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CAMEROON

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November 2, 2015

Approved By
African Department

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CONTENTS

STATE-OWNED ENTERPRISES—RECENT PERFORMANCE AND REFORM AGENDA[1]

Cameroon's state-owned enterprises (SOEs) are important providers of formal employment and have a large weight in the economy. The profitability and financial autonomy of SOEs have deteriorated in recent years, draining scarce budget resources. In addition, SOEs have amassed significant contingent liabilities in the form of debt and arrears. Weak corporate governance is a key factor in SOEs' poor performance. The reform agenda should include enhancing the monitoring of SOEs, improving disclosure of their contingent liabilities, and strengthening their governance.

A. An Overview of Cameroon's State-Owned Enterprises

1. Cameroon hosts 119 public entities and enterprises, which constitute the public sector. Over 70 percent of state-owned enterprises (SOEs) are non-commercial administrative entities charged with providing a public service. The remaining SOEs are financially autonomous and commercially oriented entities, roughly equally divided between wholly government-owned public corporations and semi-public corporations with joint public/private ownership. This study focuses on the 17 largest commercially oriented SOEs.[2] These are either exclusively government-owned or the state holds a majority equity stake in them through holdings via other SOEs. The surveyed companies cover several strategic sectors in Cameroon, including agriculture, energy, and telecommunications. They encompass the bulk of the SOE sector in terms of employment and financial assets. The focus on commercially oriented SOEs is appropriate, since they differ from public agencies in their ability to contract debt and, in so doing, generate contingent liabilities for the state. Key financial and non-financial information for the concerned SOEs for 2009–13 were provided by the Technical Committee for Rehabilitation within the Ministry of Finance (Table 1). The Committee is responsible for the financial surveillance of SOEs.

Table 1. Cameroon: Summary Data for Key State-Owned Enterprises, 2013
(CFAF billions, unless otherwise noted)

Sectors of activity	SOEs	Workforce (no.)	Capital	Assets	Turnover	Net income	Subsidies	Debt	Arrears
Agriculture	4	30564	15.3	255.0	180.9	11.5	7.8	166.4	71.0
Construction	2	672	4.5	136.4	7.0	-3.1	0.7	31.6	16.6
Electriticity and Water Utilities	2	414	11.5	351.3	15.4	-1.7	57.0	128.3	6.6
Energy	2	1098	26.5	942.0	879.5	-28.6	0.0	853.0	83.3
Transport, Storage, and Communications	7	7670	119.7	833.3	178.1	-6.4	35.4	661.0	151.8
Total	**17**	**40418**	**177.6**	**2518.1**	**1260.9**	**-28.1**	**101.0**	**1840.3**	**329.4**

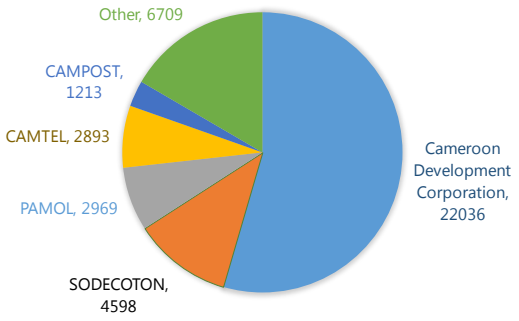
Source: Cameroonian authorities

[1] Prepared by Toomas Orav.

[2] The list excludes the National Investment Corporation (*Société Nationale d'Investissements*), a fully state-owned holding company whose portfolio includes several large public enterprises, and the national oil and gas company (*Société Nationale des Hydrocarbures*), which finances and manages hydrocarbon exploration and production in partnership with various international companies.

2. The SOEs surveyed are significant providers of employment. They range in size from a few employees to Cameroon's second largest employer—the Cameroon Development Corporation—which employs over 22,000 workers.[3] Based on the most recent available data, these 17 SOEs collectively employ about 40,000 workers, which is estimated to amount to about one-sixth of total public sector employment.[4] With little formal employment outside the public sector, this indicates the important role that SOEs play in the Cameroon labor market. The annual average total wage bill amounted to about 0.8 percent of annual average GDP in 2009–13 (Figure 1).

Figure 1. Cameroon: SOE Workforce
(2013, or most recent)

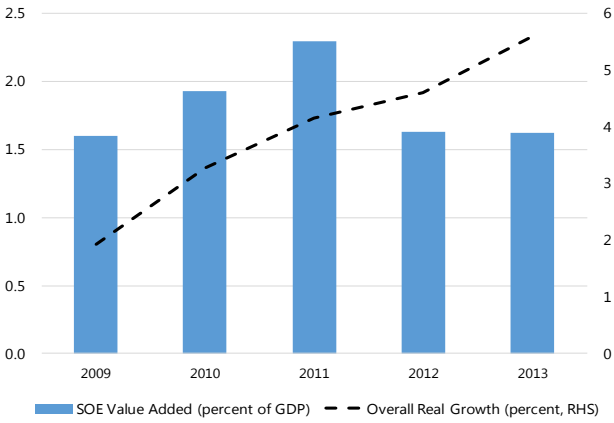


Source: Cameroonian Authorities and IMF staff estimates.

3. The SOE sector is highly concentrated. Five of the 17 SOEs account for 80 percent of the workforce, 65 percent of assets, and 90 percent of revenue. In recent years, three of these enterprises generated most of the profits, while four accounted for the bulk of losses.

4. Available data indicate that the 17 SOEs play a modest role in value addition.[5] The value added by these SOEs appears modest, averaging less than 2 percent of GDP in 2009–13. Moreover, as economic growth accelerated toward 4–6 percent per annum in the last few years, the value added by these SOEs declined substantially (Figure 2). This being said, these SOEs have important indirect economic impacts as consumers of services in their communities, and as major social contributors in terms of schools and health facilities.

Figure 2. Cameroon: Real GDP Growth and SOE Value Added, 2009–13



Sources: Cameroonian authorities and IMF staff estimates.

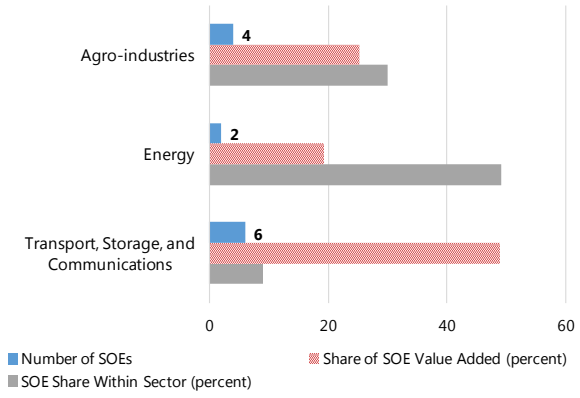
[3] The Cameroon Development Corporation (CDC) is an agricultural-industrial enterprise which acquires, develops, and operates extensive plantations of tropical cash crops.

[4] The IMF (2014) has estimated total public sector employment at around 250,000 persons.

[5] The value added created by SOEs is calculated as the total value of production less intermediate consumption of goods and services.

5. This group of SOE's features in key sectors of Cameroon's economy (Figure 3). The role of these SOEs is relatively important in agricultural exports (notably cotton, palm oil, and rubber). SOEs also have monopolies in key network infrastructure, notably in energy, transportation, and telecommunications. Cameroon Telecommunications (CAMTEL) holds a monopoly in national telephone landlines, the international gateway, and internet infrastructure. In the oil and gas sector state companies dominate extraction, refining, storage, and distribution.

