motor bikes, etc.) together with effective supervisory controls.

Appendix I. Stress Testing

Appendix Table 1. Cameroon: Solvency Stress Test	
Scope	Bottom-Up by Banks
Institutions included	All 13 commercial banks
Market share	100 percent
Date and baseline date	December 2013
Methodology	Balance sheet sensitivity analysis
Stress test horizon	Static (point in time)
Shocks	Sensitivity analysis on credit risk <ul style="list-style-type: none"> • Concentration of risk (default of largest borrower - the largest public strategic enterprises; and three largest public strategic enterprises)
Risks	Higher provisioning expense as a result of credit losses <ul style="list-style-type: none"> • Solvency of banking sector
Results	Deterioration in capital

Appendix Table 2. Cameroon: Liquidity Stress Test	
Scope	Bottom-Up by Banks
Institutions included	All 13 commercial banks
Market share	100 percent
Date and baseline date	December 2013
Methodology	Bank-run test
Stress test horizon	5-day horizon
Risks	Deposit run (10 percent daily withdrawal for 5 days)
Results	Deterioration in liquidity condition

Appendix Table 3. Cameroon: Solvency Stress Test					
(End-December 2013)					
	All banks	Foreign- controlled banks	Five largest banks	All banks excluding troubled banks	
Baseline: CAR¹ before the shock	7.6	16.6	12.4	14.7	
CAR after shock - Credit risk					
Default of largest borrower	2.6	12.2	7.8	9.8	
Default of three largest strategic enterprises	0.7	9.5	5.6	7.9	
Liquidity Risk (Number of banks illiquid)					
Withdrawal of deposits ²	Day 1	Day 2	Day 3	Day 4	Day 5
All banks	0	1	1	3	4
Excluding troubled banks	0	0	0	0	0
Five largest banks	0	0	0	0	0
Foreign-controlled banks	0	0	0	1	1
¹ CAR: Capital Adequacy Ratio.					
² 10 percent daily withdrawal on demand deposits for banks .					
Sources: COBAC; and IMF staff estimates.					

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