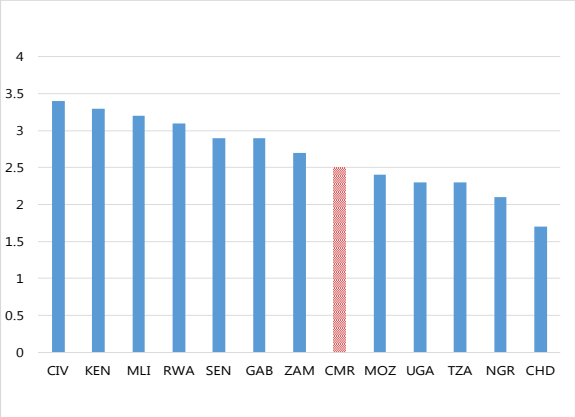
Figure 3. Cameroon: SOE Value Added by Sector, 2009–13
(average)



Sources: Cameroonian authorities and IMF staff estimates.

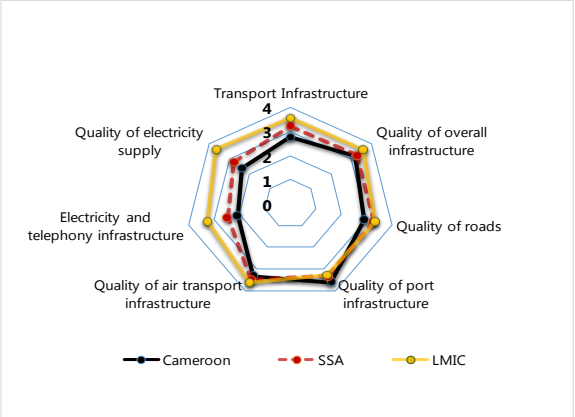
6. Surveys indicate that Cameroonian SOEs have not been effective providers of services. The yearly Global Competitiveness Report by the World Economic Forum surveys business leaders in their respective countries. In the 2014–15 edition, Cameroon received a middle rank among sub-Saharan African (SSA) countries in terms of the quality of infrastructure (Figure 4). Although Cameroon scored relatively well on ports, it lagged others on roads, air transport, electricity, and telecommunications infrastructure (Figure 5). World Bank data show that electricity consumption has remained flat—and in 2012 electricity use per person was roughly only half of the level of developing SSA countries—while subsidies to the power company averaged 0.3 percent of GDP. The weak financial standing of SOEs is a likely reason for poor infrastructure, as companies are unable to mobilize sufficient resources for investment.

Figure 4. Cameroon: Quality of Infrastructure, 2014
(Index)



Source: World Economic Forum, Global Competitiveness Index (2014–15 ed.).

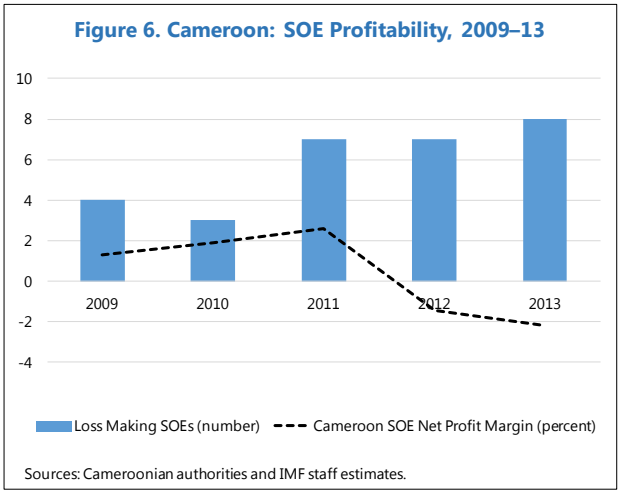
Figure 5. Cameroon: Quality of Infrastructure, 2014
(1–7, best)



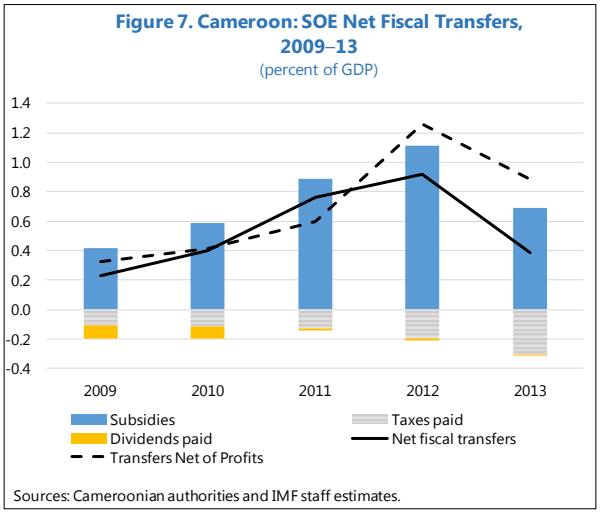
Source: World Economic Forum, Global Competitiveness Index (2014–15 ed.).

B. Financial Performance of State-Owned Enterprises

7. The profitability of SOEs is low (Figure 6). Net income in 2009–13 indicated a weak bottom line, with 8 of the 17 enterprises realizing a cumulative loss, and only one firm, operating in the agricultural sector, consistently staying above breakeven level. Financial results generally deteriorated toward the end of the period and the overall net profit margin became negative in 2012–13. The national airline and the national refinery together amassed total losses on the order of 0.5 percent of GDP a year in 2012–13, with company specific factors playing a large role, such as investment costs for the airline and the uncovered shortfalls in revenue in a context of regulated domestic fuel prices in the case of the refinery. At the same time, it is important to recognize that SOEs are not necessarily set up to maximize profit, and that a proper assessment of performance would require weighing profitability against their public service obligations, which in Cameroon's case have not been properly priced by the authorities.



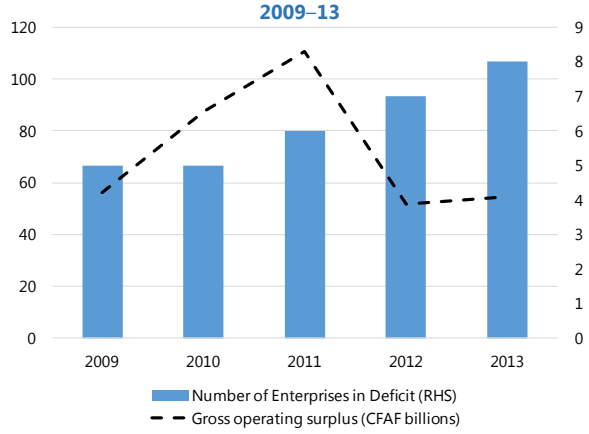
8. The state's net fiscal transfers to SOEs declined in 2013 (Figure 7).[6] Subsidies rose sharply from 0.4 percent of GDP in 2009 to an annual average 0.9 percent of GDP in 2011–12. Although widely dispersed across sectors, the largest recipients of subsidies were in the transportation and utilities sectors. The state's net fiscal transfers declined in 2013, because of stronger tax recovery and lower subsidies to a few notable sectors—electricity and air transport. However, with continuing losses in these sectors potentially carrying over into the future, transfers net of profits are a better measure of financial dependency. These averaged 1.1 percent of GDP annually in 2012–13. Although SOEs do provide useful public services, the value for money from the subsidies they receive should be carefully weighed against the opportunity cost. For example, rising subsidy spending in 2009–14 was matched by a fall in total health care spending from 1.4 percent of GDP in 2009 to 1.1 percent in 2012 (IMF, 2014).



[6] The net fiscal transfer is defined as subsidies less taxes and dividends paid. Calculating the net fiscal burden would require fuller data on SOE tax arrears owed to the state and the government's payment arrears to SOEs, as well as data on SOEs access to subsidized interest rates or rent-free property.

9. The liquidity of SOEs has become more constrained. The gross operating surplus, a measure of the portion of income derived from production that is earned by capital, has halved since 2011, with an increasing number of firms reporting gross operating deficits (Figure 8).[7]

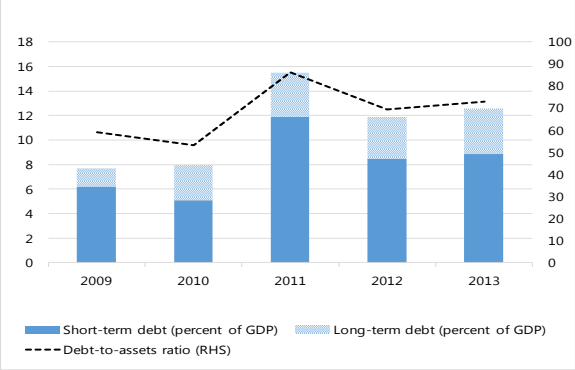
Figure 8. Cameroon: SOE Gross Operating Surplus, 2009–13



Sources: Cameroonian authorities and IMF staff estimates.

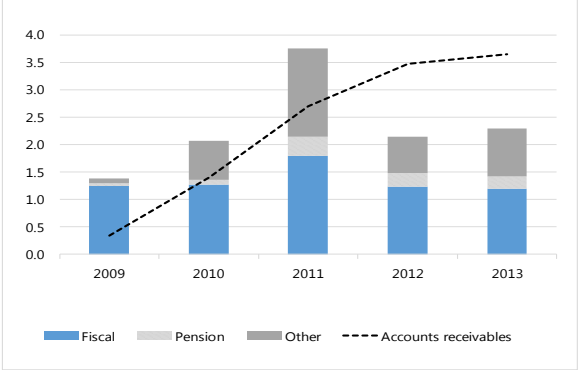
10. SOEs exhibit high levels of indebtedness, suggesting rising systemic risks (Figure 9). The debt of SOEs increased from 8 percent of GDP in 2009–10 to 12.6 percent of GDP in 2013. Although one firm accounts for nearly half of the debt, indebtedness increased for the majority of the firms. The total-debt-to-assets ratio rose substantially to exceed 70 percent, and six enterprises contracted debt near or above 80 percent of their assets. At the same time, SOEs' arrears exceeded 2 percent of GDP in 2012–13 (Figure 10). Aggregate arrears declined in 2012, as companies reduced an overhang of unpaid taxes and supplier bills accumulated in 2011. The state budget bears the burden of arrears through foregone tax revenue, accounting for over half of all arrears. The wide dispersion of arrears across SOEs suggests a generalization of late payments in Cameroon. Arrears also increase transaction costs and put pressure on smaller firms, which may not possess sufficient working capital to absorb payment delays. This in turn may lead to a rise in non-performing loans in the banking sector. A possible factor contributing to large arrears is weak recovery of payments due; SOEs' accounts receivables data point to a sharp increase to 3.6 percent of GDP in year, of which a significant portion represents outstanding payments due from the state.

Figure 9. Cameroon: SOE Debt, 2009–13



Sources: Cameroonian authorities and IMF staff estimates.

Figure 10. Cameroon: SOE Arrears, 2009–13
(Percent of GDP)



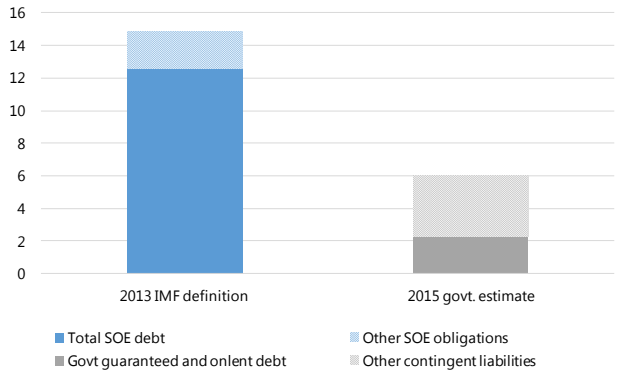
Sources: Cameroonian authorities and IMF staff estimates.

[7] Gross operating surplus is calculated as value added less payroll.

11. SOEs' contingent liabilities pose a significant fiscal risk (Figure 11). Contingent liabilities (i.e., debt and arrears) of large SOEs were estimated at 14.9 percent of GDP at end-2013, a significant fiscal risk for the state. The Ministry of Finance has developed a measure of contingent liabilities, based on information available as of mid-2015. Although the definition of contingent liabilities used by the Ministry is narrower than the one used in this paper, even on this basis contingent liabilities of SOEs at end-August 2015 were significant at 6.1 percent of GDP, of which 2.3 percent related to government-guaranteed and on-lent loans.[8,9] A lack of time series data prevents an assessment of the evolution of this narrower definition of contingent liabilities, but the Ministry of Finance indicate that the amount had been growing over time. Contingent liabilities of SOEs could pose a significant fiscal risk in the event that a large SOE cannot meet its payment obligations (IMF, 2015).

Figure 11. Cameroon: SOE Contingent Liabilities, 2009–13

percent of GDP



Sources: Cameroonian authorities and IMF staff estimates.

C. Corporate Governance

12. Cameroon's ownership arrangements for SOEs follow a dual model. A 1999 law establishes arrangements whereby specific line ministries and the Ministry of Finance share oversight functions of SOEs. This system gives the relevant sectoral ministry responsibility for overall oversight, while the executive board and management develop strategies and implement operational plans. Theoretically, this set up provides ministries with a basis for overall supervision of the SOEs in their purview.

13. The governance of SOEs appears weak. Boards and management teams are largely made up of representatives of government administrations or government officials, potentially weakening the independence of directors and, in so doing, corporate governance. World Bank analysis of a sample of 33 SOEs (including administrative establishments) found that that more than two-thirds of administrators were affiliated to the government. This type of representation could also weaken business capacity as such officials may lack practical business experience and skills. Accountability appears to be weak; although the law precludes directors from holding more than two successive three-year terms, turnover at several boards appears low with directors frequently exceeding the legal number of mandates. World Bank analysis also finds that the level of remuneration of Board members is high relative to private sector counterparts (World Bank, 2014).

[8] The Ministry of Finance's definition of contingent liabilities focuses on high-risk liabilities, including companies already experiencing payment difficulties with government-guaranteed loans and government on-lending, and arrears to suppliers.

[9] Based on Ministry of Finance reports on public sector contingent liabilities, the bulk of liabilities relate to the 17 SOEs under review.

14. Governance and accountability arrangements entail a significant potential for conflicts of interest. Line ministries have both ownership and regulatory responsibilities, enabling them to pursue public policy through SOEs rather than through regular budget channels. In this manner, SOEs have become a conduit for providing services below cost, including electricity, fuel, telecommunications, and air transport with few safeguards in place to assure their commercial viability. When government transfers do not fully cover operating losses, SOE activities become constrained, resulting in arrears vis-à-vis the government, suppliers, and each other. These debt obligations are typically addressed on an ad hoc basis through cumbersome cross-debt cancellations and/or securitization without addressing the underlying issues.

15. Transparency is limited and monitoring has been ineffective. The law requires that all non-financial firms in Cameroon comply with the Organization for the Harmonization of African Business Law (OHADA) accounting framework. To this end, all financial accounts must be reviewed by a statutory auditor approved by the Economic Community of Central African States, and validated by an annual general meeting within six months of the end of the financial year. In practice, reporting is slow with few statements respecting the mandated deadline. In addition, the coverage of reporting is poor; according to a June 2014 report, the audit chambers of the Cameroon Supreme Court have found that in recent years only one in five SOEs actually produced yearly financial statements (US State Department, 2014). Furthermore, the current OHADA standard does not comply with International Financial Reporting Standards (IFRS). As a result, the overall quality of financial reporting is weak, with the Global Competitiveness Report (2014–15) ranking Cameroon 124th (of 144 countries surveyed) in terms of the strength of auditing and reporting standards. The Ministry of Finance collates the available information provided by SOEs, but its reports lack analytical depth and are not widely disseminated.

D. Possible Reform Agenda

16. Given the potentially large fiscal risks linked to SOEs, strengthening the monitoring and disclosure of contingent liabilities is an urgent priority. International best practice holds that governments should seek to quantify and report contingent liabilities to the extent possible. For example, the government could, in the context of each annual state budget, provide a note on fiscal risks, including an estimate of the present value of the contingent liabilities of SOEs, their evolution over time, a description of their nature, and policies adopted to mitigate the corresponding risks. An additional policy lever already adopted by the authorities is an annual ceiling on debt guarantees and on-lending to SOEs—this ceiling has remained unchanged since 1996 at CFAF 40 billion. This level should be re-evaluated on an annual basis in the context of the broader debt management strategy.[10]

17. SOEs should benefit from predictable and constrained budget allocations. At present, the budget provides for allocations to SOEs, but a tight treasury position leads to uncertainty regarding whether SOEs will actually receive those resources, which then contributes to SOE arrears and disrupts proper business planning. At the same time, the authorities do not assess the adequacy of resources provided to

[10] In 2011, a presidential decree increased the ceiling on an exceptional basis in conjunction with international financial institutions participating in the financing of gas and thermal power plants.

SOEs to deliver public goods, nor comprehensively review value for money. To strengthen its financial dealings with SOEs, the government should introduce the concept of public service obligations (PSOs). This would involve defining what public goods specific SOEs are expected to provide—for example, providing below cost services to certain communities—and calculating the cost associated with these activities. If the objectives and costs are deemed realistic, the PSO would be financed through a direct budget transfer to the SOE, thus providing for predictable resources while imposing the discipline of well-defined service goals under a hard budget constraint. A good test case could be the on-going restructuring of the loss-making national airline, where the government contracted an external consultant to conduct a technical and financial audit before providing further capital.

18. SOEs need an enhanced system of risk and performance monitoring, involving regular reports. The SOE monitoring unit in the Ministry of Finance has initiated a study of indicators of specific and measurable risks for SOEs, including financial, human resources, and governance risks. This matrix of risks would include separate norms for commercial and non-commercial SOEs (i.e., administrative establishments), recognizing their different organizational focuses. Such a matrix would provide a useful tool for flagging incipient risks, which should be included in the above-mentioned annual report on fiscal risks. Going forward, an effective performance monitoring framework would require moving beyond broad benchmarks toward measures tailored to individual companies, taking into account their specific commercial and non-commercial objectives as set out by the government. This would require a substantial investment into the government ownership unit to build up its skills for analyzing company performance. Given capacity constraints, it could make sense to have the unit focus only on commercial SOEs, and keep responsibility for monitoring public agencies with the sector ministries, given that public agencies are extensions of the public sector and require different monitoring.

19. Broad governance reforms should accompany strengthened performance monitoring. A cultural shift is needed to give enterprises autonomy and accountability vis-à-vis performance objectives. This process could be supported by country- and company-level corporate governance assessments by an internationally reputable entity, such as the World Bank or the International Finance Corporation. Some steps to improve autonomy and performance could include strictly limiting line ministries' role to the core ownership function; improving the appointment process to executive boards, emphasizing previous financial and corporate governance experience; requesting SOEs to annually publish a report on their progress against performance targets; regularly evaluating the performance of executive boards; and establishing a policy on Executive Board remuneration that is competitive, but also benchmarked against private sector practices.

20. Urgent efforts are needed to improve accounting and reporting standards. The government should encourage SOEs to improve the timeliness of their financial reporting, which should be finalized within six months of the end of the financial year, as required by the law. In addition, financial reporting should be based on common standards across SOEs to produce consistent and comparable accounts. Financial reports should be accompanied by a descriptive commentary from managements that would help the government and the public to evaluate performance. Within the regional context, Cameroon could also champion the timely transition from OHADA to IFRS standards.

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FUEL PRICE SUBSIDIES—RECENT DEVELOPMENTS AND OPTIONS FOR REFORM[1]

The slump of more than 55 percent in international crude oil prices since June 2014 has had a positive impact on government subsidies for the refining and distribution of fuel oils and the net fiscal contribution of the petroleum sector has turned from negative to positive. This provides a unique opportunity for ending the fuel-subsidy scheme.

A. Background

1. This chapter builds on the work undertaken for the Article IV selected issues paper of 2013 and assesses the perspectives for the domestic fuel price liberalization (IMF, 2013. In doing so, it sets out the possible reform options for the sector, as the authorities consider how to eliminate the fiscal costs of the subsidy regime and restore the financial health of the state-owned refinery (*Société Nationale de Raffinage,* SONARA) against the background of lower international oil prices and reduced fiscal space.

2. Cameroon's policy of fixing retail prices for selected fuel products in its domestic market has been in place in its current form since 2008. The system was originally conceived as an adaptive mechanism, but in the wake of sharp price increases and attendant social tensions in early 2008, prices were frozen. The policy has been costly in terms of its fiscal burden. At the same time, as is typical of administered prices, the absence of social targeting has rendered the policy inefficient as an instrument for poverty mitigation because of the 'leakage' of benefits in favor of non-poor income groups (IMF, 2000). Moreover, by underpricing scarce resources, the policy has risked boosting excessive consumption with potentially harmful impacts from an environmental and climate change perspectives, with the added risk of inducing fuel smuggling to neighboring countries.[2]

3. Gasoline prices remained fixed until July 1, 2014 when, following IMF advice, prices of diesel and gasoline were increased by 15 percent.[3] The price increase was accompanied by downward adjustments to taxes and fees in the distribution chain and other offsetting measures, including a steep cut in the excise tax on petroleum products (TSPP), to limit the rise in transportation costs. The TSPP for super gasoline was reduced by one third and for diesel by 7.7 percent. A number of flanking social measures were designed to alleviate the impact of the price increase on households. These included an increase in the indicative tariffs for taxi transport, an increase in the minimum wage

[1] Prepared by Guy Jenkinson.

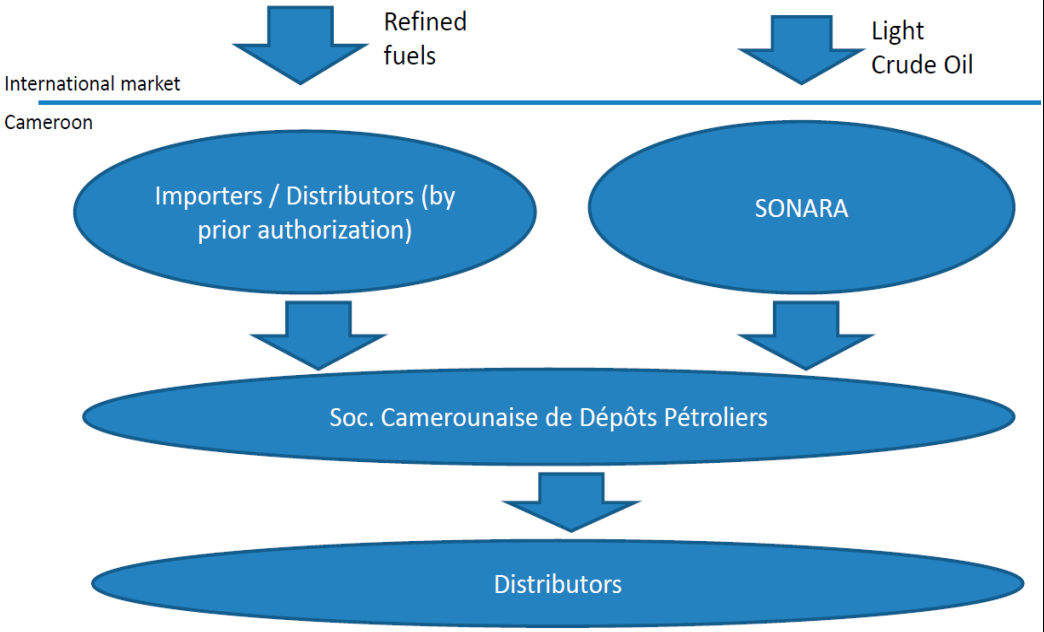
[2] IMF 2015 puts the magnitude of subsidies for fossil fuel energy at US$5.3 trillion worldwide in 2015, including direct fiscal costs and implicit subsidies from the failure to charge for environmental damages or tax energy at the same rate as other consumption products.

[3] This note focuses on the distribution on refined fuel oils that are produced by SONARA or are imported by distributors. For the sake of simplicity, and given the low volumes of kerosene and cooking gas consumed, as well as the social considerations related to these two fuels, the analysis in this note deals only with the distribution of "super"-grade gasoline and diesel. Kerosene and cooking gas subsidies could amount to up to CFAF 50 billion in 2015.

by almost 30 percent, and a public sector wage increase of 5 percent. These measures were not targeted at vulnerable groups. Moreover, the public sector wage rise amounts to a permanent increase in recurrent expenditure, which remains in place irrespective of fuel price changes.

4. The state plays an important role in fuel refining and distribution. This role is set out in the Oil Code.[4] SONARA is 80 percent state owned and imports light crude oil from the region to meet the bulk of the country's demand for refined products. Storage is the responsibility of the majority state-owned fuel stocking company (*Société Camerounaise des Dépôts Pétroliers*, SCDP) operating through 12 regional depots. SCDP is the main buyer for SONARA's output and sells to distributors for onward sale to retail outlets (Figure 1). An ad hoc committee, under the chairmanship of the public price equalization board (*Caisse de Stabilization des Prix des Hydrocarbures*, CSPH), has the responsibility of procuring imported refined products on a monthly basis to fill the gap left by SONARA in order to meet domestic demand.

Figure 1. Cameroon: Fuel Distribution



Source: Cameroonian authorities.

5. Cameroon's domestic demand for gasoline and diesel grew only modestly in 2000–06 and averaged about 0.67 million metric ton (MT; IEA, 2015). Since then, demand has almost doubled to stand at over 1.3 million MT in 2013, as consumption of fuel products has increased strongly, in line with the more dynamic growth performance of the economy. In recent years, SONARA has provided about 75 percent of the domestic supply of gasoline and diesel.

[4] The Oil Code (Loi 99/013) was adopted in 1999.

B. The Current Administered Price Structure

6. The domestic price structure is formally subjected to monthly review by the CSPH and confirmation by the Prime Minister. This is based on an "import parity price" (IPP), which is derived from a reference price drawn from market quotations plus adjustment for transport costs.[5] The taxes and fees of the price structure are added to the import parity price to derive a notional "free market price." The decline in the IPP, along with the reduction in the TSPP and the increase in fixed prices in July 2014, has resulted in the elimination of the fuel subsidy in 2015. It should be noted, however, that in the absence of the significant reduction in the TSPP for super gasoline, the subsidy would have remained. Transport and distribution margins were also adjusted downwards, reflecting a review of the appropriate margins in the sector. (Table 1).

Table 1. Cameroon: Price Structure for Domestic Fuel Products, 2012–15
(CFAF per liter)

	2012		2013		2014		2015	
	Super	Diesel	Super	Diesel	Super	Diesel	Super	Diesel
A. Import parity price CIF	**414**	**441**	**388**	**415**	**364**	**382**	**294**	**303**
B. Taxes	**239**	**191**	**232**	**184**	**211**	**177**	**169**	**149**
Sales tax (TVA)	102	107	98	102	92	95	74	74
Special excise tax (TSPP)	120	65	120	65	100	63	80	60
Custom tax	16	19	14	16	18	19	15	15
C. SONARA markup	**49.4**	**52.7**	**44.2**	**47.1**	**37.8**	**39.5**	**27.0**	**27.7**
D. Transport and distribution margins	**134**	**120**	**139**	**126**	**141**	**130**	**126**	**112**
E. Notional Free Market Price (=A+B+C+D)	**836**	**805**	**803**	**772**	**754**	**728**	**615**	**593**
F. Pump fixed price	**569**	**520**	**569**	**520**	**610**	**560**	**650**	**600**
Post-Tax Subsidy (=E-F) 1/	**267**	**285**	**234**	**252**	**144**	**168**	**-35**	**-7**

Sources: Cameroonian authorities; and IMF staff estimates.

1/ A positive sign implies a net subsidy from the state. A negative sign implies a profit.
2/ Pump prices increased to CFAF 650 per liter for super gasoline and CFAF 600 per liter for diesel on 1st July 2014. For 2014 as a whole a simple average of the pre- and post-July prices is taken. The TSPP was reduced to CFAF 80 for super gasoline and CFAF 60 for diesel on 1st July 2014; a simple average of the prevailing rates is taken for 2014 as a whole. 3/ 2015 figures are estimates based on prices prevailing up to September 2015.

7. The SONARA markup is a de facto producer subsidy. The markup (*coefficient d'ajustement*) is included in the price structure and derived as a percentage of the reference price.[6] The inclusion of this element in the pricing structure is designed to compensate for the competitive disadvantage that SONARA faces owing to its limited refining capacity. SONARA's ongoing expansion plans aim at increasing volumes and reducing its cost base, which could allow for the eventual elimination of the

[5] Transport costs are based on a formula using the three-month moving average of market quotations for shipment fees between Europe and West Africa.

[6] The reference price is based on market quotations in Europe and does not include transport costs.

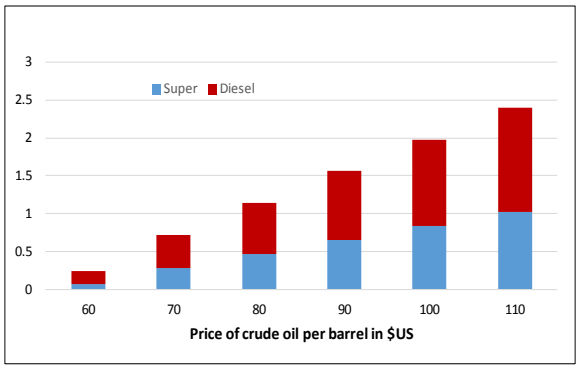
markup. The markup was reduced from 12 percent to 10 percent in July 2014, but by setting it on an ad valorem basis, the markup amplifies the volatility of the notional free market price.

8. Imported refined fuel products are also subjected to the administered price regime. Importers selling into the Cameroonian market are also compensated for the difference between the cost price and the regulated retail price. This further adds to the fiscal burden of the subsidy scheme. Staff estimates that refined products imported directly, including diesel and gasoline, are around CFAF 80 more expensive than the same products refined domestically. Explanations for the difference include the small quantities imported and the unpredictable nature of the attribution of import licenses.

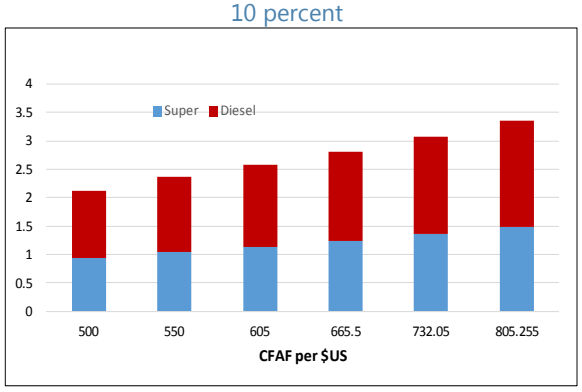
9. The level of subsidy is sensitive to oil price and the exchange rate variations. The actual amount of the required annual subsidy is difficult to predict ex ante because of the uncertainty with regard to consumption volumes, oil prices, and exchange rates. Taking a range of oil price scenarios, and holding other parameters constant, shows how the subsidy increases in line with crude oil prices (Figure 2, Panel a). Similarly, taking a range of exchange rates based on successive depreciations of 10 percent shows how the subsidy increases strongly when the CFA franc depreciates against the US dollar (Figure 2, Panel b).This underlines the difficulty in predicting appropriations to include in the budget. In effect, the subsidy regime amounts to an open-ended commitment, which became onerous when oil prices were high.

Figure 2. Cameroon: Sensitivity Analysis of the Fuel Subsidy Scheme
(Percent of GDP)

Panel a
Impact of oil price increasing to US$110



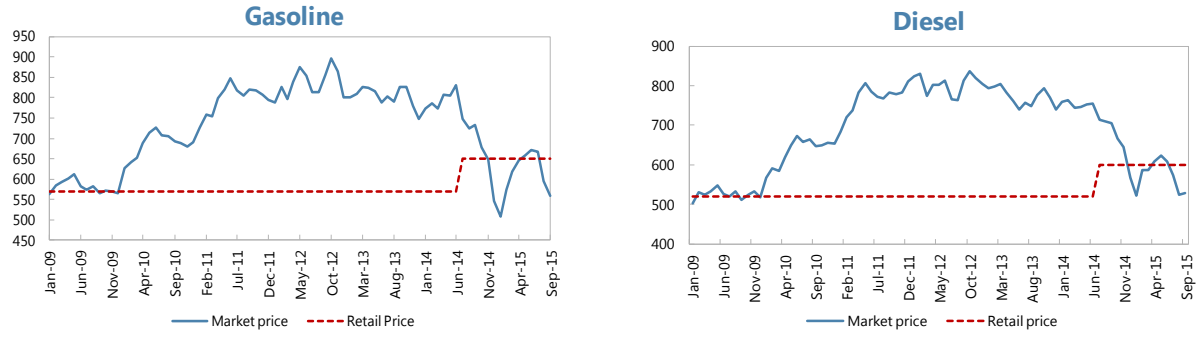
Panel b
Impact of successive exchange rate depreciations of 10 percent



Sources: Cameroonian authorities; and IMF staff estimates.

10. In the second half of 2014 and early 2015, the reduction in notional market prices led to a narrowing of the gap with the fixed retail prices (Figure 3). This reinforced the process that had begun in mid-2014 with an upward revision in the regulated prices for diesel and gasoline. Price gaps narrowed significantly, which led to the disappearance of the subsidies and the emergence of a small 'operating surplus' at SONARA.

Figure 3. Cameroon: Diesel and Gasoline Prices, 2009–15
(CFAF per liter)

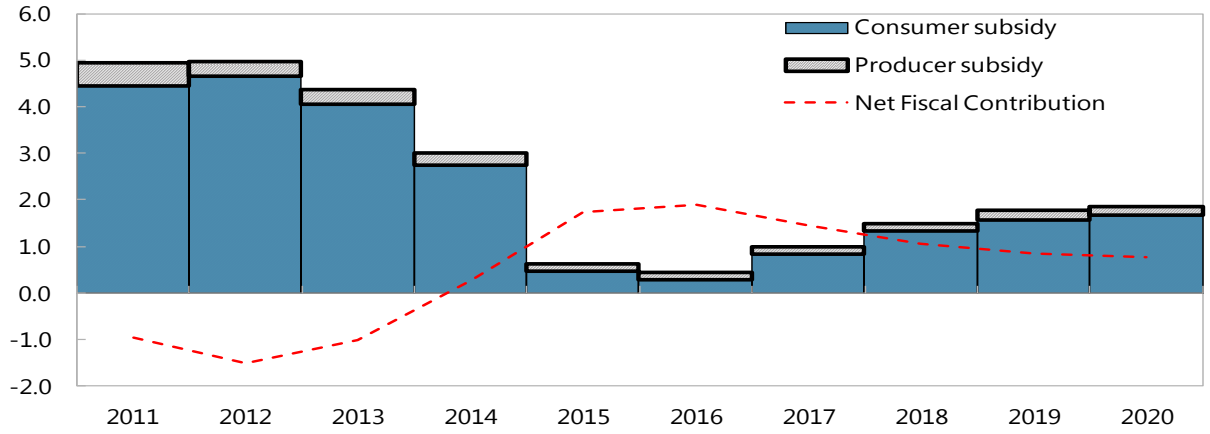


Sources: Cameroonian authorities; and IMF staff estimates.

C. Fiscal Dimension of Fuel Subsidies

11. Until the recent decline in oil prices, the fiscal impact of the fuel subsidies was significant. During periods of high international prices, a significant wedge between fixed and notional market prices emerged. This resulted in a growing subsidy, which, when combined with rising consumption, resulted in an increasing fiscal burden. In the three years prior to the mid-2014 price increase, subsidies averaged 4.8 percent of GDP a year and peaked at 5.0 percent of GDP in 2012 (Figure 4).

Figure 4. Cameroon: Diesel and Gasoline Subsidies and Net Fiscal Contribution, 2011–20
(Percent of GDP)



Sources: Cameroonian authorities; and IMF staff estimates and projections.

12. The tax regime of the sector yields a relatively low net fiscal contribution. Taxation is levied through value-added tax, customs duties, and the TSPP, and enters the system throughout the refining, distribution, and retail chain. The level of tax has, however, rarely been sufficient to offset the costs of the subsidy and the net fiscal contribution (NFC) of the sector has tended to be significantly negative. In the three years prior to the 2014 reform, the NFC is estimated to have averaged -1.2 percent of GDP per annum. The narrowing gap between international and domestic prices, along with the price increase of mid-2014, has resulted in the NFC turning positive, despite a decrease in the TSPP at the time of the price increase. Although the NFC is likely to remain positive under the baseline

scenario of relatively low market prices, an upturn in prices would quickly lead it to turn negative again. At the same time, the significant reduction in the TSPP in July 2014 reduces the potential tax take with the result that the NFC will be more strongly negative than in the past in the event of a return to higher international oil prices.

D. Impact of the Administered Price Regime on SONARA

13. The artificially low retail prices also created significant financial difficulties for SONARA. The operational deficit incurred in making its domestic sales below cost created a systematic financial shortfall that was only partially met by subsidies from the budget. The residual shortfall was settled through cumbersome cross-cancellations of mutual debts with the state, securitization, and government arrears to the refinery. The price developments since mid-2014 have resulted in some respite for SONARA, with the elimination of the shortfall for gasoline and diesel for the time being. Moreover, this has resulted in a small 'operating surplus' for SONARA. While welcome, this development does not reflect SONARA's true accounting position in view of the fact that it continues to suspend tax payments. It is understood that SONARA is currently keeping the surplus to offset outstanding government payments to cover previous shortfalls.

14. While SONARA is addressing its operational limitations through its investment program, substantial work is needed to restore the health of its balance sheet and reduce its costs. Although SONARA's refining operations have recently begun to show a small surplus, its medium-term sustainability remains uncertain. At the end of 2014, the cumulated, uncovered shortfalls owed to SONARA amounted to some CFAF 400 billion. SONARA itself has run up debts to suppliers amounting to CFAF 213 billion at the end of 2014. This has led to suppliers charging SONARA a premium of US$6–8 per barrel of crude oil, reflecting their assessment of the risk (and financing costs) of delayed payment. In addition, in the absence of sufficient and timely payments from the budget to cover the shortfalls, SONARA contracted a syndicated loan in 2014 through local banks for CFAF 143.5 billion. The cost of this bridge financing, along with the premium paid for supplies, has a clearly negative impact on SONARA's cost base and reduces its medium-term profitability. At the same time, SONARA continues to suspend tax payments as a means of maintaining liquidity.

E. The Future of Fuel Subsidies

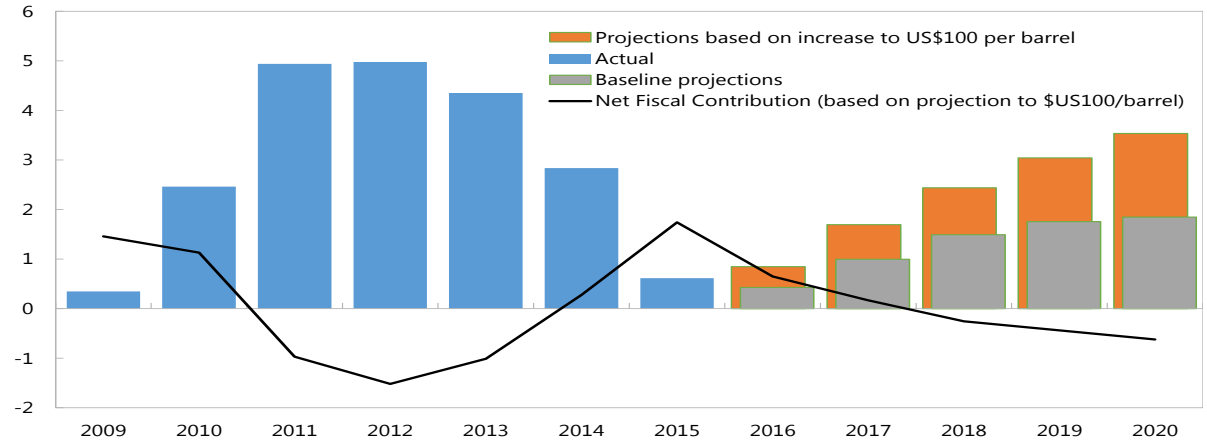
15. Fuel subsidies are projected to return in the medium term. Projections indicate that, in general terms, the current fixed price regime generates fuel subsidies once the oil price exceeds US$55 per barrel. A baseline scenario, which takes average oil price projections from the World Economic Outlook (rising towards US$63 per barrel by 2020) and consumption trends based on IMF staff projections, shows the subsidy rising again toward 1.8 percent of GDP in the medium term (Figure 4). As outlined above, these trends could be exacerbated by higher oil prices or unfavorable exchange rate movements.

16. In the event of higher oil prices or unfavorable exchange rate developments, failure to grasp the opportunity to eliminate the subsidy scheme would lead to it becoming unmanageable again. Projecting the oil price rising progressively to US$100 in 2016–20, with consumption growing in line with GDP, would lead to the subsidy reaching 3.5 percent of GDP per year

by 2020 (Figure 5). This amount is significant in a context where public expenditure needs to be prioritized carefully. At the same time, these projections show the NFC once again turning negative.

Figure 5. Cameroon: Fuel Subsidies, 2009–20

(Percent of GDP)



Sources: Cameroonian authorities; and IMF staff estimates and projections.

F. Conclusion and Options for Reform

17. With the disappearance of the need to subsidize fuel products, the opportunity exists to eliminate the subsidy scheme.[7] Doing this at the prevailing international crude oil prices would require no adjustment to current retail prices. To the extent that this move would entail an upward revision in the future, this could be accompanied by measures designed to alleviate the impact on vulnerable households. This reform could be enhanced by an automatic fuel pricing mechanism with a smoothing component, in line with the experience in a number of other countries (Box 1). Liberalized retail prices would eliminate the potential re-emergence of the price gaps that have led to the subsidy in the past. At the same time, a more market-oriented system may also provide opportunities for broader reforms to promote the efficiency of the sector.

18. The CSPH could be charged with the responsibility of developing and administering a revised pricing mechanism. As a public agency, its role at arm's length from the government would allow it to play an appropriate oversight role to ensure efficient market practices and to promote equitable access to the available distribution infrastructure (e.g., storage tanks). This reform could be introduced simultaneously with the elimination of the subsidy scheme.

[7] Other countries have recently followed this approach. India cut diesel subsidies in 2014. More recently, in January 2015, Morocco increased the pump price to eliminate diesel subsidy.

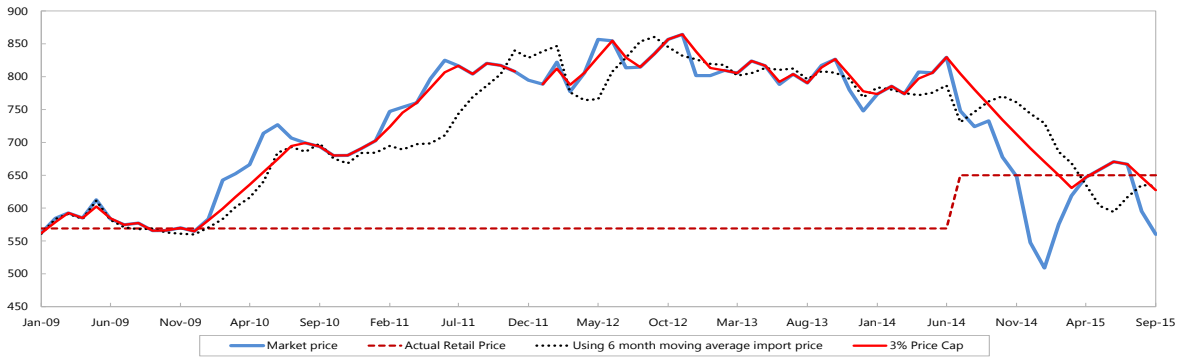
Box 1: Price-Smoothing Mechanisms[1]

A price-smoothing mechanism would help avoid abrupt retail price fluctuations, while still allowing domestic prices to align with market prices over time. Such a mechanism is typically applied in the context of a pricing formula with the objective of minimizing volatility, whilst at the same time allowing the full pass-through of international price movements with some lag. Adopting such a mechanism at the time of the elimination of the fuel-subsidy scheme would allow for a smooth transition to the new system and time for consumers and distributors alike to adapt. The key to such a system is how to specify the price change rules. These can be based on a price cap or a moving average approach:

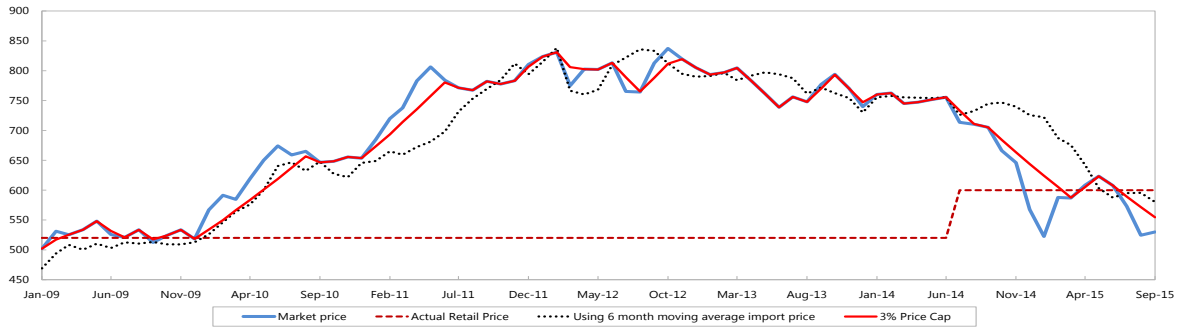
- Under the price cap approach, price movements are restricted within a specified bound range, based either on a percentage of the retail price or an absolute amount. Accordingly, the retail price implied by full pass through is calculated, typically on a monthly basis, and fully applied so long as this falls within the range allowed under the cap (e.g., + or -3 percent). If the required retail price increase exceeds the cap, then only the capped increase is allowed. The unmet portion of the required price increase is then applied the following month. This limitation of the allowable increase spreads out significant price movements over several months, but does not prevent eventual full price pass through.
- The moving average approach bases retail price adjustments on the average of the import price over a set period (e.g., 3 or 6 months) and rolling forward on a monthly basis. The longer the period of averaging, the greater the degree of smoothing of price movements. This approach does not prevent eventual full pass through either.

Simulations using historical data can give insights into how a price-smoothing mechanism could operate in Cameroon. This is shown below for both gasoline and diesel (Box Figures 1–2).

Box 1. Figure 1. Cameroon: Gasoline, 2009–15



Box 1. Figure 2. Cameroon: Diesel, 2009–15



Sources: Cameroonian authorities; and IMF staff estimates.

[1] This box is based on IMF 2012.

19. A clear communication strategy should be put in place to set out how the new system would operate. A critical consideration in any system is that it is transparent, easily understood, and predictable for consumers and distributors alike. The communication strategy should include full details of how the price mechanism operates so that consumers are able to understand future price movements. At the same time, advanced information about the package of mitigating social measures to be deployed in the event of the liberalization of prices would also bolster support for such a reform. Priority should be given to developing a workable and sustainable targeted social safety net for the most vulnerable groups to accompany price liberalization. The experience from the ongoing pilot program of cash transfers, with the assistance of the World Bank, could be a good starting point.

20. The authorities should consider raising the tax take from the sector to boost the NFC. Tax policy should explicitly take account of how a revised pricing mechanism would impact on tax levels. To the extent that the system adopted incurs some tax volatility, a general principle is that this should not be compensated through ad hoc adjustments to other elements of the price structure (e.g., transport and distribution margins) (IMF 2012). In this context, the significant reduction of the TSPP in 2014 undermines the prospects for ensuring that the sector delivers a positive NFC in the future. The present low prices afford the opportunity to restore the TSPP to its pre-2014 level and consider indexation going forward.[8] An additional issue is how to ensure that SONARA's windfall gains that have emerged in 2015 are secured as a revenue stream to the budget, once the state has settled all its outstanding obligations to SONARA.

21. Reforms to the oil sector should encompass the financial restructuring of SONARA. While SONARA is pursuing an expansion project to improve its refining capacity and the technical scope of its operations, a key priority should be to restore its balance sheet to health and ensure it is on a stable footing going forward. A financial and technical audit would provide a useful starting point for taking this forward with full information. An important advantage of a price system that fully reflects market prices is that it would eliminate, or significantly reduce, the systemic operational deficit that gave rise to the shortfall in revenues accruing to SONARA. This in turn, would reduce the current need for bridging finance, cross cancellation of shortfall amounts against tax liabilities, and eventually the premium charged by suppliers for crude oil deliveries to the refinery. To the extent that forecasts for a given year for price developments are expected to give rise to an operational shortfall in SONARA's market activity, these should be met by a budgetary transfer to be paid on a quarterly basis within the budget year in question. At the same time, increased operational effectiveness from the investment program, and reduced costs from balance sheet restructuring, should, in time, allow SONARA to compete on a commercial basis in the domestic market. This would also allow the eventual elimination of the SONARA markup, to the benefit of both consumers and the budget.

[8] Staff estimates that restoring the TSPP at its pre-July 2014 level at the present juncture would result in only a marginal increase in the pump rice for gasoline and no increase for diesel.

22. Looking to the medium term, liberalizing imports into a free domestic market would encourage price competition to the benefit of consumers. This would entail dispensing with the annual managed program of imports in favor of allowing private operators to source imports directly, in response to market demand. At the same time, further consideration should be given to the need to ensure a level playing field between SONARA and competing traders meeting market demand through imports. This should be combined with strengthened regulatory oversight of private operators in the sector to ensure competitive practices and preventing abuse of market power. The ongoing investment by both SONARA and SCDP in storage capacity could help to eliminate shortages created by periodic depot/storage constraints, thereby promoting market efficiency.

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